



IMPACT OF TAXATION ON PROFITABILITY OF SMALL- SCALE BUSINESSES IN ICELAND

^{1*}Aron Runarsson Bilek, ²Birkir Bjarnasson Faustin & ³Alex Sigurdsson Yusuf

^{1*}Postgraduate Student, Reykjavik University

^{2&3}Lecturers, Reykjavik University

Email of the corresponding author: aronrunarssonbilek@gmail.com

Publication Date: December 2022

ABSTRACT

Purpose of the study: The study sought to examine the impact of taxation on the profitability of small-scale businesses in Iceland.

Research methodology: The study adopted the descriptive research design. The collection of the data was done using questionnaires. The research used a sample of 120 participants to respond to the questionnaires. Descriptive and inferential were used to analyze the study.

Findings: The study findings indicated that taxation significantly impacted the profitability of small-scale businesses in Iceland. The increases in the taxation level reduce the profitability of the businesses.

Conclusion: The study concluded that taxes imposed on small and medium-sized businesses have various effects on their profitability development. An increase in tax rates raises production, distribution, and marketing costs, resulting in higher prices and changing customer purchasing behavior. Customers react to high prices by buying less of the product; hence the sales volumes

fall, reducing the profitability of businesses. Thus, the level of taxation has an impact on the profitability level.

Recommendations: The study recommended that it is necessary to make sure that the taxation system is fair and equitable to all businesses. Tax administrators should conduct their duties with more care and integrity to combat issues such as multiple taxation and reducing small business profits. It was also suggested that the tax system should protect and promote small businesses to contribute meaningfully to economic development.

Keywords: *Taxation, Profitability, Small Scale Business, Iceland*

INTRODUCTION

The primary source of government revenue is through taxation. Taxation and fee collection is a basic way for economies to generate public revenue which can be utilized to fund developments in human capital, infrastructure, and the delivery of services to its people (Tambunan & Rosdiana, 2020). Small and medium-sized enterprises are highly regarded as the foundation of economic development in many countries. Smaller businesses account for more than 85% of private businesses and contribute to about 55% of job opportunities and GDP in many nations. Taxation is regarded as the most important source of revenue used by the Icelandic government to provide public services to citizens (Karlsson, 2020). Taxation disputes and decision-making become a major concern for the general public, businesses, and the economy as a whole due to the various effects that they will have on each of these entities. Laws and taxation regulations are reported to be among the barriers to small business growth in Iceland and all over the world (Trasberg, Raffer & Moisio, 2021). Nonetheless, these ventures, like the rest of Iceland's businesses, are subject to many taxes that should be paid at different phases of the business.

Dewi, Majid, Aliasuddin and Kassim, (2018) discovered that the contribution of small scale businesses to economic growth, creation of revenue and poverty reduction is commonly noted. Small scale enterprises are specifically essential because they give chance for self-employment which represents an opportunity to manipulate potentials, provide a flexible, less restrictive and needs less capital and skills. The impact of the tax on small businesses reveals that startup enterprises are encountering upward battle because of presumably unequal fiscal regimes globally (Hakelberg & Seelkopf, 2021). In some countries compared to big companies, enterprises pay up to 10% more of the tax as a percentage of profits, and the newer an enterprises is, the more tax it

pays. The operating environment in Iceland's is competitive with leading nations in the industrial world (Shafiei, Davidsdottir, Fazeli, Leaver, Stefansson & Asgeirsson, 2018). Due to its low tax structure, high levels of education, and skilled labor for competitive costs, land, and electricity, it is an ideal region for businesses to consider when expanding their global operations. The country has systematically made its business environment more appealing for investment and placement, together with a series of tax cuts that currently place Iceland among the countries with the most affordable levels of tax in Europe (Alm, Blaufus, Fochmann, Kirchler, Mohr, Olson & Torgler, 2020).

