

IMPACT OF TAXES ON SMES TURNOVER IN PAKISTAN



By

Muhammad Shoaib

PIDE2020FMPHILEAF03

Supervisor

Dr. Saba Anwar

Co-Supervisor

Dr. Naseem Faraz

MPhil Economics and Finance

PIDE School of Economics

Pakistan Institute of Development Economics,

Islamabad

2023

CERTIFICATE

This is to certify that this thesis entitled: **“Impact of Taxes on SMEs Turnover in Pakistan”**. submitted by **Mr. Muhammad Shoib** is accepted in its present form by the School of Economics, Pakistan Institute of Development Economics (PIDE), Islamabad as satisfying the requirements for partial fulfillment of the degree in Master of Philosophy in Economics and Finance.

Supervisor:

Dr. Saba Anwar

Signature:



Co-supervisor:

Dr. Naseem Faraz

Signature:



Internal Examiner:

Dr. Mahmood Khalid

Signature:



External Examiner:

Dr. Samina Naveed

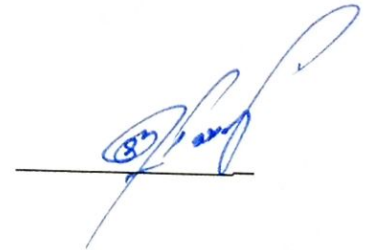
Signature:



Head,

PIDE School of Economics: Dr. Shujaat Farooq

Signature:



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Muhammad Shoaib

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ABSTRACT

This study examines the impact of taxes on the output of Small and Medium Enterprises (SMEs) in Pakistan using cross-sectional data for the fiscal year 2015-16. Through a multiple regression model employing the weighted least square technique, the relationships between various taxes (including sales tax, stamp duty, district tax, wages, and capital) and SME production are analyzed. The results indicate that sales tax has a significant negative impact on production, stamp duty has a significant negative impact on production, land tax, district tax, wages and capital has significant positive impacts on production of SMEs. These findings suggest the need for tax reforms and supportive tax policies to create an enabling environment for SMEs and stimulate their growth in Pakistan.

Keywords: Small and Medium Enterprises, Output, Taxes, Wages, Capital, Growth.

TABLE OF CONTENTS

ABSTRACT.....	iv
LIST OF TABLES	ix
LIST OF FIGURES.....	x
CHAPTER 1	1
INTRODUCTION.....	1
1.1 Contribution to GDP by SMEs.....	4
1.1 Statement of the Problem.....	6
1.2 Research Problem:	7
1.3 Research Questions.....	7
1.4 Objectives.....	7
1.5 Significance of the Study	8
CHAPTER 2	11
REVIEW OF LITERATURE	11
2.1 Introduction.....	11
2.1.1 SMEs and Growth	11
2.1.2 SMEs and Taxes	13
2.2 Conclusion	24
CHAPTER 3	26
UNDERSTANDING TAXES	26
3.1 Introduction.....	26
3.1.1 Sales Tax	26
3.1.2 Custom Duties and Tariff.....	27
3.1.3 Land tax.....	29

3.1.4 District Tax.....	29
3.1.5 Stamp Duty.....	30
CHAPTER 4	32
DATA AND METHODOLOGY	32
4.1 Introduction	32
4.2 Difference between Federal and Provincial Taxes	32
4.2.1 Federal Taxes	32
4.2.2 Provincial Taxes	32
4.3 Data Description	33
4.4 Variable Details	34
4.4.1 Dependent variable	34
4.4.1.1 Production	34
4.4.2 Independent variables	34
4.4.2.1 Indirect taxes	34
4.4.2.1.1 Sales Tax	35
4.4.2.1.2 Land tax.....	35
4.4.2.1.3 District/provincial tax	36
4.4.2.1.4 Stamp Duty.....	36
4.4.2.1.5 Wages.....	37
4.4.2.1.6 Capital	37
4.5 Percentage of Taxes from Production.....	38
4.5.1 Total Taxes Percentage	38
4.5.2 Sales Tax Percentage	39
4.5.3 Land Tax Percentage	39
4.5.4 District Tax Percentage.....	40

4.5.5 Stamp Duty Percentage	41
4.5.6 Conclusion.....	41
4.6 Variable Description	44
4.7 Source of Variables	44
4.8 Theoretical Framework.....	44
4.9 Conceptual Framework.....	49
4.10 Model Specification.....	50
4.10.1 Model	51
4.11 Conclusion.....	53
CHAPTER 5	54
RESULTS AND DISCUSSION.....	54
5.1 Introduction	54
5.2 Descriptive Statistics	54
5.3 Multiple Regression Results	56
5.4 Multicollinearity Test (Variance Inflation Factor)	57
5.5 Heteroskedasticity Test (Breusch Pagan Godfrey).....	57
5.6 Variables Plot	58
5.7 Residual Plot for Heteroskedasticity	59
5.8 Normal Q-Q Plot for Residual	59
5.9 Histogram of Residuals.....	60
5.9 Result of Ramsey Reset Test.....	60
5.11 Results Discussion.....	61
5.6 Conclusion	64
CHAPTER 6	66
QUALITATIVE WORK	66

6.1 Introduction	66
6.2 Objectives.....	66
6.3 Interview Analysis	66
6.3.1 How Taxes are Causes of failure and close-up of SMEs?	66
6.3.2 What are the Taxes you pay on your Business?	67
6.3.3 Can You Pay Tax on Inputs/Outputs?	68
6.3.4 When is an SME responsible for paying Taxes?.....	68
6.3.5 What are the Impacts of taxes on SMEs?	69
6.4 SMEDA Discussion.....	69
6.4.1 Access to Finance	69
6.3.2 Taxes on SMEs.....	70
6.3.3 Lack of Technology	70
6.3.4 Marketing Limitations	70
6.3.5 Business Location.....	70
6.4 Conclusion	70
CHAPTER 7	72
CONCLUSION AND RECOMMENDATION.....	72
7.1 Introduction.....	72
7.2 Conclusion	72
7.3 Recommendation.....	73
7.4 Limitations to the Study.....	73
REFERENCES	75

LIST OF TABLES

Table 1. 1	Definitions of SMEs	2
Table 1. 2	Contribution to GDP.....	5
Table 1. 3:	Comparison of SHMI Survey 2015 with 2006-07 & 1996-9.....	9
Table 4. 1:	Details of Variables.....	44
Table 4. 2:	Composition of Taxes (% Share).....	47
Table 5. 1:	Descriptive Statistics	54
Table 5. 2:	WLS Regression Results.....	56
Table 5. 3:	Variance Inflation Factor Results	57
Table 5. 4:	Breusch Pagan Godfrey.....	57
Table 5. 5	Ramsey Reset Results	60

LIST OF FIGURES

<i>Figure 1. 1:</i>	Growth of SMEs.....	9
<i>Figure 4. 1:</i>	Percentage of Total Taxes.....	38
<i>Figure 4. 2:</i>	Sales Tax Percentage.....	39
<i>Figure 4. 3:</i>	Land Tax Percentage	39
<i>Figure 4. 4:</i>	District Tax Percentage	40
<i>Figure 4. 5:</i>	Stamp Duty Percentage	41
<i>Figure 4. 7:</i>	Conceptual Framework.....	49
<i>Figure 5. 1:</i>	Variables Plot.....	58
<i>Figure 5. 2:</i>	Residual Plot for Heteroskedasticity	59
<i>Figure 5. 3:</i>	Normal Q-Q Plot for Residual	59
<i>Figure 5. 4:</i>	Histogram of Residuals	60

CHAPTER 1

INTRODUCTION

Small and Medium Enterprises (SMEs) are independent businesses that are not owned by larger companies. The specific criteria defining SMEs, including the maximum number of employees allowed, may vary from country to country. SMEs are the most crucial and effective way to address widespread issues like unemployment, economic inequality, underemployment, etc. Small and medium enterprises (SMEs) are seen to be crucial to a nation's economic development because they require fewer resources, use domestic technology, and reduce urban migration, (Zafar & Sadaf. (2017).

SMEs are seen as a significant sector with the potential to provide jobs and a vital source of income for the lower class, although various economists define them differently. The significance of SMEs has really been acknowledged around the world. The number of SMEs is growing. The economy's efficiency is increasing. Productivity improvements are important and play a vital role in the general welfare and poverty alleviation SMEs don't just play a role in the economy they play a vital complementary role in the economy's industrialization, but also as a structural change driver, the expansion of the economy's productivity entails in the economy, innovation. The level of specialization is also enhanced as a result of the rise of SMEs (Sharafat Ali et al, 2014).

A Small Enterprise (SE) is a company with less than 50 employees (including contract workers) and an annual sales volume of up to Rs. 150 million. Financing for small businesses is available up to Rs. 25 million. A Medium Enterprise (ME) is a corporate entity that is absolutely not a Public Limited Company and has more than 50 employees (including contract workers) or, in the case of trade outlets, fewer than 100 employees. More than 50 workers (including contract workers) and less than 250 workers are employed by manufacturing and service enterprises. The annual sales revenue for all MEs is between 150 million and 800 million rupees. According to the State Bank of Pakistan, medium-sized businesses can receive loans for up to 200 million rupees. Following table represent the SMEs definition in a good manner.

Table 1.1 Definitions of SMEs

Institution	Enterprise category	Nature of Business	Number of Employees	Value of capital (Rs)
SMEDA	Small Scale	Production Sector	Up to 36	UP to 20 Million
	Medium Scale	Production Sector	Up to 99	Up to 40 Million
SME Bank	Small Scale	Service Sector	N/A	Less than 100 Million
	Medium Scale	Service Sector	N/A	More than 100 Million
Pakistan Bureau of Statistics	Small Scale	Service Sector	Less than 10	N/A
	Medium Scale	Service Sector	N/A	N/A
SBP	Small Scale	Manufacturing	Less than 250	Less than 100 Million
	Small Scale	Service Sector	Less than 250	Less than 50 Million
	Medium Scale	Manufacturing	Less than 250	Less than 100 Million
		Service Sector	Less than 50	Less than 50 Million
Sindh Industries Deptt.	Small Scale	Manufacturing	N/A	Less than 10 Million
Punjab Industries	Small/Medium Scale	Manufacturing	N/A	Less than 10 Million
Punjab small Scale Corporation	Small/Medium Scale	Manufacturing	N/A	Less than 20 Million

Source: This table is prepared from the concerned department's website

It is important to note that the specific criteria for classifying SMEs can differ across countries, regions, and industries. Some jurisdictions may consider additional factors such as annual turnover or balance sheet totals. These definitions are intended to provide a general understanding of Small and Medium Enterprises, (SMEs).

Small firms are crucial to the growth of an economy since they are commonly acknowledged as significant contributors. They create employment opportunities and income for the government, which act as tax and revenue-generating assets. Small businesses' role as job producers cannot be overstated, particularly for individuals with poor skills. (Ghulam Moeen-Ud-Din et al, 2021).

The government of Pakistan has classified SMEs as being one of the country's four major development generators. In Pakistan, SMEs play a vital role in profit maximization and job creation. The SME sector in Pakistan is significant in terms of employment as it employs the majority of the country's non-agricultural workforce, (Economic Survey of Pakistan, 2020-21). Small and Medium Enterprises sector in Pakistan contains Cotton weaving, wood and furniture, metal products, art silk, grain milling, jewelry, carpets, sports goods, ceramics, dairy and poultry, fisheries, food and catering, and slaughtering.

SMEs are often recognized as a major pillar for poverty reduction since they generate jobs, raise living standards, and play an important role in maintaining equitable income distribution. In Pakistan, the SME sector accounts for around 40 percent of GDP and has enormous potential to boost the country's economy (SMEDA Annual Report 2019-20).

The State Bank of Pakistan (SBP) has most recently urged all banks to contribute to the creation of a strategic plan for the development of the SMEs development goal, demonstrating the government's recognition that more knowledge and practical actions are required to fully utilize the potential of the SMEs sector and guide it on a path of development. This would be the outcome of SBP's realization that strong institutions are necessary for an efficient SME sector, which also includes a wonderful network of businesses that can provide SMEs the help they need to attain financial efficiency and simplicity. A strong SME sector will also contribute to development, lowering the need for expensive imports and, in the long term, strengthening the economy. Additionally, the SBP has set a goal to considerably expand SMEs' financial inclusion by 2020, enabling the sector to develop and prosper, (SBP Report,2022).

Taxes are required in every country, essentially to raise income for government use. However, life as small and medium enterprises (SMEs) isn't in every case simple. These organizations for the most part battle to draw in cash-flow to subsidize their undertakings and frequently experience issues settling expenses and meeting administrative consistence commitments. States perceive the significance of small and medium enterprises (SMEs) in the economy and consistently offer inspiration, including great appraisal treatment and better permission to credits, to help with keeping them in business (International Tax Dialogue , 2007).

Small businesses play a vital part in today's economic system. If you look at the experience of developed nations, the sector should be concentrated to 2/3 of the population who is economically involved. Micro businesses should address employment issues, increase population welfare, contribute to the preservation of a competitive environment, and foster practical invention. However, the survival of a small business is practically impossible without the government's active assistance, which should be to build a variety of initiatives to encourage small enterprises, as well as the adoption of tax policies that encourage their growth (Zhdanovas A.B et al, 2015).

1.1 Contribution to GDP by SMEs

Small and Household Manufacturing Industries (SHMI) has an important role in the National economy due to its significant contribution to GDP and employment. The SHMI 2015 report indicates a notable increase in the contribution to GDP (producers value), recording Rs. 476,260 million, as opposed to the Rs. 104,592 million reported in SHMI 2006-07 (Table-1.2). This surge, attributed to a rebasing impact, reflects a 22% rise in comparison to the National Accounts PBS.

Breaking down the total contribution to GDP at the Pakistan level, the SHMI survey reveals that small manufacturing industries contribute Rs. 393,969 million, constituting 83%, while household industries contribute Rs. 82,289 million, representing 18%. Table-3.18 furnishes statistics on the contribution to GDP from the top 10 industries, accounting for 56% of the total units (1,242,124) reported in all areas of the SHMI survey.

Among these leading industries, the jewelry and goldsmiths' articles sector holds the foremost position, contributing Rs. 58,608 million, which equates to 12% of the total SHMI

contribution. Following closely are prefabricated buildings mainly of metal at Rs. 43,044 million and Furniture at Rs. 42,407 million, each contributing approximately 9%. Among the top ten industries, the Ornamental & building stone articles industry has the smallest share at Rs. 9,450 million, contributing 2% to the total.

Table 1.2 Contribution to GDP

PSIC Code	Description	No. of Units	Contribution to G.D.P (Million Rs)	%	Contribution to G.D.P (Per Unit) Rs-000
32113	Manufacture of jewelry, goldsmiths' articles	29518	58608	12%	1.99
25112	Manufacture of prefabricated buildings mainly of metal, metal doors.	38266	43044	9%	1.12
31001	Manufacture of chairs and seats, sofas, sofa beds and sofa sets	37844	42407	9%	1.12
13992	Manufacture of tulles and other net fabrics, and of lace and embroidery	40872 0	26413	6%	0.06
10611	Grain milling	96513	22543	5%	0.23
10719	Others (Manufacture of bakery products)	13530	19305	4%	1.43
10759	Others (Manufacture of prepared meals and dishes)	1063	16695	4%	15.71
16101	Sawing, planing and machining of wood.	16716	16530	3%	0.99
16221	Manufacture of wooden goods intended to be used in the construction industry	12124	9469	2%	0.78
23961	Cutting, shaping and finishing of stone for use in construction on roads, as roofing	2442	9450	2%	3.87
Total of 10 Industries	656736	26446 5	56%	0.38	
All other Industries	585388	21179 4	44%	0.36	
Total Industries	1242124	47626 0	100%	7.35	

Source: This table is derived from SHMI data by PBS.

Taxation may have a significant impact on many aspects of the economy, including the formation of new businesses and the development of small and medium enterprises (SMEs). These SMEs, which are concerned about their deals and transactions as well as their surroundings, engage in serious business and tax strategy, which includes good financial management procedures (Nelson Maseko, 2013).

Most huge firms have their origins in small and medium businesses, indicating that the future large businesses are today's SMEs, which must be fostered to ensure their long-term growth. As a result, SMEs are often regarded as the "seedbed" for indigenous entrepreneurship, generating a large number of minor investments that would not have occurred elsewhere (Alfons J. Weichnrieder, 2007).

