TAX MODELS FOR THE INNOVATION ACTIVITY OF SMALL AND MEDIUM SIZED ENTERPRISES

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Abstract: *Small and medium-sized enterprises (SMEs) are an important driver for job creation and economic growth, and an important source of innovation. Innovation through the activities of research and development is a crucial driver of economic growth. For that reason, in many countries, there is an active policy on encouraging innovation. Innovation capacity of SMEs in Moldova is very low.*

Subsequently, the innovation impact on national economy is rather small. The current legal framework does not stimulate enough innovation activity. There is no system of well-established direct and indirect tax incentives aiming to favour research and developing activities at the level of enterprises.

Key words: *small and medium-sized enterprises; tax models; innovation; sources of finance.*

Small and medium sized enterprises (SMEs) play an extremely important role in modern economies. They create job, enhance competition, contribute to technological change, increase the use of domestic resources and products and are a source of innovation.

Innovation through the activities of research and development is a crucial driver of economic growth. Both economic theory and empirical evidence support the idea that innovation plays a vital role in increasing productivity on a sustainable basis.

Governments may use different mechanisms to stimulate business activities through research and development, including: direct funding of research and development in the private sector and tax incentives. Each form of stimulating research and development has advantages and disadvantages. Direct funding, including loans, grants, equity financing allows governments to keep control over the nature of the research and development carried out. Unlike direct funding of research and development, tax incentives address to a broad circle of beneficiaries, leaving them independence in spending funds on research and development.

However, the general trend across European countries is to increase the availability and simplicity of research and development tax incentives, which makes the mix of policies more indirect over time [3]. That is why more and more countries implement tax incentives for their economic strategy. Tax incentives for research and development activities are widely used in OECD countries and non-OECD countries. According to OECD, 27 out of 34 OECD member states provide research and development tax incentives to business.

The existing research and development tax incentives regimes differ considerably across countries in terms of their generosity, their design and the way they explicitly target different enterprises or specific areas. Fiscal incentives for research and development usually take one of the following forms [4]:

- tax credits, which are the amounts deducted from tax liabilities;
- tax allowances, which are amounts deducted from gross income;
- tax deferrals, which are reliefs in the form of delay in the tax payment;
- preferential tax rates.

Tax credits are specified percentage of research and development expenditures, which are applied against payable income tax, while a *tax allowance* is a deduction from the taxable income. Thus, the value of tax allowances depends on the income tax rate, while a tax credit does not. This aspect is of a particular importance in case of the progressive tax scale whose diversified tax rates affect the amount of deduction. Another distinction between tax allowance and tax credit refers to the possibility to carry the non-deducted from income expenses forward to next years.

Tax deferrals can appear as an accelerated depreciation, which allows enterprises to reduce the value of a fixed asset involved in research and development, a higher rate during the first years of the asset's life, yielding a larger deduction over the life of the asset relative to normal depreciation rates.

The analysis of tax solutions offered in various countries compels to indicate the fourth model of tax preferences stimulating growth of research and development expenditures, the *preferential tax rates.* As an example, there may be indicated France, which applies a reduced income tax rate relative to revenues obtained from sales of a patent, or also the Netherlands – in the case of income from innovative activities [3].

In recent years, there have not been seen major changes across the European Union member states or third countries in terms of new types of research and innovation measures that were implemented.

Since 2012 small and medium sized enterprises in the Republic of Moldova benefit from a favorable tax regime. Thus, this regime benefits economic operators that are not registered as value added tax (VAT) payers, except for farmers and sole traders.

Economic operators that comply with this provision and that on December 31 of the previous fiscal year obtained an operational income of: up to 100 000 lei: apply the 3% income tax rate on the operating income in the reporting fiscal period; between 100 000 and 600 000: can apply either the fiscal regime of 3% or the general tax regime if they became VAT payers.

Economic operators that during the reporting fiscal period became VAT payers may apply the general tax regime. Economic operators that during the reporting fiscal period ceased to be VAT payers shall apply the 3% tax regime.

The only legal provision on the income tax of legal entities aiming to revive innovation activity of economic units is that allowing deduction of scientific investigations and research expenses, paid or incurred during the taxable year as current expenditure.

At the same time, this regulation does not apply to land or other property subject to wear and to any other expenses paid or incurred to discover or specify the location of natural resources, determining their quality and quantity.

The deduction of depreciation of any depreciable intangible property is allowed as well (patents, copyright and related rights, industrial designs, contracts, special rights, etc.) with expired useful life, estimating its useful life by applying the linear method.

The innovation capacity of SMEs in the Republic of Moldova is low. As a result, innovation impact on national economy is reduced as well. Moldova has a low share of staff engaged in high technological intensity production. The following reasons determine the low innovative potential of SMEs in the Republic of Moldova:

- the existing legal framework does not sufficiently encourage innovation activity. There is not any well-established system of direct and indirect financial incentives (for instance tax incentives) aiming to encourage research and development activities of firms;
- state's low financial capacity to support SMEs;
- although the Code on science and innovation stipulates that research and development funding should be at least 1% of GDP annually, this provision is not respected and budgetary funding is below this amount;
- lack of framework on venture capital;
- poor absorption capacity of technological innovation by production sector;
- insufficient cooperation between research environment and business.

Identification of policy options and tools available to enhance innovation capacities of SMEs is an important part of any strategy aiming to support the improved standards of living. The solutions to overcomethe lack of an efficient incentive system for encouraging innovation of SMEs in the Republic of Moldova in accordance with the best international practices are as follows:

- adopt the laws on venture funds and create a national venture fund;
- develop innovation infrastructure;

- establish innovation brokerage centers and connect them to specialized international networks, market intellectual property through them.
- develop partnerships between research organizations, universities and economic operators; encourage hiring by firms of researchers in different areas of activity;
- develop public-private partnerships in research.

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