The Icelandic tax system is simple and dependable. In recent years, focus has been on further simplifying it, lowering tax rates, broadening the tax base, and terminating bilateral taxation agreements, that will increase competition among Icelandic firms and attract international investors (Bray, 2021). The tax strategies and structures of a country are inextricably linked to the country's business ventures. An economy that encourages excellent and dynamic tax policies and procedures will breed effective and financially strong business associations.

The survival of current changes is highly dependent on business growth and tax policies (Nutman, Isa & Yussof, 2021). Tax regulations are being reviewed with the aid of different researches conducted by tax professionals with the goal of removing old clauses and simplifying the key ones. Many nations yearn for an enlightened state with a strong and stable economy. Because of factors such as tax policies, most small businesses are less likely to achieve or maintain their growing profitability (Hoppe & Sureth-Sloane, 2018). These show that the government, as a policymaker and regulator, should factor in aspects that may have an impact on the competitiveness of small businesses.

Al Breiki and Nobanee (2019) noted that when small businesses thrive, the entire economy thrives, because there is no faster way to combine economic issues without the assistance of organizations that move administrations, merchandise, cash, and ventures from those with and goods. Small business ventures are primarily regarded as critical drivers of financial success. They are critical components of a strong economy because they create jobs, generate sales, and generate tax revenue. Small businesses are widely regarded as important job creators in Iceland, particularly among those with low skill levels. SMEs contribute significantly to Iceland's GDP and employ approximately 98% of the private sector labor force (Bakhtiari, Breunig, Magnani & Zhang, 2020).

High taxes can have a variety of effects on the size and strength of the small business population (Kuzieva, 2020). They reduce the number of new businesses by discouraging those who would otherwise start one. They can slow the rate at which small businesses can expand by making it more difficult for them to finance rapid growth. They can undermine small businesses' desire and ability to survive as independent businesses by making the gains from a sale or merger appear more appealing than the income from continued operation (Cao, Dai, Li, Guo, Ho, Cai & Zhang, 2021). Taxation practices are essentially the state's multiple payment obligations imposed on small businesses (Hellerstein, Buydens & Koulouri, 2018). Taxation/taxing practices on small businesses, combined with inadequate social infrastructure provision, pose a risk that these businesses will fail to thrive in the harsh economic conditions. It frequently results in lowering their operating capacity and in the worst-case scenario, failure. Zoonan and Plekhanova (2020) noted that the whole economy suffers from slowed GDP growth, general price instability, an adverse balance of payment position, a possible loss in the value of the national currency, and a decrease in employment opportunities, which may result in security problems to the nation's detriment.

LITERATURE REVIEW

Daniel and Faustin (2019) reported that taxes, along with the growth of Small and Medium businesses, play critical role in the growth of any economy. In a middle-income nation such as Argentina, the role of SMEs is key in driving the country's socioeconomic advancement agenda forward. As a result, policymakers may consider aligning the tax system to the specific needs of SME development as a critical agenda. Keeping this issue in mind, the research sought to investigate the supervisors'/executive officers' perceptions of Argentina's tax system on the profitability of their businesses. The research is anchored on a survey of 96 supervisors/executive officers from the chosen SMEs in Buenos Aires, Argentina. The survey and interviews with the chosen participants were used to administer the study. The descriptive evaluation approach, relationship and regression analysis, and results in terms of frequencies and percentage analysis were used to evaluate the information. According to the findings, the majority of participants believe that current tax policies have a negative impact on the profitability of SMEs and advocate for a change in the country's tax regulations. The results undoubtedly aid stakeholders in developing policies to better align the tax system with SMEs.