It is general knowledge that revenue earned through individual and enterprise taxation is a significant source of government income. It is even more critical in an economy like ours that is trying to stay afloat. Tax income is a source of cash for development initiatives such as the construction of infrastructure such as decent roads, reliable power, and reliable water. All of these factors work together to create a favorable climate for businesses and as a result, the economy overall grow, (Amer Saadi Kallel Shakkour et al, 2020).

The tax policies and systems of any country are closely linked to its businesses and enterprises. The tax policies and systems of any country are intricately related to its businesses and enterprises. The implementation of good tax regulations by a country's economy results in a lucrative and financially healthy business climate. Increased economic growth is the result of good corporate success. Why? Because if you want an economy to move faster, you'll need institutions that can help individuals with surpluses, money services, and investments flow to people in need; people with excess supply to those in deficit. This highlights how businesses and tax policy are intertwined. Both are required for the other to exist (Doreen Musimenta et al, 2017).

1.1 Statement of the Problem

Small and medium enterprises (SMEs) are the backbone of the majority of economies throughout the world, especially in developing countries like Pakistan. Multiple taxations and large tax loads are one of the causes that contribute to these premature business closures. The reason for this is because, under many government strategies, small and medium businesses are seen and handled in a similar manner as big firms, when working with small and medium

businesses, it is important to take into account their distinct characteristics. There is a need to consider how these tax policies can be meant to motivate the growth of small and medium while also ensuring that they are administered in the most efficient way possible. (Sherazi et al, 2013).

Some enterprises are still at the point of failure, while the majorities are still trying to keep their operations surviving to meet up high tax rates. Taxes have been huge constraints on their businesses (Bateman (2007)).

1.2 Research Problem:

Pakistan's small businesses face numerous challenges that hinder their growth and prevent them from transitioning into larger enterprises. One major obstacle identified in this research is the burden of multiple taxes. Small businesses often find themselves grappling with a complex and convoluted tax system that encompasses various layers of taxation. These include federal, provincial, and local taxes, along with additional levies such as sales tax, income tax, and property tax. The cumulative effect of these taxes not only increases the administrative burden on small businesses but also significantly reduces their profitability and ability to reinvest in growth. This, in turn, limits their capacity to expand operations, hire more employees, and innovates, ultimately stunting their growth potential.

Based on the narrative of the Statement of the problem as stated in the preceding text, I am narrowing my research problem to “**Impact of taxes on SMEs turnover in Pakistan**” and have operationalized my topic into given research questions and objectives.

1.3 Research Questions

- 1) What is the relationship between multiple taxation and Small & Medium Enterprises (SMEs) output in Pakistan?
- 2) What is the incidence of taxes (across firms and by type of taxes).
- 3) `What is the impact of multiple taxations on the failure and close-up of Small and medium enterprises in Pakistan?

1.4 Objectives

This Study has the following objectives

- 1) The main objective of the study is to explore the relationship between multiple taxation and Small and Medium Enterprises (SMEs) output in Pakistan.
- 2) To explore the incidence of taxes (across firms and by type of taxes).
- 3) To examine the impact of multiple taxations on the failure and close-up of SMEs in Pakistan.

1.5 Significance of the Study

The study examining the impact of taxes on the output of Small and Medium Enterprises (SMEs) in Pakistan holds significant importance for various reasons. Firstly, SMEs play a crucial role in the economic development of Pakistan, contributing to employment generation, innovation, and poverty reduction. Understanding the specific impact of taxes on their output is vital for designing effective policies and strategies to foster their development. By examining the effects of taxes on SMEs, the study can provide valuable insights into the challenges faced by these enterprises and help policymakers identify measures to alleviate their tax burden, improve their competitiveness, and create an enabling environment for their sustainable growth. Furthermore, the findings can also contribute to the existing body of knowledge on SME development and taxation, aiding researchers and economists in formulating evidence-based recommendations and informing future studies in the field. Ultimately, the significance of this study lies in its potential to inform policies that promote the growth and prosperity of SMEs, thereby contributing to the overall economic well-being of Pakistan. If we see the that SMEs are grow over the years.

Upon comparing SHMI 2015 with data from SHMI 2006-07 and 1996-97, it is evident that the overall number of manufacturing units has seen an annual growth rate of 6.51% throughout this timeframe. Specifically, household establishments have experienced a notable increase of 10.92%, while small establishments have shown a more modest growth of 1.58%. The provided table indicates that the total manufacturing establishments reported in 2015 amount to 1,242,124, a significant rise from the 704,065 establishments reported in SHMI 2006-07. Further analysis reveals a decrease in household establishments in the Baluchistan province between 1996-97 and 2006-07, followed by a subsequent increase at a higher rate in the period from 2006-07 to 2015.

Table 1. 3: Comparison of SHMI Survey 2015 with 2006-07 & 1996-9

Province	2015			2006-07			1996-97		
	Total	Household units	Small Estab.	Total	Household units	Small Estab.	Total	Household units	Small Estab.
Pakistan	1242124	787964	454160	704065	309894	394171	427784	161098	266686
Punjab	764220	462255	301965	490623	219771	270852	299749	119087	180662
Sindh	223717	166420	57297	96677	43979	52698	63151	22292	40859
KP	165703	85514	80189	108749	40293	68456	52895	9813	43082
Baluchistan	88484	73775	14709	8016	5851	2165	11989	9906	2083

Source : SHMI Survey 2015-2016

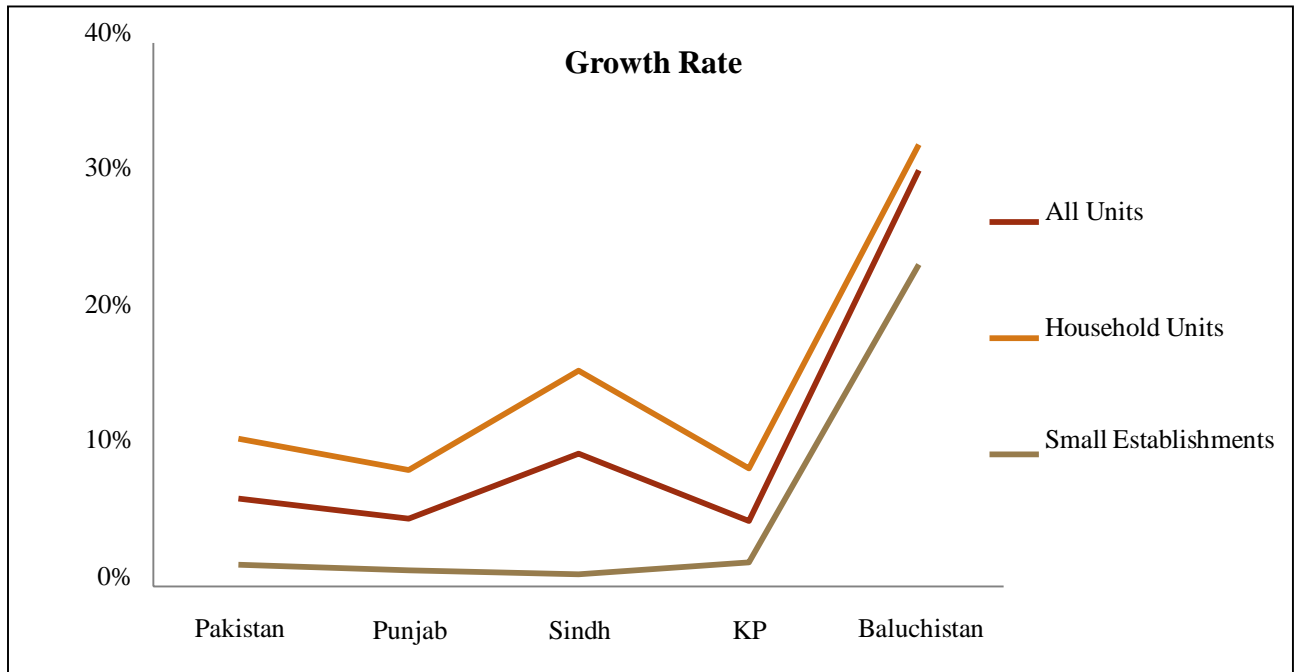


Figure 1. 1: Growth of SMEs

The burgeoning growth of Small and Medium Enterprises (SMEs) in Pakistan over the years underscores their pivotal role in shaping the nation's economic landscape. Despite not being

substantial contributors to taxes, research highlights the substantial impact of SMEs on the country's GDP. This research holds paramount significance as it underscores the need to recognize and prioritize the SME sector, not merely based on current tax revenues but by acknowledging its significant and growing contribution to the overall economic output. As a critical driver of economic development and employment, the research suggests a reevaluation of the taxation paradigm for SMEs, emphasizing the importance of fostering an environment that supports their continued expansion and maximizes their positive impact on Pakistan's economic vitality.

CHAPTER 2

REVIEW OF LITERATURE

2.1 Introduction

This section discusses the literature on the impact of taxes on SMEs on different countries around the world. This chapter is going to critically analyze the different articles on different aspects of SMEs

2.1.1 SMEs and Growth

The SMEs sector makes a significant contribution to the economy of any country. The existing tax structure is continually changing, making it tough for business owners to keep up. Simplified regulations and administrative procedures in the field of taxation policy of activity; improvement of the country's infrastructure is essential for appropriately increasing the growth of the SME sector; poor infrastructure cannot successfully support the development of SMEs (Kamran Sherazi). Information portals, conducting online meetings, and other information to support business owners should be implemented to create a favorable climate for the development of small businesses (DolgiH.N et al, 2015).

The ways to stimulate the growth and development of these businesses must be devised for them to attain their full potential. Subsequently, they will need to survive in a favorable commercial and regulatory climate. The majority of big businesses have their origins in small and medium businesses; they began as SMEs before growing. This suggests that today's SMEs are the future major businesses, and they should be supported to guarantee their growth and transformation into large businesses (Aryeetey & Ahene, 2004). Thus, the focus of this research will be on how tax policy may help SMEs to grow. In developing countries like Pakistan, it is critical to create the necessary supportive framework for the growth of SMEs so that they can play the important role that they are expected to play in economic progress. This role includes mobilizing household savings for investment, making a contribution to GDP, increasing the use of local raw materials, creating jobs, and significantly contributing to the alleviation of poverty (Smatrakaley, 2006). As a result, an effective tax policy must be put in place to ensure economic development and optimal resource utilization. This may not be the case as taxes are collected to

control private investment behavior rather than to stifle any entrepreneur initiative, which seems to be a significant barrier to the growth of the SMEs they are intended to support.

The consequences of a general tax policy in macro terms will support economic growth, boost tax collections, and benefit society, it is necessary to construct a political notion of tax policy. Tax collection for micro, small, and medium enterprises operators must be done properly, taking into account principles of fairness, so that it can stimulate compliance and the company's performance rather than be a burden that stifles SMEs' growth (Amin Purnawan et al, 2019).

The majority of SMEs expressed strong dissatisfaction with government officials' misbehavior and disruptions caused by unnecessary and excessive regulations, as well as the lack of effective government employees. The grievances stemmed primarily from the tax department's behavior and the miserable attitude of government agencies created to support SMEs in Pakistan. On the other hand, terrorism has made Pakistan's law and order situation difficult. This is one of the most pressing issues facing SMEs today, and it is posing a significant obstacle to their growth, (Amin Purnawan et al, 2019).

Taxation and SME development were significantly correlated. The study suggests that there should be a tax policy that is favorable to all start-up enterprises, preferably a tax vacation or the adoption of a growth restriction that can be described as a level stable enough to support tax payments. The tax break is the most frequently used incentive by the government, but this agreement excludes businesses from other tax obligations and also prevents a few businesses from deducting certain tax expenses during the tax holiday period, such as operating costs and interest payments, which tend to at least partially offset investment incentives. However, tax incentives are mistakenly thought of as straightforward incentives with a light compliance cost, such as the absence of income tax calculations during the holiday season. Because of this impression, tax incentives are seen as being more effective in promoting the development and expansion of small and medium-sized businesses. (Oluwaremi Feyitimi, 2016 et al).

The growth of Small and Medium Enterprises is significantly influenced by taxes. SMEs are critical to the growth of the economy in developing markets like Ghana. In this study, the researchers determine the effect of tax policies on SME growth in Ghana and investigate how SMEs perceive tax policy. The results of this study, which used multiple regression analysis,

showed that the majority of respondents believed that tax policies had a negative influence on SMEs growth, and perception in Ghana (Bismark Ameyaw et al, 2016). The government's role is far from helpful as it tends to excessively regulate the market, leading to common instances of rent-seeking. The regulations imposed by the Federal Board of Revenue (FBR) create hindrances for the growth-friendly environment. Additionally, the presence of corrupt and inefficient FBR personnel makes it exceedingly difficult for companies to thrive and survive, (Ul Haque, N 2021).

Small and medium enterprises (SMEs) are acknowledged in several economic literature as a key driver of economic growth across all economies, including Nigeria. The main objective of this study was to look at how different taxes affected the financial performance of small and medium-sized enterprises in Nigeria, particularly in Abuja. The primary source of data was used. ANOVA (analysis of variance) was used to evaluate the hypotheses. According to the study's results, there is a strong correlation between multiple taxes and the financial performance of SMEs in Abuja, Nigeria. Disproportionate multiple taxation practices also provide a significant challenge to the budgeting and planning performance of SMEs in Abuja, Nigeria (Rita Tabet, Pauline E.Onyeukwu, 2019).

Pakistan's policy and regulatory framework are particularly supportive of the growth of the SME sector, and the government's overall emphasis is still interested in the development of major enterprises. Small businesses frequently lack adequate access to business resources. This hostile climate for SMEs in Pakistan will persist unless and until competent authorities implement a new revolutionary policy. (Kamran Sherazi). According to SMEDA, tax rules are the most challenging issue for 67 percent of small firms in Pakistan, and 28 percent of SMEs believe overall taxes in the nation are also very high.

2.1.2 SMEs and Taxes

SMEs may enhance productivity, raise people's income, and contribute to regional income if they are correctly managed. SMEs are becoming more important as a result of globalization and structural change initiatives. The state's responsibility is to create a strong regulatory framework as well as effective monitoring and enforcement tools. The government must take into account the reality that such tax breaks or incentives are required for SMEs with low-wage staff. Because SMEs' capacity is restricted, both in terms of income and technology employed, the incentives

used can be chosen by taking into account applicable requirements (Ahmad Ali Almohtaseb, 2021). If a tax rule is clear and specific, taxpayers may believe that claiming a doubtful deduction is unethical. As a result, it is proposed that taxpayers who believe that using a specific deduction is unethical will be less likely to use it. In contrast, if a tax rule is imprecise and confusing, taxpayers may be less likely to see a problematic deduction as unethical. Taxpayers in this situation may be tempted to claim the deduction. Tax authorities should provide training seminars and short courses on taxes to assist SMEs in improving their accounting abilities and expanding their expertise. SMEs must also have a competent accounting system in compliance with the Tax Law's principles and requirements. (Hoang Thi Hong LE, 2020).

The developed nations encourage SMEs in their economic goals and programs, implementing particular macroeconomic policies such as targeted fiscal policies, tax exemptions, and special taxing schemes that directly influence SMEs' operating costs, flexibility, and competition (Salehi, Khazaei, & Tarighi, 2019). Large corporations, on the other hand, are a more appealing, clear-cut, and less complicated group than SMEs. Governments have always targeted major corporations when developing public policy, especially tax measures (Holban, 2007).

Furthermore, SMEs' contributions to tax revenue are typically lower than their assistance to output and job creation. Although SMEs make up three-fifths of the manufacturing industries that are completely dependent on major manufacturing enterprises for their supply, they have not yet developed enough competitiveness to expand their share of production. (International Tax Dialogue, 2007). The government also doesn't play a very helpful role. The government overregulates the market. Rent hunting is common. FBR regulations are creating obstacles to a growth-friendly atmosphere. Similarly, the crooked and incompetent FBR personnel are making it impossible for companies to survive, (Ul Haque, N 2021).