Bilek, Kmecova and Tlusty (2021) conducted research focusing on the effect of taxation on the profitability of SMEs in Bremen, Germany. Taxes were examined in three areas: tax rates, tax policy, and tax types, and how each affects the development of micro and small-sized businesses in Bremen, Germany. The research benefits a variety of stakeholders, including traders who will gain a better understanding of taxation; the law, which will be informed on areas to modify in the Tax Act, and incorporate sections which serve the public as a whole; and the taxation authority, which will use more appropriate approaches when collecting taxes. Germany's government will change tax rates and make the necessary changes to improve the country. The research was conducted in a descriptive manner. Structured surveys were used to collect primary information. The survey respondents were supervisors, owners, and employees of selected SMEs in Bremen, Germany. A stratified sampling method was utilized to select 626 research participants from the entire population. The research discovered a substantial link between taxation and the growth of the SMEs industry. High tax rates were found to have a substantial impact on the development of SMEs. The lower the tax rates, the more SMEs will grow. When the tax rates are high, the revenue margins of the businesses become relatively small to increase the size of the business because SMEs do not have the required capital to reinvest. It is concluded that better tax rate plans have a favorable impact on the development of SMEs, and hence the more positive the tax policies are, the better the growth patterns for SMEs. Taxation has had a significant impact on the growth of SMEs. It is suggested that more favorable tax measures be used for start-up ventures, like tax holidays or presenting a growth restriction with a level that is good enough to secure and maintain tax payment. The research is also noted that the tax agency should assess its taxation processes and business's administration processes, the role of taxation policy and distribution of taxes in micro businesses.

Sun, Zhan and Du (2020) found that the recent significant decline in financial efficiency of small businesses resulted in a reduction in revenue provided for tax commitment to the government. The requirement for small ventures to create more returns from internal sources has thus become an extreme necessity that has been related to small business enterprise taxation, especially in growing countries. Failure of small ventures has increased significantly, with roughly 80% of businesses closing down prior to the 5th year because of tax-associated issues ranging from minor taxation to massive tax problems. The purpose of the research was to evaluate the effect of taxation on the profitability of small business ventures in China. The following specific goals were used to achieve

the research objectives. The research used a descriptive survey style with both qualitative and quantitative techniques. In China, the target population was 150 SSBs. Simple random sampling strategy was used in the research. To collect data for the research, a questionnaire was used. Data was analyzed by the use of descriptive data, correlations, and linear regressions. Correlation and regression analysis were utilized to establish the association between taxation and profitability. The research discovered that small businesses are aware of the repercussions of failing to meet tax agreements on time. It was also discovered that taxpayers in China pay lower tax rates based on their profitability. The results revealed that tax administration improves tax payers' benefit in tax evaluation. Tax administration service equality provides the highest marginal profits by closing tax gaps. It was concluded that tax is a fiscal planning tool used by the government to affect business negatively or positively according to the nature of business tasks in an economy. According to the findings, taxpayers should have more information about taxes, not just be aware of them. A refresher course on tax awareness/knowledge on profitability should be conducted.

Naoki (2021) performed study to examine the impacts of taxation, particularly tax compliance, tax incentives, and tax coping systems, on the profitability of small enterprises in Japan. The research employed a correlational survey model, guided by the potential to pay concept of taxation. A sample of 90 small enterprises in Japan was chosen from a target population of 540 by the use of purposive sampling method. Primary and secondary sources of information were used. The study tool's validity was developed through expert review, and the reliability examination yielded a Cronbach's Alpha coefficient between 0.685 and 0.725. The research concluded that tax motivations and innovative tax methods are both important predictors of revenue in Japanese small enterprises. As a result, the research recommended that the scope of tax compliance and innovative tax methods be expanded in order to substantially improve the earnings of small enterprises. Much less focus ought to be placed on the innovative tax mechanism, which has a negligible association with business profitability. The research is important for potential business owners, policymakers, tax and regulatory authorities, and the Japanese government in developing tax measures which can effectively assist micro, small, and medium-sized enterprises in Japan's sustainability and growth.