As there is a link between SMEs' sizes and their ability to pay taxes, taxes should be collected in response to their sizes and profits, taking into account all other variables that might limit their growth. Although SMEs have survived despite multiple taxation by tax authorities, there is a need for SMEs to be taxed at a lower rate so that they may invest in other activities that will contribute to company growth. It will also assist SMEs in being better prepared to compete in a competitive market. Furthermore, legislative incentives such as tax breaks for SMEs who

invest in local procurement of raw materials, significant value addition to goods for export, and other business ethics should be used by the government. Likewise, the government might raise support for the subsector's growth through direct budget allocation, as well as expand SME investment possibilities focused on specific areas of increase in the production. (Akpan Efremon Johnny, 2021).

Tax collection should be specified in terms of which government organizations are liable for collecting particular taxes from SMEs. This will prevent the three levels of government from collecting the same sort of tax from the same enterprise. The government should also implement a policy to avoid the imposition of unlawful taxes such as the community tax, the boys or youth tax levied, and the association or union levy. These taxes apply to all local governments in the state, including the state capital, where the majority of these SMEs operate. The government should guarantee that SMEs receive tax breaks as a kind of stimulus for their successful launch. Henceforth, the government should stop collecting excessive taxes from SMEs so that they can remain to exist as separate entity (Akpan Efremon Johnny, 2021).

A new paradigm of taxation is required that pays respect to the interests of the corporate sector. SMEs are intended to contribute to the absorption of unemployment, the expansion of business prospects, and social justice via solidarity and the sharing of a fair tax burden. It is also a vital component of economic democracy's empowerment and growth since it assures that people are not economically disadvantaged (Alfons J. Weichenrieder).

Small businesses should pay a lower tax rate to allow them to invest in their growth and have a greater chance of surviving in a competitive market. More tax incentives, such as exclusions and tax breaks, should be considered by the government since they would attract investors who will be future possible tax payers. Because a small business pays a small amount of tax compared to a larger corporation, tax collectors tend to give larger firms more attention. As a result, a large number of SMEs get away with not paying their taxes, resulting in income that could have been invested in development programs that would benefit SMEs as well. Therefore, this is an issue that must be addressed (Ojochogwu Winnie Atawodi).

Taxes provide money to the government, allowing it to create an environment that facilitates the development of all enterprises, including SMEs. At the same time, if an SME has

significant regulatory costs, it is more likely to avoid paying taxes, lowering the income that could have been utilized to build this situation and hence diminishing the SME's chances of survival. Many of the issues with the tax authorities emerge from poorly designed tax policies and a lack of confidence about future policy changes. A tax policy's goal should be to reduce collection costs while limiting revenue loss, economic disruption, and the injustice and capriciousness of the tax burden (Doreen Musimenta et al, 2017).

The need of offering tax relief to small businesses in counteracting the inherent disadvantages of being small is a compelling argument. If reliefs are to be available to all enterprises, SMEs will grow properly (Claire Crawford, 2008). Small business reliefs frequently add to the system's complexity, especially when combined with anti-avoidance laws. As a result, even smaller companies may prefer a straightforward and neutral system of company taxes over a more complex one that favors some small enterprises (Freedman).

Small firms should be given tax benefits and reliefs, according to a strong presumption in government, which may often be seen in politicians' speeches. The reasons behind this aren't always obvious, but they have something to do with the definition of little that is utilized. There may be some rationale for favoring a certain group if new enterprises, growth, or entrepreneurship are being targeted; however, there is frequently a slippage from speech about entrepreneurship or similar application through reliefs or incentives for all small businesses. This is unavoidable due to the difficulty of identifying organizations with more elusive traits; yet, this is a process that can cause significant tax system disruption. (Judith Freedman, 2007).

In both starting and growing their businesses, SMEs in Pakistan face an increasingly complicated legal, tax, and administrative environment. According to studies, tax regulations are the most burdensome for 67 percent of businesses. Taxes are a big problem for SMEs, and 28% of enterprises believe the country's taxes are too high. From the perspective of small businesses, the current tax system and administration distort incentives and discriminate against small businesses that are harassed by the tax agencies. Smaller businesses reported tax challenges to be more limiting than bigger businesses, with 69% of businesses with assets of less than Rs.1 million experiencing the most difficulties. Due to financial restrictions, many small businesses claim they are unable to comply with the law or employ a skilled (SMEDA).

The current method is non-standardized and gives tax officials too much freedom. There is no reason or consolidation in the existing provincial or local tax structure. As a result, there has been a persistent battle between tax officials and businessmen, resulting in a relatively gradual increase in the tax base. Two industries, retailers and small and medium-sized manufacturers have previously proposed fixed taxes as a solution to this ongoing problem. Recognizing the need to adapt policies to meet the needs of the SME sector, Pakistan's tax structure is undergoing modification. However, instead of addressing the issues that directly affect SMEs, these changes focus on tax administration and management. SMEs are not afforded any incentives to enter the official sector. There has been no thought of updating tax legislation from the standpoint of a typical SME or even microbusiness (SMEDA Pakistan).

The current tax structure hinders the expansion of small businesses. Effective tax rates on capital investments made by entrepreneurs practically double as a firm expands as the asset size of the business increases from under \$1 million to over \$30 million. The provinces that have been widening the tax rates for large and small businesses are particularly concerned about the issue. Small firms' limited access to capital financing a disadvantage sometimes attributed to market failure is the major justification for taxing them more favorably. The proper use of economic resources is determined by people and companies, and an effective tax system reduces distortions in these decisions. This would sometimes suggest that taxes should be imposed at equal rates on a variety of competing uses, including products, services, enterprises, and labor. Taxes may sometimes be used as an alternative to other public policies (such as government expenditure programs, rules, and subsidies) to affect economic behavior. (Duanjie Chen and Jack Mintz, 2011).

Developing nations must determine whether or not to tax small businesses. If it is decided to tax, the actual tax mechanism, the enforcement scheme, and the administrative rules and procedures that will specify the relationship between the taxpayer and the state must all be established and put into place. The traditional justifications for small business taxation include the need for revenue, the desire for taxpayer fairness across businesses of various sizes, and the improvement of the overall enforcement regime through the inclusion of more enterprises in taxation (William F. Fox and Matthew N. Murray, 2020).

Lowering the cost and fee load on SMEs. To establish a simple and calm atmosphere for SME development, all irrational charges must be eliminated since the weight of taxes and extra costs on SMEs is now too heavy, (Xiangfeng Liu, 2009). The government should create regulations requiring banks to lend to SMEs, offer sufficient incentives for banks to do so, and raise the proportion of bank loans to SMEs to a minimum of 10%. Considering this, banking institutions that lend to SMEs may be excused from paying business taxes. Additionally, corporations and individuals that sell or lease patents to SMEs may be excused from paying company taxes or may be eligible for a tax deduction (Gao 2008).

SMEs should receive assistance from the government. Market inefficiencies and the disproportionately high compliance costs borne by SMEs can be addressed by carefully designing government programs for SMEs, including particular tax regulations. As governments work to support SME development, innovation, and growth, it is important to take into account the variety of the SME sector as well as the many issues encountered by SMEs and their owners when designing the taxation regulations (Benny Irawan & Khoirunurofik, 2019).

Interest rates, taxes, and a lack of government support were the three environmental elements that are influencing small firms' success or failure. High tax rates were cited as the most important force causing the SMEs' failures. Taxes in Singapore, especially personal income taxes (which apply to single private limited companies and partnership-based SMEs) are regarded as excessive as compared to several regional countries. To keep luring foreign investment to Singapore and to support business organizations in maintaining their competitiveness, several experts have encouraged the government to decrease taxes (Lau Geok Theng and Jasmine Lim Wang Boon). The government has been advised by several experts to reduce taxes, even more, to maintain Singapore's investment appeal and support business organizations' competitiveness.

Since general sales tax is a single indirect tax for the whole country, which will make India would a single common market. A single tax known as GST is applied to the delivery of goods and services from the manufacturer to the customer. To determine the association between company size, business experience, and GST-perceived concerns and problems from three divisions in the Chittoor District, the study's objectives included determining the knowledge of GST among Micro, Small, and Medium Enterprises (business operators). According to the

study's findings, more than 72% of respondents are aware of the GST system and its problems (Dr.s. Gautami, 2018)

Another study stated here would examine the impact of GST on Small & Medium Enterprises in India. The Rajya Sabha's adoption of the Common Goods and Services Tax led to confusion among the nation's Small and Medium Enterprises (SMEs). A common misconception is that when GST is adopted, perks like excise exemption would be removed, which might harm SMEs. The GST was introduced by the government to expand the base of taxes rather than raise the cost of taxes on companies and customers. This study investigates the positive and negative effects of the GST on the MSME sector. (Dr.I.Siddiq, Dr. K. Sathya Prasad, 2017).

The study elaborates on the impact of multiple taxations on Small and medium enterprises in Nigeria. This study used a survey design method with an SME workforce of 80. A simple questionnaire was used to collect data. Simple frequencies were used to analyze the data and ANOVA is used to test the research hypothesis. The findings of the study demonstrate that various taxes harm SMEs. Additionally, SMEs and their capacity to pay taxes are significantly correlated. The study suggests that the government supports a tax strategy that increases the capital allowance for SMEs when enforcing taxes. The government should also take into account a tax strategy that encourages investment in SMEs by merging all taxes into one pot and then distributing the remaining funds to different government rewards rather than enacting several closely related but separate taxes at the same time. (Ebere U. Okolo et al, 2021).

The goal of this study is to investigate the link between multiple taxes and SMEs' survival as well as the effects of multiple taxes on SMEs' expansion and development. Additionally, it examined how multiple taxes affected SMEs' decisions to invest. The information obtained for this investigation through a well-structured questionnaire was studied using descriptive statistics. The researchers conclude that multiple taxes have an impact on SMEs' capacity to grow and expand in Nigeria. Therefore, it is impossible to overlook the fact that business owners consistently list tax-related problems as their main problems (Cross Ogohi Daniel, 2020).

The purpose of this research is to determine whether there is any connection between the development of SMEs in Nigeria and the tax atmosphere in which they do business. SMEs in Zaria, North Central, Nigeria, answered questionnaires, and the non-probability judgmental

sampling approach was used. The Spearman's Rank Correlation method was used to test the hypothesis. It was realized that the majority of the SMEs examined experienced challenges with high tax rates, multiple taxing, complex tax regulation, and a lack of adequate information or education regarding tax-related problems. The study found a significant negative relationship between taxes and a company's capacity for expansion and self-sufficiency (Stephen Ojeka, 2014).

This paper focuses on the tax barriers that small and medium-sized businesses in Italy must overcome. Small firms frequently use their financial limitations and limited access to bank loans as justification for preferential tax treatment. On the other hand, tax relief for SMEs is not always the appropriate reaction to flaws in the financial sector. On the one hand, the evidence that SMEs face significant financing limitations is not overwhelming. Our estimation findings by using Accelerator Model indicate that the user cost of capital has a detrimental impact on the investment made by small and medium-sized businesses (Marco Manzo, 2011).

Using SMEs in Nyarugenge as a case study, the paper examines the impact of tax incentives on the expansion of small and medium enterprises (SMEs) in Rwanda. A combined qualitative and quantitative research strategy was used. The relationship between the variables was explained using a multiple regression analysis. The study found that there was a strong positive and substantial association between tax incentives and the expansion of small and medium firms in Rwanda. According to the study's findings, tax incentives are vital for SMEs to develop sustainably. The government should make rules and regulations that mainly address the problems with SMEs' growth in the long-run, (Daniel Twesige1 & Faustin Gasheja, 2019).

In this study, the researcher uses a survey questionnaire in Jordan to check the behavior of SMEs regarding paying the VAT and suggest that the government and policy makers create and implement the value-added tax law on SMEs, this research offers some important information, (Ahmad Ali Almohtaseb et al, 2020).

The goal of this research outline criteria for SME sector entities (SMEs) not categorized as legal entities (i.e., they are operated by individuals and subject to personal income tax) to select the most advantageous taxation system. A case study that takes into consideration relevant tax laws and is based on actual economic data supports this objective. The study's findings provide

advice for business owners who are struggling to decide which income taxation structure is best for them, bearing in mind that tax planning is an important component of the entity's operational strategy (Mariusz Nyk, 2016).

The study aims to examine the impact of the government's new regulation (turnover of more than 4.8 billion in a year) implementation in Indonesia, Govt. regulation number 46 the Year 2013 on the income tax to be filled by SMEs. The result of this research using Paired Sample T-test, shows that the implementation of new regulation will hurt the SME taxpayers (Anna Purwaningsi).

Recently, the world economy has experienced significant growth, which has been attributed to the efforts of SMEs, particularly in emerging nations. This study investigates the impact of numerous taxes on Nigeria's small and medium-sized enterprises. The study used a survey research approach with 91 participants. Simple percentage calculations were utilized to statistically analyze this data, and an ANOVA was used to evaluate the study's main hypothesis. The findings demonstrated that different taxes negatively impact SMEs' ability to survive and that there is a strong correlation between SMEs' size and their ability to pay taxes, (Adebisi, 2013).

The writers of this study-based essay outline the primary challenges facing manufacturing SMEs in the Gauteng Province when it comes to collecting government taxes. Analysis of the replies revealed that SMEs face a significant administrative cost related to tax clearance. The tax deductions and services that are accessible to SMEs are frequently unknown to them. Small businesses (and likely other taxpayers as well) would prefer simple reductions in tax rates and penalties over complex tax incentive programs that frequently increase regulatory burdens rather than offering real tax relief (Abrie & Doussy, 2006).

For private firms in underdeveloped countries, interacting with the government in general and the tax administration, in particular, may be difficult. Bad tax policies and a lack of knowledge about potential future policy changes are the root causes of many of the problems that individuals have with the tax authorities. The complexity and ambiguity of tax legislation, high tax rates, and the absence of an integrated fiscal strategy that takes social taxes, local taxes, and

other levies into consideration when calculating the overall tax burden imposed on the business sector are all common issues (Lewis I. Baurer, 2005).

Taxation may have a significant impact on a variety of economic factors, including company formation and the growth of small and medium-sized businesses (SMEs). Small business taxation issues are widespread, particularly in developing nations. On a smaller scale, small business tax evasion issues can also be problematic in rich economies. There may be a solution through tax simplification (Alfons J. Weichenrieder, 2007).

Stephen I. Ocheni used the descriptive research design to investigate the impact of tax on the performance of small and medium enterprises in the Nigerian economy. The paper, therefore, suggested that the tax rate imposed on small businesses should be lower for them to be better prepared, have adequate money, and thrive in a competitive market. Government should introduce legislation to prevent unreported taxes. Also, they suggest that there should be consistency in tax policy to mitigate the effects of variables that work against the expansion of SMEs in connection to their capacity to pay taxes by the government. Any policy that will push for enough funding and other activities that will lead to SME growth is beneficial for adoption.

This study intends to examine the connection between the final income tax policy adjustments and MSMEs taxpayers' commitment. This study employs both an empirical and legal methodology. Seven taxpayers were surveyed and interviewed for empirical data, while legal data was gained by examining the government's taxes policy. This study demonstrates that the final income tax rate's drop from 1% to 0.5% and the legal clarity around the timing of the taxation imply a favorable effect on taxpayers (Siti Rahma Novikasari et al, 2021).

One of the elements influencing SMEs' performance is tax policy. The study used multiple regression analysis to examine the effect of taxation on the performance of SMEs and to discover other factors impacting the operation of SMEs in Nigeria. Only 352 SMEs were chosen from the 2014 World Bank Enterprise Survey. Overall, research revealed that factors such as legal/ownership status, ease of access to electricity, ease of access to financing, resource utilization, and theft significantly influence the growth of SMEs in Nigeria, whereas factors such as registration status, taxation policies, and degree of competition have little impact on growth.

However, the existing tax system in Nigeria severely hinders the capacity of SMEs to generate sales (Wasiu Adekule et al, 2022).

The amount of taxation, as well as how it is administered and adhered to, has a significant influence on the progress of small and medium enterprises. Therefore, a primary objective of any tax policy should be to preserve the optimal balance between the tax rate, compliance costs, tax administration, and economic development. The introduction of a fixed (lump-sum) tax intended to reduce welfare losses by bringing entrepreneurs out of the shadows and the imposition of a single tax which was supposed to simplify the accounting system and reduce compliance costs are the two current policies in Ukraine that have an impact on SME taxation that are examined in this paper. It could be analyzed the researcher that there could be a negative relation between the amount of taxation and the growth of Small and medium enterprises in Ukraine (Yadviga Semikolenova).