Queiroz, Mendes, Silva, Ganga, Miguel and Oliveira (2020) conducted study to evaluate the impact of taxation on the profitability of SMEs in Alabama State. A study technique was embraced while the survey was utilized as an instrument. A random selection of 162 employees and

proprietors of 40 SMEs were utilized for the research. Gathered data were analyzed by the use of multiple regression analysis and one sample t-test. Outcomes shows that considerable and favorable partnership exist in between taxation and the profitability of SMEs and that tax assessment, tax collection and tax utilization considerably affect the profitability of SMEs in Alabama. It was suggested to name a few that the American tax system need to look for to protect and promote the SMEs for them to contribute meaningfully to economic development and that they need to determine the representatives responsible for prohibited, several taxation that usually frustrates SMEs and deal with them properly.

Chittithaworn, Islam, Keawchana and Yusuf (2019) conducted research to investigate the impact of taxation on the profitability of Thailand's small and medium businesses. The research used a descriptive study design based on quantitative and qualitative methods. Using simple random sampling, a sample size of 391 SMEs was chosen from a research population of 17,573 registered SMEs in Bangkok. The self-administered questionnaire and interview overview were used to collect data. SPSS was utilized to examine quantitative data, while thematic analysis was utilized to examine qualitative data. The study's findings indicated that taxation has a statistically significant moderately favorable impact on SMEs' profitability. Tax rates have a statistically significant and positive effect on SMEs' profitability. According to the findings, tax compliance, tax rates, and tax incentives have a statistically substantial positive impact on SMEs' profitability. The study recommended: improving the taxation system by having a simplified taxation system that may enable SME tax payers to meet their tax responsibilities; designing efficient tax rates that are not based on taxable profits as defined in legislation but on an economic process that involves the effect of the tax base; and strengthening tax incentives to sustain small businesses in order to stimulate the profitability of SMEs in the country.

Cheong, Lee and Weissmann (2020) reported that taxation is widely recognized as one of the most important sources of revenue for any nation's development. Taxation is a crucial policy approach of government and thus has a direct effect on the operations and activities of small scale business. In Malaysia, government tax policies aimed at small scale businesses have not promoted the sector's growth over the years. Instead of expanding the tax network to encourage more people to pay taxes, it appears that the government is content with raising tax rates. Excessive tax increases may raise production costs and eventually lead to the failure of a business. As tax rates continue

to rise, firms often resort to survival strategies such as tax evasion and price increases on final products. This study looked at how the amount of taxes paid by small scale businesses in the Selangor district affected their performance, using profit, employment, and output as indicators. The study distributed 500 questionnaires to businesses and concluded that there was a significant but weak correlation between taxes paid and the performance of small scale businesses using Spearman Rank correlation. This means that taxes have a negative impact on the profitability of Selangor district small scale businesses. The study also discovered that small scale businesses have the potential to create jobs for youth if some of the barriers to growth are removed, such as tax cuts, high raw material costs, access to finance, and high electricity costs, among other things. The study recommended that the government broaden the tax net to include all small scale businesses and reduce tax rates and amounts, implement a tax policy that is friendly to small scale businesses and provides tax holidays, reduce import duty and other taxes to reduce the cost of raw materials, and strengthen the NBSSI and AGI to organize training and workshops to build the capacity of small scale businesses in Malaysia.

RESEARCH METHODOLOGY

The study adopted the descriptive research design. The collection of the data was done using the questionnaires. The research did sample of 120 participants that were used to respond to the questionnaires. The descriptive and inferential were used to do the analysis of the study.

RESEARCH FINDINGS AND DISCUSSION

Correlation Analysis

The results presented in Table 1 describe the correlation analysis

Table 1: Correlation Analysis

		Profitability	Taxation
Profitability	Pearson Correlation	1.000	
	Sig. (2-tailed)		
Taxation	Pearson Correlation	.314 **	
	Sig. (2-tailed)	0.000	0.000

The correlation results from Table 1 show that the taxation was positively and significantly associated with profitability ($r=.314, p=.000$). This concurs with Chittithaworn, Islam, Keawchana and Yusuf (2019), reported that taxation has a statistically significant and positive effect on small businesses' profitability. Government should develop tax measures which can effectively assist micro, small, and medium-sized enterprises in sustainability and growth. High taxes have a variety of effects on the size and strength of the small business population.