In Gauteng, a study of small and medium-sized businesses in the manufacturing, retail, and business services sectors was done. Since Gauteng is home to the vast majority of small, medium, and microenterprises (SMMEs), the study concentrated on this region. According to the research, the majority of small and medium-sized businesses (SMEs) in the business services sector outsource their tax management duties because they don't have the time. Additionally, it was discovered that the size and kind of an organization have an impact on how taxation inputs are used in business choices. The SMEs who participated in the survey suggested that the amount of interest and penalties levied be reduced as a tax reduction policy (JMP Venter & B de Clercq, 2016).

Small and medium enterprises (SMEs), which are the economic backbones of many nations, get government backing for a variety of technology breakthroughs like cloud enterprise resource planning(ERP) to promote economic development. It has been good to see Malaysian government financial support (GFS) for SMEs implementing cloud ERP. Our results demonstrate how GFS, including matching grants, subscription fee repayments, income tax, and other indirect tax deductions, support SMEs in successfully adopting and utilizing cloud ERP. Government subsidies, refunds of subscription fees, and tax deductions are all major factors in the success of small firms' adoption of cloud enterprise resource planning (Olakunle Jayeola et al, 2022).

The study discusses how public regulators and self-regulatory institutions have affected the performance of SMEs during the last decade in Ghana. It is acknowledged that experimenting with various regulatory approaches in areas like taxes, labor regulations, business locations, and prices will have some influence on the production, (Ernest Aryeetey et al,2005).

The study used an exploratory approach to check the impact of taxation on SMEs in Nigeria. According to research, small and medium-sized enterprises SMEs cannot compete for business with larger firms. As a result, governments must promote SME growth by fostering an environment that is favorable to them through the use of effective tax incentives. Additionally, tax policy will allow the government to raise the most money possible without endangering the viability of small firms. It is suggested that SMEs should pay a smaller proportion of taxes (Ajibade et al, 2020).

The study using multiple regression analysis shows that In terms of how their earnings rise, taxes have varied effects on small and medium-sized firms. The study finds that price variations in a range of goods and services are influenced by changes in tax rates. The results show that higher tax rates result in greater expenses for manufacturing, distribution, and sales, which raise prices and cause consumers to alter their purchasing habits. Fewer goods are purchased as a result of the increased pricing (Evans Tee & Lawrence Asare Boadi et al, 2016). Another study using multiple regression analysis concludes that taxes have a negative impact on firm financial performance and also have a substantial impact on the performance of SMEs, (Wadesango Ongayi et al, 2021).

2.2 Conclusion

These studies provide valuable insights into the specific impact of taxes on SME growth, taking into account different tax policy instruments, country contexts, and empirical methodologies. They contribute to the understanding of how tax policies can shape the business environment for SMEs and influence their performance and growth potential.

Limited research on the specific impact of taxes on SMEs in Pakistan: While there may have been studies on the overall business environment in Pakistan, there might be a lack of in-depth research focusing explicitly on the impact of taxes on small and medium-sized enterprises (SMEs). Understanding how different tax policies affect SMEs' operations,

Overall, the literature emphasizes the importance of designing tax policies that are conducive to SME growth and entrepreneurship. By reducing tax burdens, simplifying tax systems, and providing targeted incentives, policymakers can foster an environment that supports SME development, job creation, and economic prosperity.

CHAPTER 3

UNDERSTANDING TAXES

3.1 Introduction

The purpose of taxes is to generate money for the government on a national and subnational (regional, provincial) level. Although governments also get funding from non-tax sources (such as fees, penalties, interest, and dividend earnings), taxes often account for the lion's share of their overall income. In order to achieve social and economic goals, government expenditures such as developing infrastructure and social security programs (healthcare, income assistance, and education) are funded by tax revenue collection. Typically, taxes are categorized as either direct or indirect. In contrast to a tax that is levied on a transaction, a direct tax is placed on the income, wealth, and assets of a person or business. Because both the incidence and the burden of the tax fall on the same person or entity, it cannot be transferred to another party. In this study is based on only indirect taxes on small and medium enterprises (SMEs). The detail of indirect tax are given below.

3.1.1 Sales Tax

In Pakistan, sales tax is the main source of income and is mostly collected throughout the import process. Numerous amendments have been made to the Sales Tax Act of 1990 and its supporting rules throughout the years. SMEs have not been taken into account as a separate industry. The typical GST rate for the majority of commodities during the past ten years has been 17%. However, the eighth schedule of the Sales Tax Act currently specifies a number of distinct rates for various commodities.

The finance minister pledged that flaws in the Sales Tax system will be fixed in the budget address of 2009–2010. "The Government of Pakistan is committed to reforming the current general sales tax system," he declared. With numerous rates (between 16% and 25%), exemptions, and domestic zero-rated facilities for privileged and entrenched interest groups, the current Sales Tax has degraded into an unjust tax. Additionally, it has significantly increased potential for corruption and rent-seeking. The proposed Sales Tax changes would address the administrative and policy issues with our present GST to fix all of the aforementioned issues. In the 2019-20 budget, for instance, SRO 1125 (I)/2011 was revoked, and all the benefits available

under it, such as the zero-rating of sales tax and reduced rates of sales tax for specific sectors, were abolished. While GST has remained at 17% over the years, the government's revenue crunch and IMF pressure have pushed the former to withdraw tax concessions and reduce tax expenditures, though often arbitrarily and suddenly. (Karandaz Pakistan Report, 2023).

Sales tax holds significant relevance in the context of Small and Medium-sized Enterprises (SMEs) in Pakistan, as it directly influences several vital aspects of their business operations and financial performance. Firstly, sales tax contributes to the overall cost of production for SMEs. When these businesses manufacture goods or provide services, they frequently have to pay sales tax on the purchase of raw materials, equipment, and other inputs. This increased cost structure can make it challenging for SMEs to maintain competitive prices while preserving profit margins.

Secondly, sales tax can have a notable impact on pricing and consumer demand. The higher prices resulting from sales tax can influence consumer purchasing behavior. As SMEs pass on the tax burden to consumers through elevated prices, it can lead to decreased demand for their products or services. Consequently, SMEs may need to adjust their production levels to align with reduced demand.

Finally, sales tax is a critical factor that SMEs in Pakistan must navigate in their production processes. It affects their cost structure, pricing strategies, cash flow management, and overall competitiveness. Comprehending and effectively managing the complexities of sales tax compliance are imperative for SMEs to ensure their financial health and sustainability in the dynamic Pakistani business landscape.

3.1.2 Custom Duties and Tariff

These are taxes that a nation imposes on imports of goods and services. They can be ad valorem assessments made as a proportion of the item's worth or set charge tariffs based on the kind of goods. Each nation sets its own customs duties, referred to as most-favored-nation (MFN) tariffs, on a variety of items. In order to establish mutually advantageous commercial connections, nations can sign bilateral or regional trade agreements with trading partners. Other indirect taxes include entertainment taxes (on any type of commercial entertainment),

environmental taxes (on any form of carbon consumption, such as coal or cement), stamp fees, and environmental taxes. These are frequently imposed at the regional or provincial levels.

Similar to sales tax, customs taxes have historically been assessed without any special consideration for the SME sector. Even though tariffs have decreased over time, customs charges continue to be a significant source of federal tax income; however, with the implementation of the GST, their percentage of overall tax collections has decreased from 56% in the 1980s to 25% in recent years, (Karandaz Pakistan Report, 2023).

Custom duties and tariffs are highly relevant factors in the context of production for Small and Medium-sized Enterprises (SMEs) in Pakistan. These trade-related levies and charges can significantly impact various aspects of SME operations, trade, and competitiveness.

Firstly, custom duties and tariffs can substantially affect the cost structure of SMEs in Pakistan. When SMEs import raw materials, machinery, or components, they are subject to custom duties and tariffs. These levies directly increase the cost of inputs required for production. Consequently, SMEs may face higher production costs, which can potentially reduce their profit margins and competitiveness, especially in price-sensitive markets.

Secondly, custom duties and tariffs influence the pricing of domestically produced goods and imported products. SMEs that face competition from imported goods often need to align their pricing strategies with the cost implications of these trade-related charges. In some cases, high tariffs on certain imports can create a protective barrier for domestic SMEs, shielding them from foreign competition. However, this protectionism might also limit the incentive for SMEs to improve efficiency and quality.

Custom duties and tariffs are integral factors that directly affect the production, pricing, competitiveness, and trade strategies of SMEs in Pakistan. The management of these trade-related costs, compliance with customs regulations, and an understanding of trade agreements and exemptions are critical for SMEs to optimize their production processes, expand their markets, and sustain their business growth in a globalized economy.

3.1.3 Land tax

A tax on the worth of the land alone, unaffected by building, personal property, or other improvements, is known as a land tax. Joseph, Stiglitz (2015). Most economists support land value taxes since they don't lead to economic inefficiencies and alleviate disparity (Rogier van den, 2009). It is known that a recurring tax based on land value is justified theoretically. As demonstrated by classical and neo-classical economists like Adam Smith, David Ricardo, John Stuart Mill, and Alfred Marshall, the economic rent (and its capitalized similar, value) that land has the capacity of producing over the return produced after efficiently utilizing capital and labor is determined by its insufficiency and by its location. Neither of these factors is derived from any productive activity on the part of the property owner. Land value is, therefore, the price of monopoly: the scarcer and less interchangeable a piece of land is, and the more attractive the location, the more desirable it is concerning the market and the inputs of production.

Land tax is a relevant factor in the context of production for Small and Medium-sized Enterprises (SMEs) in Pakistan, as it has direct implications for their business operations and financial planning.

Land tax affects the overall cost structure of SMEs. Land is a crucial asset for many SMEs, particularly those involved in manufacturing or real estate development. When land is subject to taxation, SMEs must allocate a portion of their budget to cover this recurring expense. The cost of land tax increases the overall cost of production, which can, in turn, impact the profitability and pricing strategies of SMEs. High land tax rates may lead to higher operating costs, potentially squeezing profit margins.

Land tax is a relevant factor that SMEs in Pakistan must consider when planning their production activities and business operations. It directly affects their cost structure, location decisions, investment plans, and overall financial viability.

3.1.4 District Tax

District taxes are sales and use taxes levied by certain cities, regions, and other governmental bodies with voter approval. It can vary on a regional basis. This form of taxation is distinct from national or federal taxes and is typically levied on various activities and properties conducted or owned within the district's boundaries. Common types of district taxes include

property tax on real estate holdings, professional tax on individuals engaged in specific vocations, vehicle tax on registered vehicles, entertainment tax on recreational activities, advertisement tax on public advertisements, agricultural income tax on farming-related income, and transfer tax on property or asset transfers. District taxes play a crucial role in funding local infrastructure projects, public services, education, and other community-oriented initiatives.

District tax represents a local-level tax imposed on various activities, such as property transactions, services, or specific trades, depending on local regulations. This tax can significantly affect the cost structure of SMEs, particularly those engaged in activities subject to district taxation. When SMEs engage in transactions or services subject to district tax, they must allocate resources to cover these expenses, which can add to their overall operating costs. For instance, property transactions, such as land or real estate acquisitions, can involve substantial district tax payments, increasing the overall cost of such investments.

District tax can impact the location decisions of SMEs. SMEs often consider different regions and districts when establishing their operations. The level of district tax, its enforcement, and the ease of compliance can influence these location decisions. Lower district tax rates in certain areas may make them more attractive to SMEs for setting up production facilities or expanding their businesses. Conversely, high district tax rates or complex tax structures may discourage investment in specific districts, potentially affecting economic development in those regions.

3.1.5 Stamp Duty

Stamp duty in Pakistan is a tax levied on various types of legal documents and transactions. It is governed by the Stamp Act, which varies from province to province within the country. Stamp duty is collected by the respective provincial governments and is primarily aimed at generating revenue. When buying or selling property, such as land, houses, or commercial buildings, stamp duty is payable on the transfer documents, such as sale deeds, gift deeds, and lease agreements. Stamp duty applies to various agreements and contracts, such as partnership agreements, loan agreements, employment contracts, and rental agreements.

Stamp duty is typically associated with transactions involving property, agreements, and legal documents. For SMEs engaged in real estate transactions, such as acquiring land or

properties for production facilities, stamp duty can be a substantial cost. This additional expense directly impacts the cost structure of SMEs, potentially increasing their overall investment outlay. Consequently, SMEs may need to allocate more financial resources for stamp duty, which can affect their capacity to invest in production, purchase equipment, or expand operations.

The predictability and stability of stamp duty rates and regulations are vital for SMEs' production planning and investment decisions. Frequent changes in stamp duty rates or unclear regulations can create uncertainty for SMEs. This uncertainty may lead to delays in decision-making, as SMEs are hesitant to commit to property transactions or legal agreements without a clear understanding of the stamp duty implications.

CHAPTER 4

DATA AND METHODOLOGY

4.1 Introduction

As we know that methodology of the research provides details about the research. In this chapter, the study will discuss the description of the data and econometric methodology in detail.

4.2 Difference between Federal and Provincial Taxes

4.2.1 Federal Taxes

Income Tax: SMEs are subject to income tax based on their annual profits. The tax rates may vary depending on the SME's legal status and the income threshold. However, some SMEs may qualify for tax exemptions or reduced rates based on specific criteria set by the government.

Sales Tax: SMEs engaged in the supply of goods or services are liable to collect and remit sales tax to the federal government. The standard rate of sales tax is applied, but certain goods and services may be exempted or subject to reduced rates.

Customs Duties: For SMEs involved in import or export activities, customs duties are applicable on imported goods. These duties can significantly impact the cost of inputs and finished products, affecting the overall competitiveness of SMEs in the international market.

Withholding Tax: SMEs are required to deduct withholding taxes on various transactions, such as payments to suppliers, contractors, or employees. These withheld taxes are then submitted to the tax authorities on behalf of the recipients.

4.2.2 Provincial Taxes

Property Tax: SMEs owning or renting properties may be subject to property tax imposed by provincial governments. The rates and assessment methods may vary across provinces.

Professional Tax: Some provinces levy professional taxes on SMEs based on their nature of business or profession.

Stamp Duty: SMEs engaged in legal and financial transactions may have to pay stamp duty on documents executed within the province.

Vehicle Tax: If an SME owns vehicles for business use, provincial governments may impose vehicle taxes based on factors like vehicle type, weight, or usage.

Entertainment Tax: SMEs operating in the entertainment and hospitality sector may be subject to entertainment tax levied by some provinces.

It is crucial to consider these provincial and federal taxes separately while analyzing the impact on SMEs. Different provinces may have varying tax rates and incentives for SMEs, leading to diverse responses from business owners. SMEs operating in different provinces may face distinct tax burdens, compliance requirements, and access to support programs, all of which can influence their overall performance and sustainability

4.3 Data Description

The study is based on cross-sectional secondary data. The latest available data (during the fiscal year 2015-2016) were collected from the Census of Small and House Hold Manufacturing Industries (SHMI) through the Pakistan Bureau of Statistics (PBS). The SHMI Survey aimed to capture data from both urban and rural areas in the four provinces of Pakistan through random selection. However, it is important to note that the survey did not include erstwhile FATA, AJK, and Gilgit Baltistan within its scope. Therefore, while the survey is nationally representative, enumeration in military restricted areas was not conducted. The dependent variable is the production of SMEs and the independent variable is the indirect taxes (including sales tax, stamp duty, district tax, land tax, wages and capital) that SMEs pay. The total number of observations from Pakistan is 262 which are Small and Medium Enterprises.

In the 2015 Small and Household Manufacturing Industries (SHMI) report for Pakistan, the total number of manufacturing units was estimated at 1,242,124. Among these, 195,189 units (15.71%) were located in rural areas, while 1,046,935 units (84.29%) were situated in urban areas. Within the overall count, 787,964 units were identified as household manufacturing units, and 454,160 units were classified as small manufacturing establishments.

To reduce the chance of heteroscedasticity, all variables are taken in log form. While autocorrelation may also be a problem in a regression model, it is not a serious challenge in primary or cross-sectional research (Greene, 1992). There is some missing value in a data set. It is not possible to drop the sector which has missing values. So, following the method of Julian J. Faraway (July 2002), the missing value can be treated by taking the averages of the most similar firms.

4.4 Variable Details

4.4.1 Dependent variable

4.4.1.1 Production

The total value of production of small and medium enterprises could be taken. Production is the process of merging different sources, both material and immaterial, to produce a final product. This result should ideally be a product or service that is useful and increases people's benefit. It includes the value of finished goods and byproducts, receipts for work performed to third parties, receipts for repairs and maintenance, the value of sales of semi-finished goods and byproducts, wastes, and used goods, the value of sales of goods bought for resale, the total rise in the value of ongoing work, and the worth of fixed assets manufactured by the establishment for its ultimate use (investment). Several price notions might be used for valuation.

4.4.2 Independent variables

4.4.2.1 Indirect taxes

Indirect taxes are levied on products and services before they are sold to customers; these taxes are eventually included in the market price of the product or service that is purchased. Sales taxes, per-unit taxes, value-added taxes, goods and services taxes, excise taxes, consumption taxes, and tariffs are examples of indirect taxes. As an alternative, if the entity that pays the tax collecting authority does not experience a comparable decrease in revenue, i.e., effect and tax incidence are not on the same entity implying that tax can be moved or passed on, then the tax is indirect (Schenk et al,2007). An intermediary (like a public shop) collects an indirect tax from the person (like the consumer) who is responsible for paying the tax that is included in the cost of the item being purchased. Then, the intermediary files a tax return and sends the government the tax money together with the return. In this context, the word "indirect

tax" is used to contrast with "direct tax," which is paid by the government directly to the individuals (whether legal or natural) against whom it is levied. According to some observers, an indirect tax can be levied by the taxpayer to a third party, whereas a direct tax cannot be (Britannica). Indirect taxes might be passed on to the final consumer of goods or services and levied on a transaction.

4.4.2.1.1 Sales Tax

Governments can then impose a single rate of sales tax across all products and services or separate rates for certain products and services. At the end of the process, a single-stage sales tax is collected i.e. at the point of sale. Comparatively, multi-stage sales taxes are imposed at every point along the value chain, from manufacture to distribution. Sales tax is therefore paid by all parties involved suppliers, manufacturers, distributors, retailers, and final customers. As a result, when items move from one step to the next, the final consumer is forced to pay "tax on previously paid tax" since the taxable value at each level includes values taxed at the preceding stage. This strategy is criticized for causing economic distortions, particularly if it isn't backed up by a reliable tax credit system that enables businesses to recoup the "extra" tax they paid when submitting returns.

4.4.2.1.2 Land tax

A tax on the worth of the land alone, unaffected by building, personal property, or other improvements, is known as a land tax. Joseph, Stiglitz (2015). Most economists support land value taxes since they don't lead to economic inefficiencies and alleviate disparity (Rogier van den, 2009). It is known that a recurring tax based on land value is justified theoretically. As demonstrated by classical and neo-classical economists like Adam Smith, David Ricardo, John Stuart Mill, and Alfred Marshall, the economic rent (and its capitalized similar, value) that land has the capacity of producing over the return produced after efficiently utilizing capital and labor is determined by its insufficiency and by its location. Neither of these factors is derived from any productive activity on the part of the property owner. Land value is, therefore, the price of monopoly: the scarcer and less interchangeable a piece of land is, and the more attractive the location, the more desirable it is concerning the market and the inputs of production.

In Pakistan, land tax is a provincial tax levied on the ownership, possession, or use of land by individuals and entities, including small and medium-sized enterprises (SMEs). For SMEs, land

tax may apply if they own land or real estate properties for their business operations. The tax amount is typically determined based on the assessed or market value of the property and is payable to the respective provincial revenue authorities. In cases where SMEs rent land or property for their business activities, the responsibility for paying the land tax lies with the property owner (landlord), but landlords may pass on some or all of the tax burden to the SME through the rental agreement.

4.4.2.1.3 District/provincial tax

District taxes are sales and use taxes levied by certain cities, regions, and other governmental bodies with voter approval. It can vary on a regional basis.

In Pakistan, district tax refers to a tax levied by the local government authorities at the district level. The tax is imposed on various activities or services provided within a specific district to generate revenue for local development projects, infrastructure improvements, and the provision of public services. The specific nature and rates of district taxes can vary from one district to another, as they are determined by the respective local government bodies.

4.4.2.1.4 Stamp Duty

Stamp duty in Pakistan is a tax levied on various types of legal documents and transactions. It is governed by the Stamp Act, which varies from province to province within the country. Stamp duty is collected by the respective provincial governments and is primarily aimed at generating revenue. When buying or selling property, such as land, houses, or commercial buildings, stamp duty is payable on the transfer documents, such as sale deeds, gift deeds, and lease agreements. Stamp duty applies to various agreements and contracts, such as partnership agreements, loan agreements, employment contracts, and rental agreements.

In the context of Pakistan SMEs businesses, stamp duty refers to a tax levied on various legal documents and instruments that formalize transactions. These documents include agreements, contracts, deeds, leases, and other written instruments that are used to establish legal rights and obligations. Stamp duty is imposed by the provincial governments, and each province may have its own set of rates and regulations for different types of documents. SMEs in Pakistan may encounter stamp duty when entering into agreements with suppliers, customers, landlords,

or other parties, as well as when executing documents related to property transactions, loans, or business licenses.

The rates and calculation methods for stamp duty vary across different provinces in Pakistan. Each province has its stamp duty laws and regulations, and the rates may differ based on factors such as the nature of the transaction and the value of the document or property involved.

4.4.2.1.5 Wages

Wages of SMEs labor refer to the compensation paid to the employees or workers who are employed by Small and Medium-sized Enterprises (SMEs). SMEs are businesses that fall within a certain size range, as defined by the number of employees, revenue. The concept of wages is essential in labor economics and industrial relations as it directly impacts the standard of living and economic well-being of workers. Wage levels can significantly influence the motivation, job satisfaction, and productivity of employees. Moreover, wages are subject to negotiation, and labor unions often play a role in advocating for fair wages and improved working conditions on behalf of employees. Wages are a critical aspect of labor cost for employers, and they can impact a business's competitiveness and profitability. As such, the determination of fair and competitive wages is a delicate balance between meeting the needs of employees and maintaining the financial sustainability of the organization.

4.4.2.1.6 Capital

Capital assets refers to the long-term, tangible assets that a business or organization uses to conduct its operations and generate income. These assets are not intended for immediate resale, but rather, they are utilized over an extended period to produce goods or provide services. Fixed capital is a crucial component of a company's capital structure and plays a significant role in its productive capacity and overall efficiency. Capital is a fundamental element that allows the firm to acquire necessary assets, finance day-to-day activities, and invest in projects to achieve its strategic objectives. The proper management of capital is crucial for optimizing financial resources, ensuring operational efficiency, and sustaining the firm's long-term viability and profitability. It plays a central role in the firm's financial decision-making, risk management, and overall business growth. The capital structure of a firm, comprising both equity and debt

components, determines how it finances its operations and represents a critical aspect of its financial health and stability.

4.5 Percentage of Taxes from Production

4.5.1 Total Taxes Percentage

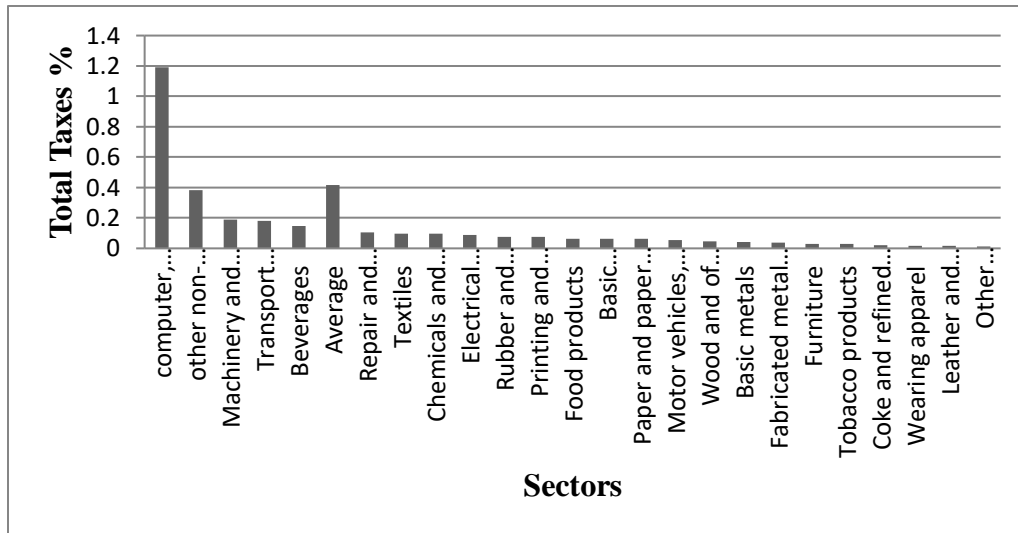


Figure 4. 1: Percentage of Total Taxes

This graph shows the percentage of total taxes from the production of SMEs in Pakistan. As we see that the manufacturing of electronic products pays high total taxes and the manufacture leather of products pays low total tax. The average of all sectors paying total tax is 0.41%.

4.5.2 Sales Tax Percentage

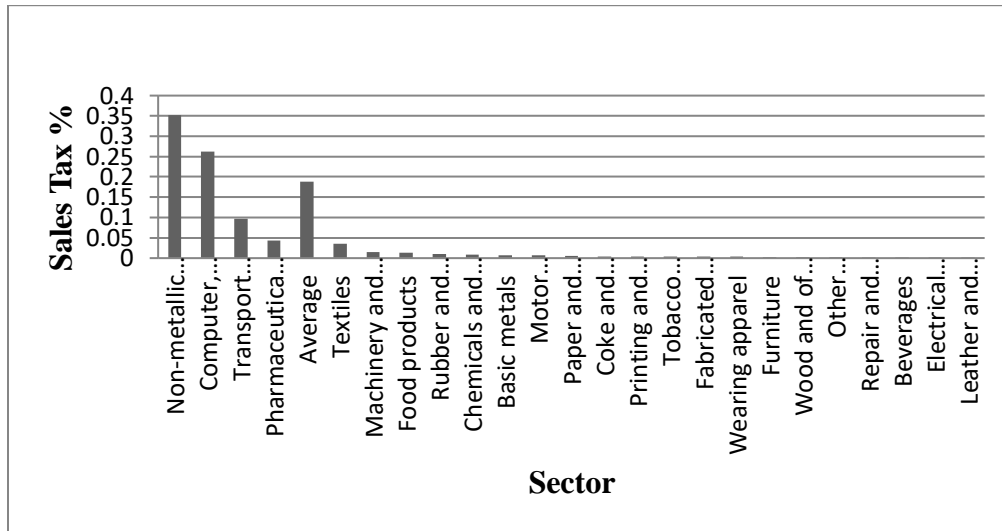


Figure 4. 2: Sales Tax Percentage

This graph shows the percentage of sales taxes from the production of SMEs in Pakistan. As we see that the manufacturing of nonmetallic mineral products pays high sales tax and the leather manufacture of products pays low sales tax. The average of all sectors paying sales tax is 0.18%.

4.5.3 Land Tax Percentage

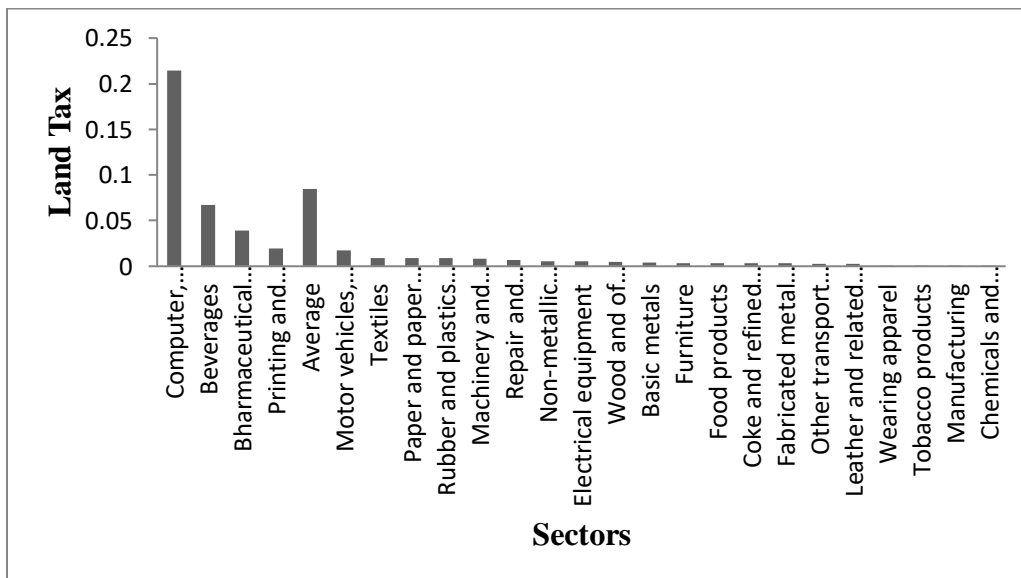


Figure 4. 3: Land Tax Percentage

This graph shows the percentage of land tax from the production of SMEs in Pakistan. As we see that the manufacturing of electronic products pays high land tax and the manufacture of chemical and chemical products pays low land tax. The average of all sectors paying land tax is 0.08%.

4.5.4 District Tax Percentage

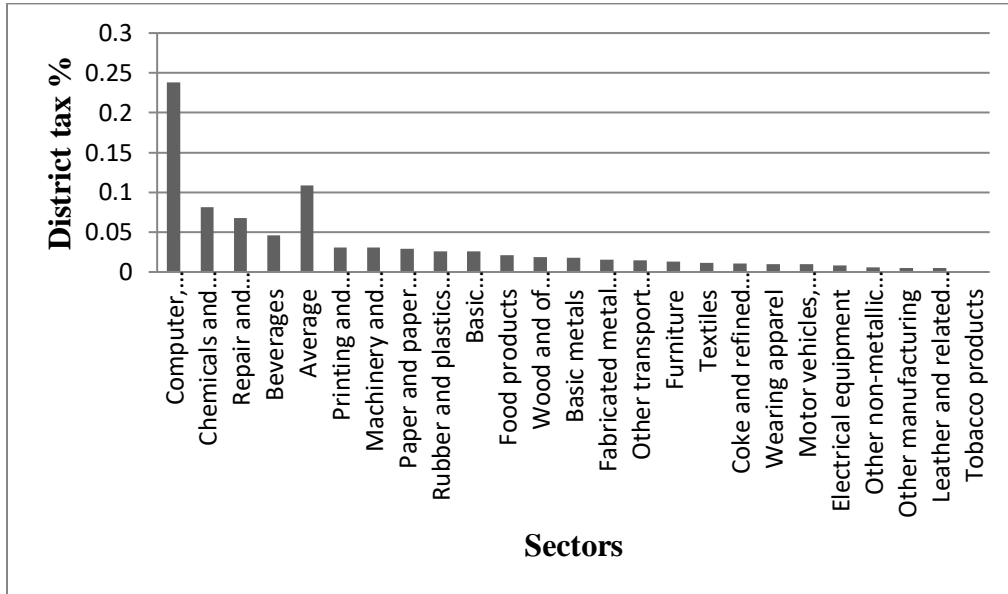


Figure 4. 4: District Tax Percentage

This graph shows the percentage of district taxes from the production of SMEs in Pakistan. As we see that the manufacturing of electronic products pays high district taxes and tobacco products pay low district tax. The average of all sectors paying district tax is 0.1%.