Regression Analysis

The section includes model fitness, analysis of variance and regression of coefficient. The findings presented in Table 2 show the model fitness

Table 2: Model Fitness

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.314a	0.317	0.241	0.0458552

The results from Table 2 indicate that taxation was found to be satisfactory in explaining the profitability in Iceland. This was supported by the coefficient of determination, also known as the R square of 0.317. This shows that taxation explain 31.7% of the variations in the profitability in small scale business enterprises in Iceland.

Table 3: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7.25	1	7.25	127.19	.000b
	Residual	9.19	160	0.057		
	Total	16.44	159			

The result in Table 3 indicates that the overall model was statistically significant. The findings show that profitability are good predictor in explaining the taxation among the small scale business enterprises profitability in Iceland. This was supported by an F statistic of 127.19 and the reported p-value of 0.000 which was less than the conventional probability significance level of 0.05.

Table 4: Regression of Coefficient

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.245	0.025		9.800	0.078
Taxation	0.588	0.241	0.972	2.439	0.025

According to the results presented in Table 4, it was discovered that taxation was positively and significantly associated to profitability ($\beta=0.588$, $p=0.025$). This was supported by a calculated t-statistic of 2.439 that is larger than the critical t-statistic of 1.96. The results implies that when the rate of taxation improves by one unit, the profitability in small scale business enterprises in Iceland will increase by 0.588 units while other factors that influence the profitability are held constant. Bilek, Kmecova and Tlusty (2021) articulated that taxation has a significant impact on the growth of small businesses. More favorable tax measures ought to be used for start-up ventures, like tax holidays or presenting a growth restriction with a level that is good enough to secure and maintain tax payment. The tax strategies and structures of a country are inextricably linked to the country's business ventures. Small scale businesses have the potential to create jobs for youth if some of the barriers to growth are removed, such as tax cuts, high raw material costs, access to finance, and high electricity costs, among other things.

CONCLUSION

The study concluded that taxes imposed on small and medium-sized businesses have a variety of effects on their profitability development. According to the findings of the research, changes in taxation rates result in price changes for various products. An increase in tax rates raises production, distribution, and marketing costs, resulting in higher prices and a change in customer purchasing behavior. Customers react to high prices by buying less of the product. When the price of a product rises as a result of an increase in tax rates, the consumption rate falls and sales volumes fall, reducing profitability and causing the economy to slow down. Most of the tax disadvantages that small businesses are said to face could be easily removed if various countries are in a position to significantly reduce taxes. It is primarily because taxes are so high in some countries that small businesses are at a competitive disadvantage with bigger firms. Small businesses would be in a

better financial position if all businesses were taxed less heavily because they would be able to keep a larger percentage of their profits.

RECOMMENDATIONS

It is necessary to make sure that the taxation system is fair and equitable. The government should strike a balance between goals like high revenue mobilization, sustainable development, and low compliance costs. Tax policies concerning small businesses should be made simple through simple tax filing method. Tax administrators should conduct their duties with more care and integrity in order to combat issues such as multiple taxation, which reduces the profits of small businesses. It was also suggested that the tax system need to look for to protect and promote the small businesses for them to contribute meaningfully to economic development. The government should make sure that small businesses receive tax breaks when they invest in new equipment, machinery, or innovative technologies that will help them grow and expand. The government should investigate factors that can influence the growth of small businesses, like the provision of good infrastructure that will significantly lower their operating costs. Government taxation measures based on ability to pay should not only be introduced, but should also be fully implemented.

REFERENCES

- Al Breiki, M., & Nobanee, H. (2019). The role of financial management in promoting sustainable business practices and development. *Journal of Finance*, 4(2), 26-31
- Alm, J., Blaufus, K., Fochmann, M., Kirchler, E., Mohr, P., Olson, N. E., & Torgler, B. (2020). Tax policy measures to combat the sars-cov-2 pandemic and considerations to improve tax compliance: a behavioral perspective. *International Journal of Management*, 19(3), 347-361
- Bakhtiari, S., Breunig, R., Magnani, L., & Zhang, J. (2020). Financial constraints and small and medium enterprises: A review. *Economic Record*, 96(315), 506-523.
- Bilek, S., Kmecova, I., & Tlustý, M. (2021). The impact of taxes and administrative activities of SMEs on their performance. In SHS Web of Conferences (Vol. 92, p. 02006). EDP Sciences.