4.5.5 Stamp Duty Percentage

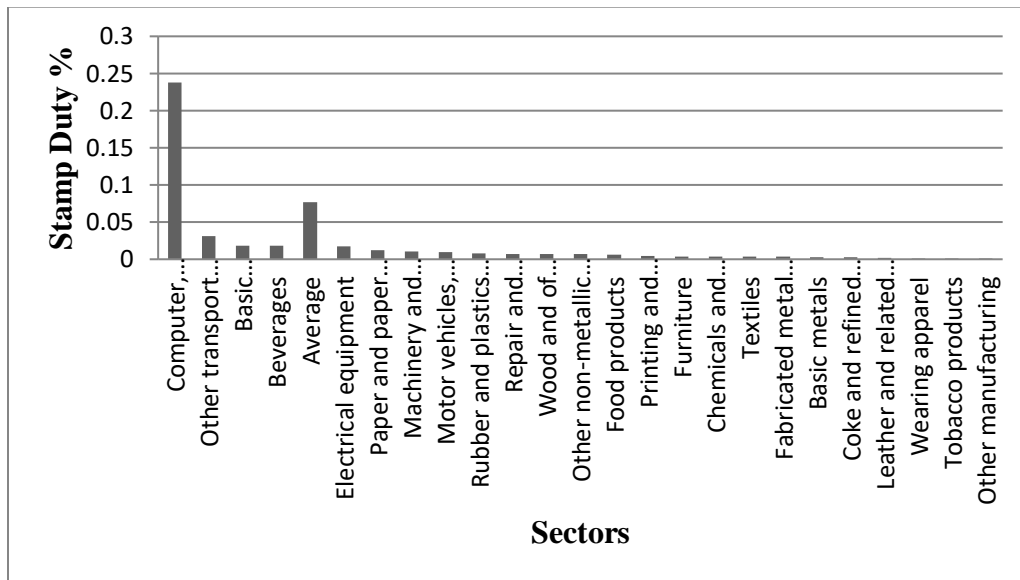


Figure 4. 5: Stamp Duty Percentage

This graph shows the percentage of stamp duty from the production of SMEs in Pakistan. As we see that the manufacturing of electronic products pays high stamp duty and tobacco products pay low stamp duty. The average of all sectors paying stamp duty is 0.07%.

4.5.6 Conclusion

In conclusion, the analysis of tax burdens across various industries in Pakistan reveals a complex landscape of tax payments. Different industries face varying tax obligations, influenced by factors such as industry type, profitability, import-export dynamics, and government policies. The findings highlight that taxes, including sales tax, land tax, district tax, stamp duty, and other taxes, have differing impacts on industries based on their specific characteristics and government priorities. While some industries, such as the manufacturing of electronic products, face higher tax payments due to factors like larger business values and import-intensive operations, others like wearing apparel enjoy relatively lower tax burdens. The variations in tax payments can be justified by considering factors such as industry profitability, market value, government

regulations, and policy objectives. It is crucial for policymakers to strike a balance between revenue generation and industry support, ensuring that tax structures are equitable, promote growth, and align with broader economic objectives.

Overall in this descriptive analysis, Manufacture of computer, electronic and optical products and other small electronics products manufacturing have the highest share in all taxes in Pakistan. In order to know why this sector have highest share of each type tax, a discussion which expert which conclude that, the main reason of highest share of electronics products share is that the high revenue generation within the electronics sector. The manufacturing and sales of computers, electronic devices, and other technological products tend to yield substantial profits, resulting in a higher overall tax liability. As a major contributor to the country's economy, the government may impose higher taxes on this sector to fund public projects, infrastructural developments, and technological advancements.

Moreover, the taxation structure for electronic products may play a role in the industry's higher tax payments. Electronic goods often undergo value addition at multiple stages during production and distribution. As a result, value-added taxes, such as sales tax, are applied at each stage of the supply chain. These taxes accumulate as products move through the distribution network, contributing to the industry's higher tax burden. Additionally, the electronics sector is relatively organized and formalized, making it easier for tax authorities to monitor and collect taxes from businesses operating within this industry, unlike informal sectors where tax evasion might be more prevalent. To facilitate this sector, increase production, and boost exports, reducing the tax burden is a potential strategy. Here's how this could be achieved:

Tax Incentives and Exemptions: The government can consider offering tax incentives and exemptions specifically tailored to the electronics manufacturing sector. These incentives could include reduced or waived import duties on essential components and machinery, reduced corporate income tax rates, and exemptions from specific local taxes or stamp duties. Such measures would reduce the overall tax burden on manufacturers in this sector.

Research and Development (R&D) Tax Credits: Encourage R&D activities within the electronics manufacturing sector by providing tax credits for companies investing in research and

development. This can spur innovation, lead to the development of advanced products, and enhance the competitiveness of Pakistani electronics on the global market.

Export Promotion: Create export-oriented tax policies that provide relief to electronics manufacturers exporting their products. For example, zero-rating or reduced sales tax on exports can make Pakistani electronics more competitive in international markets.

Customs and Import Duties: Streamline customs and import duties to make it easier and more cost-effective for electronics manufacturers to import necessary components and equipment. Reducing or waiving import duties on essential items can significantly lower production costs.

Reducing Regulatory Hurdles: Simplify and expedite regulatory processes related to permits, licenses, and certifications for electronics manufacturing. A more business-friendly regulatory environment can encourage investment and expansion.

By implementing these strategies and reducing the tax burden on the electronics manufacturing sector, Pakistan can create a more conducive environment for growth, foster innovation, increase production, and ultimately boost exports in this dynamic and globally competitive industry.

4.6 Variable Description

Table 4. 1: Details of Variables

Dependent Variable	Symbol	Description of variable
Production	LOG (Y)	Value Production of the firm at basic prices is in log.
Independent variable		
Sales Tax	LOG (ST)	The value of sales tax imposed on SMEs is taken in log.
Land tax	LOG (LD)	Value of land/vehicle tax in log form.
District/provincial tax	LOG (DT)	Value of district/provincial tax taken in log form
Stamp Duty	LOG (SD)	Value of stamp duty taken in log.
Wages	LOG(WG)	Values of wages of labor taken in log form
Capital	LOG(CT)	Value of fixed assets.

4.7 Source of Variables

The dependent variable Production and independent variables sales tax, land tax, district tax, stamp duty, wages and capital have been taken from The latest available data (during the fiscal year 2015-2016) were collected from the Census of Small and House Hold Manufacturing Industries (SHMI) through the Pakistan Bureau of Statistics (PBS). The SHMI Survey aimed to capture data from both urban and rural areas in the four provinces of Pakistan through random selection. However, it is important to note that the survey did not include erstwhile FATA, AJK, and Gilgit Baltistan within its scope.

4.8 Theoretical Framework

This theoretical framework is based on the actual association between taxes and the production of small and medium enterprises in Pakistan. Generally, the taxes are not direct impacts on production. If we talk about sales tax, politicians may utilize sales taxes to harm a sector or a business. There are some goods whose costs must be kept high to turn a profit when the tax on products made by one firm is greater than the tax on products made by another

comparable company. These businesses will have less prospect of surviving Sales taxes on items will increase the expenses of manufacturing businesses since raw materials are now more expensive. As a result, the cost of producing items will increase, increasing the price of the final product and hurting the finances of the last customer. (Hitesh Bhasin, 2019).

The Cobb-Douglas production functional form is widely recognized for its applicability to only two factors of production, limiting its adaptation to additional factors or inputs. Recognizing this limitation, the current study employs an extended Cobb-Douglas production function, accommodating more inputs beyond just capital and labor, such as taxes. The Cobb-Douglas production function is a mathematical formula used to represent the relationship between inputs (capital) and output in a production process. It is commonly expressed as:

$$Q=A \cdot K^{\beta} \cdot (1-T)$$

This framework assumes that the impact of labor on production is negligible or not under consideration.

If taxes are part of the production function, we might express it as:

$$Q=A \cdot K^{\beta} \cdot (1-T)$$

Where

T represents the tax rate. This assumes that taxes affect the overall output by reducing it proportionally. The presence of (1-T) implies that taxes reduce the total output of the production function. As the tax rate (T) increases, the reduction factor becomes larger, resulting in a diminished overall output.

The higher prices resulting from sales taxes can influence consumer behavior. When prices increase due to sales taxes, consumers might reduce their purchasing power or switch to cheaper alternatives. As a consequence, SMEs may experience a decline in consumer demand for their products.

The price of a product rises as a result of the sales tax. If there are multiple middle sellers for a product, the seller typically increases the price of the item by more than the tax. Under the

premise of sales tax, the product's price goes up excessively. Because of the market demand for goods, the amount of sales tax revenue is unpredictable. Goods with a sales tax added to them are more costly, which reduces consumer demand for the product.

Land tax can impact Small and Medium-sized Enterprises (SMEs) by increasing their operating costs, potentially reducing profit margins and limiting capital allocation. Indirectly, it can lead to higher market rents and supply chain costs, affecting their competitiveness and location decisions.

District tax impacts the production of Small and Medium-sized Enterprises (SMEs) by increasing their operating costs. When SMEs are subjected to district taxes, they are required to allocate a portion of their revenue to cover these tax liabilities. This reduces the funds available for essential business operations, such as purchasing raw materials, investing in new equipment, or hiring skilled labor. As a result, SMEs may find it challenging to maintain or expand their production capacity, hindering their ability to meet market demand and grow their businesses. This, in turn, can limit their overall productivity and competitiveness within the local economy.

Stamp duty can have a significant impact on the production of Small and Medium-sized Enterprises (SMEs) by increasing their overall operational costs. When SMEs engage in various transactions, such as property purchases, lease agreements, or contracts, they are required to pay stamp duty on the associated documents. This additional financial burden can strain their limited resources, reducing their capacity to invest in essential growth areas like technology, workforce development, or expanding their product lines. SMEs often operate on tight budgets, and the imposition of stamp duty can divert funds away from productive endeavors, hindering their ability to compete, innovate, and thrive in the market.

Indirect taxes can be moved forward since they are imposed on goods and services that are (ultimately) consumed (by consumers). They thus put a tax burden on tax payers. Economic incidence is typically the main focus of incidence analysis since it reveals who ultimately suffers the burden of taxes that are shifted forward. A tax is progressive if the final tax burden, expressed as a percentage of income, is higher for high-income people compared to lower-income people, regressive if it is higher for low-income people compared to high-income

households, and proportional if it is expressed as the same percentage of income for everyone (Ara & Iffat et al.).

Indirect taxes have a significant impact on the reduction in production levels of Small and Medium Enterprises (SMEs). The higher tax rates imposed on consumers can lead to reduced demand for goods and services, resulting in lower sales and production levels for SMEs. So, every time prices rise as a result of higher tax rates, there is a decrease in consumption and a reduction in sales volumes, which lowers profitability and slows the growth of SMEs. Even more so, paying taxes is one of the financial outflows from a company that lowers its ability to spend. This is because a large amount of the money collected is used to pay taxes rather than for the development of the business, (Evans Tee & Lawrence Asare Boadi et al, 2016).

Pakistan's tax system mainly relies on indirect taxes which constituted 73 of total tax receipts in 2020-21 whereas direct taxes constituted 38 percent (Table). Of the 74 percent of indirect taxes, Sales Tax (ST) dominated with a share of 24.1 whereas Import Duties (ID) and Excise Duties constituted 19.3 percent and 11.6 percent respectively.

Table 4. 2: Composition of Taxes (% Share).

Tax Head	2014-15	2018-19	2019-20	2020-21
A. Direct Taxes	39.9	37.8	38.1	36.5
B. Indirect Taxes	60.1	62.2	61.9	63.5
Sales Tax (ST)	42	38.1	39.9	41.8
Import Duty (ID)	11.8	17.9	15.7	15.8
Excise Duty (ED)	6.3	6.2	6.3	5.9
Total (A+B)	100	100	100	100

Source: Annual Report, Federal Board of Revenue (FBR).

This share of taxes is shows the overall share of direct and indirect taxes. Some indirect taxes that used in study are missing. But the proportion indirect taxes can be completed with major indirect taxes by FBR.

Finally, taxes can affect the incentives for entrepreneurship and risk-taking, as high tax burdens may discourage individuals from starting new businesses or investing in innovative ventures. These cumulative effects of taxes on production can create disincentives for firms to expand, innovate, and invest, ultimately stifling economic growth and reducing overall productivity levels.

4.9 Conceptual Framework

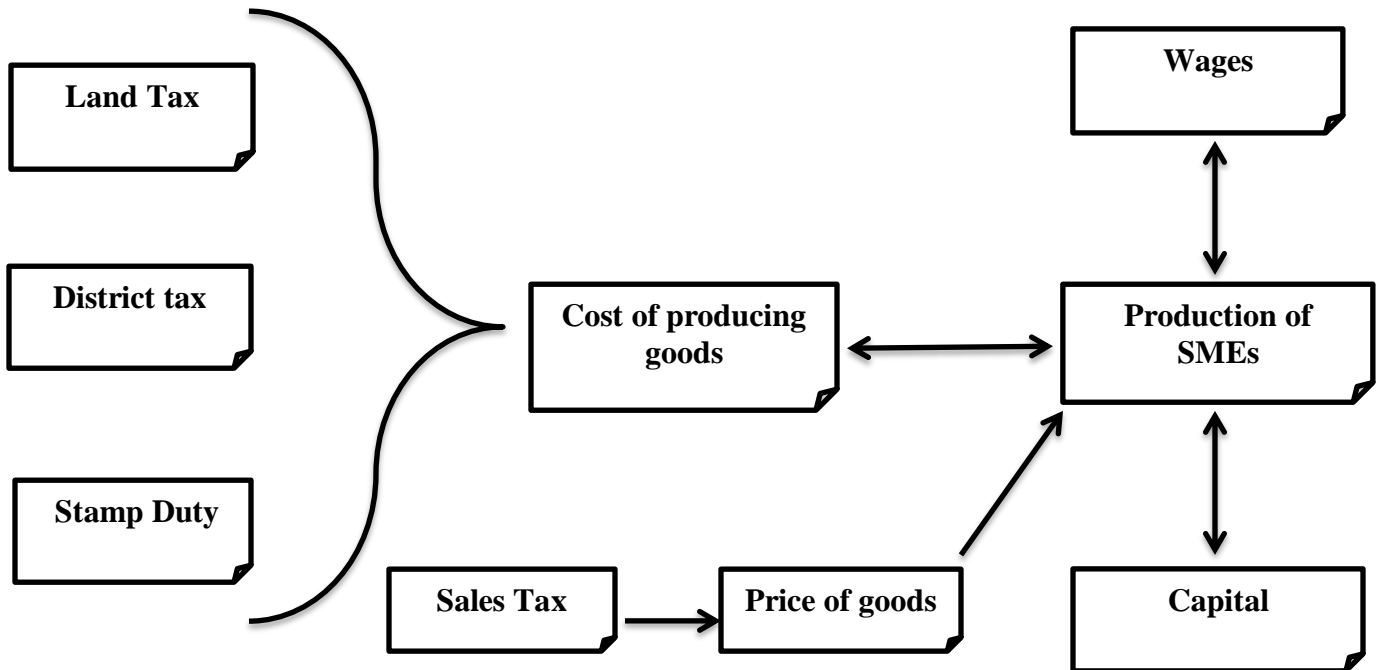


Figure 4. 6: Conceptual Framework

4.10 Model Specification

This section explains the econometric technique used in the study. Multiple regression models were estimated by using the Weighted Least Square technique. Python statistical software was used to analyze the data to determine the relationship between dependent and independent variables.

A single dependent variable (criterion) and several independent variables (predictors) can be analyzed using multiple regression analysis, a statistical method. Multiple regression analysis aims to predict the single dependent value that the researcher is interested in by using several independent variables whose values are known (Fang, J. 2013). Finding the independent variables and defining the mathematical form of the equation linking the predicted value of the dependent variable to these independent factors is the first stage in a multiple-regression study. Similar to basic regression, these constants are determined by identifying the value of each that minimizes the sum of squared deviations between the actual values of the dependent variable and the values predicted by the regression equation (Brown, 1990).

Mabah and Obiezekweh (2018), in their study on electronic banking and the performance of small and medium enterprises in Nigeria, used multiple regression models to find out the relationship between electronic banking and the performance of SMEs. Wadesango Ongayi and Doctrine Tadiwanshe et al (2021) in the research on the impact of taxation policies on the performance of small and medium enterprises used multiple regression analysis to estimate the relationship between taxation rules and the performance of SMEs.

By the use of multiple regression analysis, researchers may evaluate the strength of the relationship between a dependent variable and several independent variables as well as the contribution of each predictor to the association, Katerina Petchko (2018). The extra advantage of multiple regression analysis is that it can integrate equally common functions from the association. In the simple regression model, only a single function of a particular independent variable can act in the equation (Wooldridge, J. M. 2015).

The relationship between (dependent variable) production of SMEs and (independent variables) sales tax, import duty, excise duty, district/provincial tax, land/vehicle tax, and industrial cost is measured using the following multiple regression model.

4.10.1 Model

The Multiple regression model was as follows:

$$Y = \beta_0 + \beta_1 ST + \beta_2 LT + \beta_3 DT + \beta_4 SD + \beta_5 OT + \beta_6 IC + \varepsilon \quad (3.1)$$

$$\ln(Y) = \beta_0 + \beta_1 \ln(ST) + \beta_2 \ln(LT) + \beta_3 \ln(DT) + \beta_4 \ln(SD) + \beta_5 \ln(WS) + \beta_6 \ln(CT) + \varepsilon \quad (3.2)$$

Where:

$\ln Y$ = Log of Production of SMEs

$\ln ST$ = Log of Sales tax

$\ln DT$ = Log of District/provincial tax

$\ln LT$ = Log of Land tax

$\ln SD$ = Log of Stamp duty

$\ln(WS)$ = Log of Wages

$\ln(CT)$ = Log of Capital

β_0 = Constant term, intercept indicates the production of SMEs when independent variables are zero

β_1 β_6 = Coefficients, explaining the impact of the independent variable on the dependent variable.

ε = Error Term, represents the other variables that impact the production of SMEs but are not included in the study.

Multiple regression analysis is more suitable to *ceteris paribus* analysis. Because it enables us to explicitly account for several additional variables that simultaneously impact the dependent variable. Multiple regression models allow for a large number of potentially associated explanatory variables, which allows us to infer causation in circumstances when a simple regression analysis would be inappropriate (Wooldridge, J. M. 2015).

Therefore, if we increase the number of elements in our model that help explain y , then we can account for a larger portion of the variation in y . Multiple regression analysis may thus be used to create models that are more accurate at forecasting the dependent variable. The ability to integrate rather broad functional form correlations is another benefit of multiple regression analysis. The equation for the basic regression model can only have one function for a single explanatory variable. We shall examine how much additional latitude the multiple regression model offers (Wooldridge, J. M. 2015).

Weighted Least Squares (WLS) is a statistical estimation technique used to address heteroscedasticity and unequal variances in linear regression models. It extends the concept of Ordinary Least Squares (OLS) by incorporating weights for each observation based on their variances or specific properties. This allows WLS to give more importance to precise data points and downweight those with larger variances, leading to more efficient and unbiased parameter estimates. In the field of social sciences, WLS has been applied to address unequal variances in survey data or observational studies (Allison, 2009).

To describe the link between two or more explanatory factors and a dependent variable by assuming a linear relationship, multiple linear regressions is based on the linear and additive relationships of the explanatory variables. Due to their simplicity, regression-based models, which have been the most widely used modeling approach, are only effective when there are linear correlations between the input and output variables. (Moslem Abdipour et al, 2019). The ability to analyze associations among more than two variables is provided by the multiple regression analysis, which is a circumstance that accounts for the majority of macroeconomic study situations. The least squares approach is the most well-known method of estimation for multiple regression (Anghelache, C et al, 2014). This study used WLS as an alternative to Ordinary Least Squares (OLS) to address specific issues in the data. Briefly mention the reasons for choosing WLS, such as heteroscedasticity, unequal variances.

Multiple regression analysis is a strong tool that is often employed, also one of the statistical methods that are most frequently abused, because several criteria must be completed, statistical tests to determine the model's accuracy and the data's goodness of fit, potential model weaknesses and difficulties in comprehending the results, (Mendenhall and Sincich 339). One of the most used statistical techniques for both academic and practical research is multiple

regression analysis. Its application to many types of data and issues, simplicity in interpretation, resistance to breaches of the underlying assumptions, and general availability all contribute to its appeal (Charlotte H et al).

A more crucial justification for performing multiple regression analysis as opposed to simple regression is that "if the dependent variable depends on several independent variables, a simple regression of the dependent variable on a single independent variable may result in a biased calculation of the impact of this independent variable on the dependent variable" (Mansfield, 1994, p. 510). The link between the dependent variable and any one of the independent variables, when a dependent variable is a function of more than one independent variable, may be deceptive since the perceived relationship may reflect changes in other independent variables. These other independent variables may change in a way that gives the impression that this independent variable has a greater or lesser impact on the dependent variable than it does since they are completely unregulated. So, we need to develop a multiple regression to incorporate all independent variables to evaluate the real impact of this independent variable on the dependent variable (Fang, J. 2013).

4.11 Conclusion

In conclusion, this chapter has delved into the details of the independent variables, namely sales tax, stamp duty, district tax, and their relationship with SME production. The primary aim was to investigate the impact of these tax-related factors on SME growth using a multiple regression model with the weighted least squares technique. Furthermore, we provided insights into the measurement and operationalization of the independent variables. We identified data sources that contributed to our analysis, ensuring the accuracy and reliability of our findings. By using the multiple regression model with the weighted least squares technique, we aimed to capture the simultaneous effects of these tax-related factors on SME production.

CHAPTER 5

RESULTS AND DISCUSSION

5.1 Introduction

This chapter presents the results and discussion of the analysis conducted to examine the impact of sales tax, stamp duty, district tax, wages of labor, capital of firms and industrial costs on SME Output. The subsequent sections provide a detailed presentation and analysis of the findings, highlighting the effects of each independent variable on SME production.

5.2 Descriptive Statistics

Table 5. 1: Descriptive Statistics

	Mean	Median	Maximum	Minimum	Std. Dev.	Skewness	Kurtosis
PRODUCTION	5903366	850416	135000000	3480	16786590	5.021888	32.29497
SALES TAX	1312.034	105	211046	1500	13109.82	15.7293	251.959
LAND TAX	256.5573	70.5	4085	501	536.3401	3.953697	21.50974
DISTRICT TAX	780.4771	101	23683	601	2156.908	6.168013	54.75879
STAMP DUTY	268.7767	57	8183	470	763.4612	6.255464	53.29885
WAGES	874517.8	94116	13963401	252	1932043	3.461109	16.59138
CAPITAL	522485.8	55575	12749177	390	1365691	5.406443	40.91402

Table 5.1 presents clear and self-explanatory descriptive statistics for the variables under examination. It provides essential summary measures, including the mean, median, maximum value, minimum value, standard deviation, skewness, and kurtosis for each variable. These statistics offer valuable insights into the central tendencies, variability, and distribution characteristics of the data. By presenting these measures in a comprehensive manner, the table enables readers to grasp the key features of the variables at a glance, facilitating a better understanding of the data's overall behavior and distribution patterns.

In summary, the descriptive statistics for the provided dataset reveal several important insights. For the "Production" variable, the mean production value is notably higher than the

median, indicating a right-skewed distribution with a long tail on the higher end, potentially driven by extreme values. The "Sales tax" variable exhibits extreme skewness and kurtosis, with a mean significantly higher than the median, implying a highly right-skewed distribution with a heavy tail of outliers. Similarly, the "Land tax," "District tax," and "Stamp duty" variables also display pronounced right-skewness and heavy-tailed distributions, with the latter two showing particularly high kurtosis values. On the other hand, "Wages" and "Capital" demonstrate right-skewness but with slightly milder tails. The median represents the middle value in the dataset, while the mean is the average. When the mean is greater than the median, it suggests that the data is skewed to the right, meaning there are outliers or extreme values pulling the mean higher. Additionally, kurtosis measures the heaviness of the tails of the distribution, with higher kurtosis indicating heavier tails and more extreme values. This analysis helps us understand the shape and characteristics of the dataset, which can be valuable for making informed decisions or further statistical analysis.

5.3 Multiple Regression Results

Table 5. 2: WLS Regression Results

Variable	Co-efficient	Std-error	t-value	p-value
LOG(WS)	0.225	0.023	9.734	0.000*
LOG(LT)	0.153	0.032	4.846	0.000*
LOG(SD)	-0.143	0.034	-4.220	0.000*
LOG(CT)	0.228	0.029	8.017	0.000*
LOG(DT)	0.998	0.049	20.269	0.000*
LOG(ST)	-0.214	0.048	-4.468	0.000*
C	2.077	0.126	16.457	0.000

Source: Multiple regression model results by using the WLS technique. * is a significance level of 5%.

5.4 Multicollinearity Test (Variance Inflation Factor)

Table 5. 3: Variance Inflation Factor Results

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
LSALES_TAX	0.000	18.416	1.941
LLAND_TAX	0.001	31.273	2.920
LDISTRICT_TAX	0.001	29.814	3.641
LSTAMP_DUTY	0.001	20.673	2.424
LWAGES	0.000	31.824	1.170

Source: From own Regression

The VIF values are all relatively low, and none of them appear to be much higher than 5 or 10, which is often used as a threshold for identifying problematic multicollinearity. In this context, low VIF values indicate that the variables in model are not highly correlated with each other, which is a good sign for regression analysis. Low multicollinearity suggests that each variable can contribute unique information to the model independently.

5.5 Heteroskedasticity Test (Breusch Pagan Godfrey)

Table 5. 4: Breusch Pagan Godfrey

Test Statistics	11.982
Test P-Value	0.0623

Source: Breusch Pagan Godfrey test results.

The p-value is 0.0623, which is slightly above the common significance levels of 0.05 and 0.01. Therefore, it would likely fail to reject the null hypothesis of homoscedasticity at those significance levels, suggesting that there is not strong evidence of heteroscedasticity in regression model.