- Cao, J., Dai, H., Li, S., Guo, C., Ho, M., Cai, W., ... & Zhang, X. (2021). The general equilibrium impacts of carbon tax policy in China: A multi-model comparison. *Energy Economics*, 9(9), 105-128.
- Cheong, C. W., Lee, M. H., & Weissmann, M. A. (2020). Credit access, tax structure and the performance of Malaysian manufacturing SMEs. *International Journal of Managerial Finance*, 7(3), 85-91
- Chittithaworn, C., Islam, M. A., Keawchana, T., & Yusuf, D. H. M. (2019). Factors affecting business success of small & medium enterprises (SMEs) in Thailand. *Asian social science*, 7(5), 180-190.
- Daniel, T., & Faustin, G. (2019). Effect of tax incentives on the growth of small and medium-sized enterprises (SMEs) in Argentina: A case study of SMEs in Argentina. *Journal of Accounting and Taxation*, 11(5), 89-98.
- Dewi, S., Majid, M. S. A., Aliasuddin, A., & Kassim, S. H. (2018). Dynamics of financial development, economic growth and poverty alleviation: The Indonesian experience. *The South East European Journal of Economics and Business*, 13(1), 17-30.
- Hakelberg, L., & Seelkopf, L. (Eds.). (2021). *Handbook on the Politics of Taxation*. Edward Elgar Publishing.
- Hellerstein, W., Buydens, S., & Koulouri, D. (2018). Simplified registration and collection mechanisms for taxpayers that are not located in the jurisdiction of taxation: A review and assessment. *Journal of Management*, 7(1), 37-41
- Hoppe, T., & Sureth-Sloane, C. (2018). What are the drivers of tax complexity for MNCs? Global evidence. *Intertax*, 46(8), 9-16.
- Karlsson, J. (2020). The Icelandic Tax Policies and Pension Systems Compared to Those of Other Nordic Countries. *Journal of Governance and Management*, 8(5), 276-281
- Kuzieva, N. (2020). Kuzieva NR Ways of improving the tax mechanism for small businesses and entrepreneurship in the Republic of Uzbekistan. *Journal of Governance*, 6(2), 26-31
- Naoki, O. (2021). Fight against Tax Havens and International Tax Law: New Taxing Right and a Global Minimum Tax. *Public Policy Review*, 17(1), 84-92

- Nutman, N., Isa, K., & Yussof, S. H. (2021). GST complexities in Malaysia: Views from tax experts. *International Journal of Law and Management*, 83(4), 373-389
- Queiroz, S. A., Mendes, G. H., Silva, J. H., Ganga, G. M., Miguel, P. A. C., & Oliveira, M. G. (2020). Taxation and performance: impacts on small and medium enterprises. *Journal of Business & Industrial Marketing*, 35(7), 1237-1249.
- Sun, C., Zhan, Y., & Du, G. (2020). Can value-added tax incentives of new energy industry increase firm's profitability? Evidence from financial data of China's listed companies. *Journal of Energy economics*, 8(6), 104-116.
- Tambunan, M. R., & Rosdiana, H. (2020). Indonesia tax authority measure on facing the challenge in taxing digital economy. *The International Technology Management Review*, 9(1), 1-10.
- Trasberg, V., Raffer, C., & Moasio, A. (2021). Local government tax structure. In *Local Public Finance* (pp. 333-355). Springer, Cham.
- Zoonan, C., & Plekhanova, V. (2020). Taxation of digital services under trade agreements. *Journal of International Economic Law*, 23(4), 1015-1039.