5.6 Variables Plot

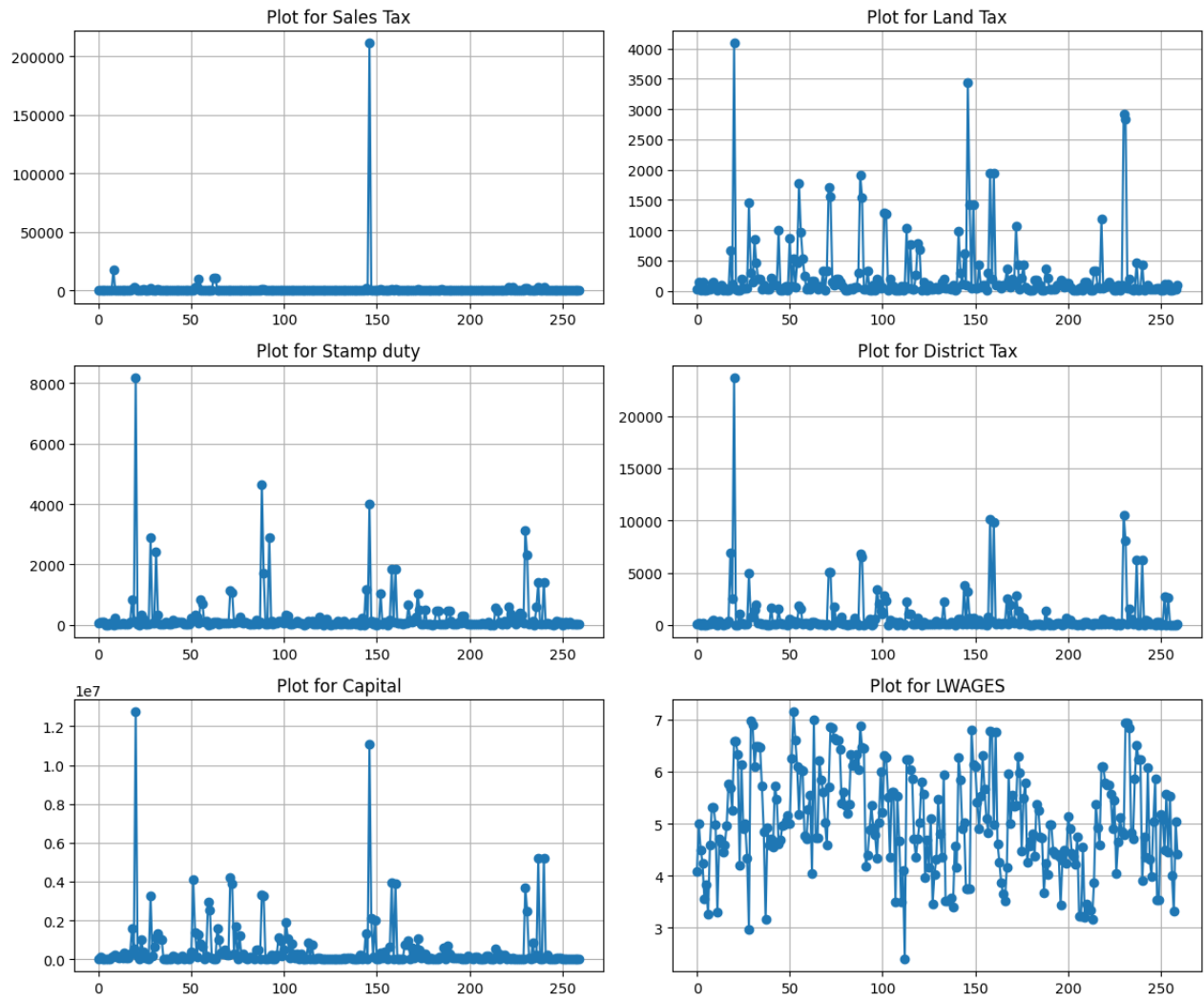


Figure 5.1: Variables Plot

5.7 Residual Plot for Heteroskedasticity

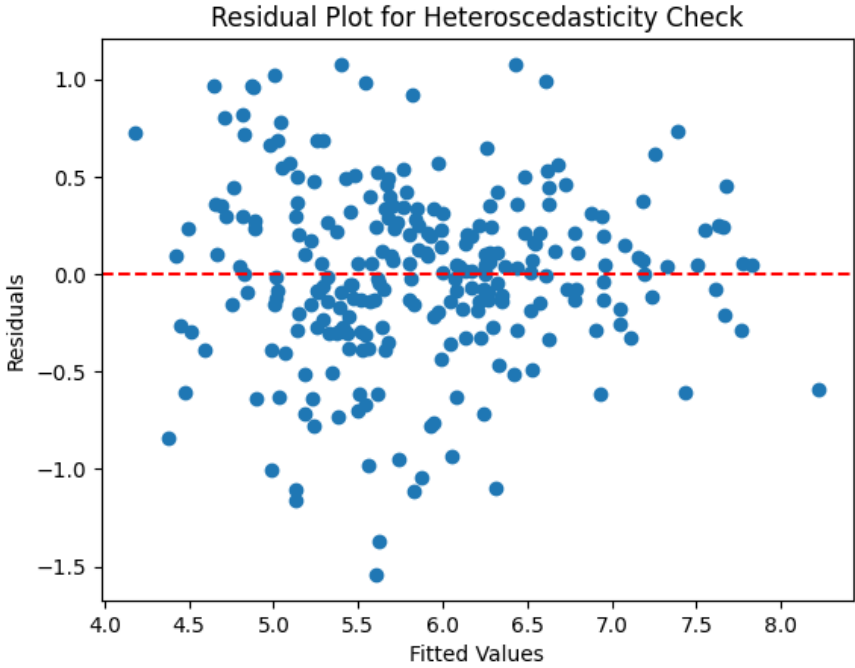


Figure 5. 2: Residual Plot for Heteroskedasticity

5.8 Normal Q-Q Plot for Residual

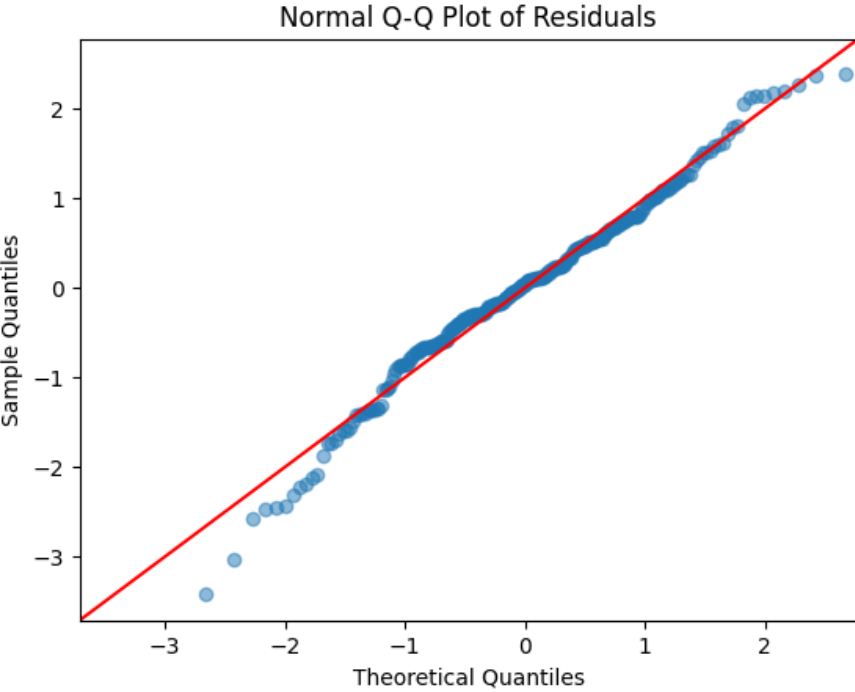


Figure 5. 3: Normal Q-Q Plot for Residual

5.9 Histogram of Residuals

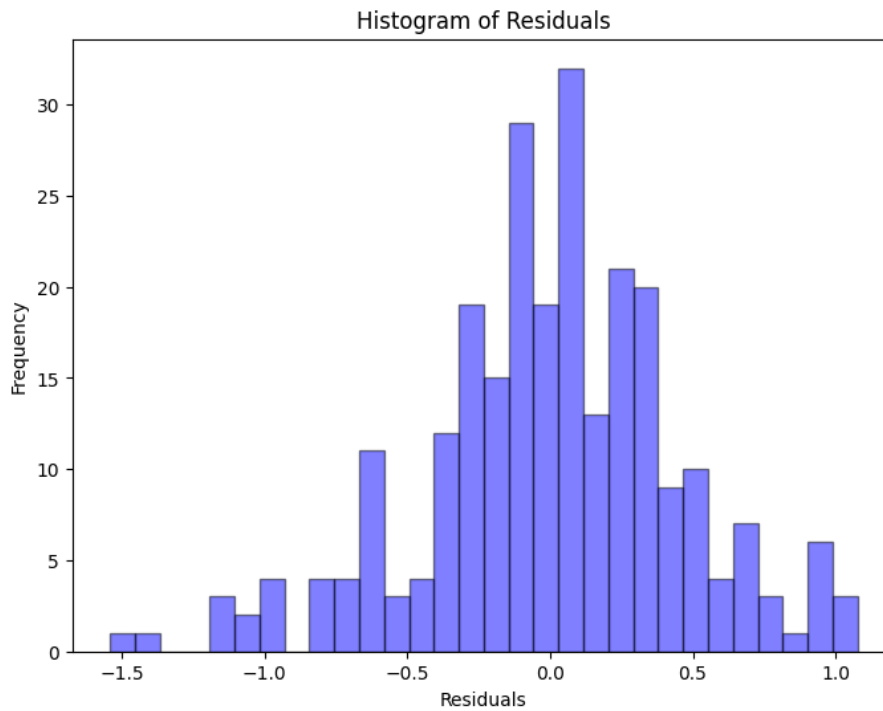


Figure 5. 4: Histogram of Residuals

5.9 Result of Ramsey Reset Test

Table 5. 5 Ramsey Reset Results

Test Statistics	0.774
Test P-Value	0.462

Source: Ramsey Reset test results.

The Ramsey Reset test results indicate that there is no strong evidence of misspecification in linear regression model. The test statistics of 0.774 and the p-value of 0.462 suggest that the model appears to adequately capture the relationships between the variables, without significant omitted variable or functional form issues.

5.11 Results Discussion

The results in Table are from a multiple regression model using the weighted least square technique where there is only one dependent variable which is the production of SMEs in Pakistan. The sales tax LOG (ST) has a significant negative impact on production. The coefficient value is -0.214. ST has a negative coefficient that indicates the inverse relationship with production. Here coefficient is the sales tax elasticity of production. An elasticity of -0.2 indicates that production decreases in response to higher sales tax rates, but the decrease is relatively small compared to the magnitude of the tax rate change.

When the sales tax elasticity of production is less than one and the sign is negative, it indicates an less elastic and inverse relationship between sales tax and production. The elasticity of production measures the responsiveness of production to changes in a particular factor, in this case, the sales tax. A value of less than one suggests that the percentage change in production is less than the percentage change in the sales tax rate. This implies that production is relatively insensitive to changes in the sales tax. The negative sign indicates an inverse relationship, meaning that as the sales tax rate increases, production decreases. In other words, higher sales taxes act as a disincentive for production activities, leading to a reduction in output.

This relationship can be explained by the fact that higher sales taxes increase the cost of production for businesses. When the cost of production rises, it becomes less profitable for firms to produce goods or services, leading to a decrease in production levels. Overall, a negative and inelastic sales tax elasticity of production suggests that higher sales taxes have a dampening effect on production, causing a reduction in output. Similar results were found by S. Azra Batool and Salyha Zulfiqar, (2012) for Pakistan in which sales tax shows a negative relationship with output and is statistically insignificant, also shows that an increase in sales tax LOG (ST) reduces the output of the firm. It means that an increase in taxes reduces the revenue of the firm and therefore further investment of the firm suffers. The results are also similar to the finding of Teodora Roman & Nicu Marcu et al, (2022) who conclude that the taxes paid by SMES was negatively and statistically significantly related to the performance of SMEs in European Union countries.

District tax LOG (DT) also has a significant impact on production. The coefficient value is 0.998. Here coefficient is the district tax elasticity of production. The positive sign indicates a

direct relationship, meaning that as the district tax rate increases, production also increases. In other words, higher district taxes act as a stimulant for production activities, leading to an increase in output. The results are similar to the findings of Emelia Awotwe (2018). The study found that high tax rates are associated with the high growth of SMEs in Ghana.

This relationship can be explained by the potential benefits that come with higher district taxes. For example, increased tax revenue may be invested in infrastructure development, education, or other public services that enhance the business environment and productivity. This favorable business environment encourages firms to expand their production and investment, thereby increasing overall output. The results are similar to the findings of Ravselj, D & Aristovnik,(2019) for the European Union countries and Slovenia separately. By analyzing their effects on new firm density and overall early-stage small business development, the findings demonstrate that the tax burden is less significant than the tax administrative burden among European Union countries. Moreover, the results are similar to the findings of Emelia Awotwe (2018). The study found that high tax rates are associated with the high growth of SMEs in Ghana. The reason behind this positive relation could be that the collection of district tax is relatively low compared to other types of taxes. As a result, the burden of district tax on SMEs may not be significant enough to hinder their production activities significantly. It is possible that district tax is not considered a major or critical type of tax for SMEs, and its impact on their production decisions might be relatively minor.

Capital of firms has significant positive impacts on production. The coefficient value is 0.228. Here coefficient is stamp duty elasticity of production. Capital elasticity of production refers to the responsiveness of production output to changes in the amount of capital used in the production process.

A capital elasticity of production value greater than zero (positive value) indicates a positive relationship between the amount of capital employed by firms and their production levels. In this case, a 1% increase in capital is associated with a 0.023% increase in production output. This suggests that as firms increase their capital investment, their production levels will also increase, though the effect may not be extremely pronounced given the relatively low elasticity value.

For example, if a firm invests more in machinery, technology, or infrastructure, it can enhance its production capacity, improve efficiency, and potentially take on larger projects, leading to an increase in the quantity of goods or services produced. This positive capital elasticity implies that capital is a significant factor in influencing the production capabilities of firms. However, it's important to note that the elasticity value of 0.023 suggests that production is not overly sensitive to changes in capital. This means that while an increase in capital investment will positively impact production, there are likely other factors that also influence the level of output.

Stamp duty has significant negative impacts on the production of SMEs. The coefficient value is -0.143. Here coefficient is the stamp duty elasticity of production. An elasticity of -0.143 indicates that production decreases in response to higher stamp duty, but the decrease is relatively small compared to the magnitude of the tax rate change. This implies that production is relatively insensitive to changes in the stamp duty.

The negative sign indicates an inverse relationship, meaning that as stamp duty increases, production decreases. In other words, higher stamp duty acts as a deterrent for SME production activities, leading to a reduction in output.

Stamp duty is a tax levied on specific documents, transactions, or legal agreements. When SMEs are required to pay higher stamp duty, it increases their transaction costs and financial burden. This can limit their ability to invest in production, hinder their cash flow, and reduce profitability. Higher stamp duty can discourage SMEs from engaging in certain transactions or activities that are subject to tax. For example, it may discourage SMEs from entering into contracts, acquiring assets, or expanding operations. This reduction in business activities can lead to a decline in production.

Land tax LOG (LT) has significant impacts on production. The coefficient value is 0.153. Here coefficient is the Land tax elasticity of production. It means that it has little significant impact on production for Small and Medium Enterprises (SMEs) in Pakistan. Additionally, if the elasticity of production for land tax is less than one and the sign is positive, it suggests an inelastic and positive relationship between land tax and production.

This relationship can be explained by several factors: Higher land tax can incentivize SMEs to utilize their land more efficiently and effectively. The increased tax burden may encourage SMEs to maximize the productivity of their land holdings, leading to increased production.

Revenue generated from land tax can be used by the government to invest in infrastructure development, such as roads, utilities, or transportation networks. Improved infrastructure can positively impact SMEs' access to markets, suppliers, and customers, enhancing production capabilities. These results are similar to the findings of Ravselj, D& Aristovnik,(2019) for the European Union countries and Slovenia separately. By analyzing their effects on new firm density and overall early-stage small business development, the findings demonstrate that the tax burden is less significant in European Union countries. The results indicate that the collection of land tax at the district level is relatively low, and this could be a contributing factor to the observed positive correlation with SME production. It appears that land tax, being considered as a less significant type of tax for SMEs in this context, does not impose a substantial financial burden on businesses. As a result, SMEs can allocate more resources towards their production activities, leading to the positive association observed in the data.

Wages LOG (WS) has significant impacts on production. The coefficient value is 0.225. Here coefficient is the Wages elasticity of production. A wages elasticity of production value close to zero (0.225 in this case) indicates that changes in wages have an significant impact on production levels for firms. Specifically, a 1% increase in wages is associated with only a minimal 0.225% increase in production output. This suggests that variations in labor costs, represented by wages, have little effect on the overall quantity of goods or services produced by the firms.

5.6 Conclusion

The study's findings shed light on the multifaceted implications of various taxes and fees on small and medium-sized enterprises (SMEs) in Pakistan. Notably, the research reveals that sales tax exerts a detrimental and statistically significant effect on SME production, indicating that it could hinder growth and operational efficiency within this sector. But impacts is small, because the sales tax elasticity production is less than one The impact of stamp duty appears negative as well, although it is deemed statistically significant, suggesting that its influence on SME production. On a more encouraging note, the study uncovers a positive correlation between

district tax with production levels among SMEs. These findings underscore the potential benefits of certain fees and costs in facilitating SME growth and output. Additionally, the study highlights that capital investment has a statistically significant positive impact on production, affirming its crucial role in fostering expansion and productivity within SMEs. However, it is worth noting that wages, despite having positive effects, are deemed statistically significant, indicating that other factors may play a more substantial role in driving SME production in Pakistan. Overall, this research provides valuable insights for policymakers and stakeholders in understanding the nuanced relationship between taxes, fees, and SME production dynamics in the country.

CHAPTER 6

QUALITATIVE WORK

6.1 Introduction

Another lens for in-depth investigation of phenomena is the qualitative method. Quantitative is all about breadth whereas qualitative is all about depth. It was judged crucial to authenticate the findings in the context of the study once the secondary data analysis yielded results. It offers a thorough insight into how people interpret some of their everyday circumstances in specific contexts. By focusing on the "why" and "how," it seeks to explain the occurrence.

6.2 Objectives

For this study, the expert and owners of SMEs, opinions, and experience on taxes were discussed. Various methods is existing for collecting that kind of information, the most widely used approach is the interview method. For this research, SMEs owner and expert interviews from collected from the Islamabad Chamber of Small Traders and the SMEDA office in Rawalpindi. The main objective of the expert interview is to catch information about a specific area of interest, concentrating on the understanding of a particular field of action. The Questions which were discussed are given in headings. Experts are thought to be experienced persons recognized under their exact information, their community position, or their status (Kaiser 2014).

6.3 Interview Analysis

In interviews, various examining questions were asked after the opening open-ended questions. Following information collected from the Islamabad Chamber of Small Traders.

6.3.1 How Taxes are Causes of failure and close-up of SMEs?

In Pakistan, small and medium-sized enterprises (SMEs) often face a myriad of challenges related to taxes, which can significantly impact their chances of success and even lead to business failure. One prominent issue cited by SME owners is the high tax burden they bear. With limited profit margins, SMEs find it challenging to sustain operations when taxed at rates that erode their earnings. The high tax burden can impede their ability to reinvest in the business, expand, or meet financial obligations, ultimately hindering their growth and causing closures.

Another critical factor is the complexity of tax compliance. SMEs lack the resources and expertise to navigate the convoluted tax laws and regulations in Pakistan. Complying with tax requirements can be time-consuming and costly, diverting precious resources from core business activities. Non-compliance, on the other hand, can lead to penalties and legal issues, putting SMEs under significant financial strain and pushing them closer to failures. According to the respondents, the impact of multiple taxations on the failure and closure of Small and Medium Enterprises (SMEs) in Pakistan is a significant challenge. The burden of multiple taxes, including overlapping taxes at various levels, creates financial strains for SMEs, as they operate with limited capital and cash flow. Compliance with numerous tax regulations becomes complex and time-consuming, diverting SMEs' resources from core business activities. Moreover, the lack of coordination among tax authorities leads to uncertainty and confusion, discouraging investment and hindering business expansion plans. These factors collectively contribute to financial distress, reduced profitability, and ultimately, the failure or closure of SMEs.

In addition to the financial strains and administrative burden, taxes can also contribute to the failure and closure of SMEs in Pakistan through other channels. Firstly, high tax compliance costs can reduce the competitiveness of SMEs, particularly in industries with thin profit margins. SMEs may struggle to absorb the additional costs, leading to price increases that make their products or services less attractive to customers. This can result in reduced sales, market share erosion, and ultimately, business failure.

Lastly, SME owners express concerns about the inequitable tax structure and the perceived lack of government support for smaller businesses. When they observe larger corporations receiving more tax benefits and incentives, while SMEs face an uneven playing field, their motivation to continue operating diminishes. The absence of tailored support and frequent changes in tax policies add to the uncertainty, making it difficult for SMEs to plan for the future and make informed financial decisions. These challenges collectively contribute to the negative impact of taxes on SMEs' output and can lead to closures in the highly competitive business landscape of Pakistan.

6.3.2 What are the Taxes you pay on your Business?

There are two types of taxes that we pay on our businesses, first are direct taxes and second are indirect taxes. Direct tax is levied on the income or profits of the firms such as income tax.

An indirect tax is a charge placed on products and services before they are delivered to the consumer, who eventually pays the tax as part of the market price of the commodity or service bought such as sales tax, land tax, district tax, business/license fee, import duty and excise duty. Taxes are starting from individuals to a public limited company or listed companies.

6.3.3 Can You Pay Tax on Inputs/Outputs?

Inputs are used to produce goods. Sales tax is levied on inputs that we bought from another input producer. The company owner includes the sales tax on the price of that good or input material. Import duty can be charged to us on our imported raw materials. Export duty could also be imposed on specific products. We can also pay the tax output. An industry's output is the total amount of goods and services generated within that industry during a specific period and sold to customers or other firms. Sales tax can be charged on goods that we produce in our firm. We can include sales tax in the price of the product or put the burden on the consumer. This will cause of lowering the purchasing power of consumers. There are two types of sales tax. One is registered sales tax and the other is non-register sales tax. When you are a filer and you can buy a thing from a filer. The seller charged 18% sales tax. For example, you bought a good cost of 100 rupees, you pay 18 rupees sales tax and you sell this good to another consumer and are charged a price is 200 rupees. Now 36 rupees sales tax charged on that product. If you buy the good from a registered person then you will return 18 rupees in the form of the tax return.

6.3.4 When is an SME responsible for paying Taxes?

When an individual starts a business and his business is involved in income generating process. Then he needs to register his business and now he is responsible for paying all kinds of taxes that apply to his business. Before registration, a business is not responsible for paying taxes. But unfortunately, the tax system in Pakistan is not well managed through a proper channel. There is inequality in the tax system. Some SMEs are registered that are paying taxes, but most of the SMEs are not willing to register themselves, do not show the record of their business, and also want to avoid taxes. So, this is also the one of main reasons for small businesses are always small businesses and do not become medium businesses and medium businesses have not come to large businesses. The avoidance of taxes may be the result of FBR policies that are not business-friendly. There are no incentives to taxpayers that encouraged them to pay taxes.

6.3.5 What are the Impacts of taxes on SMEs?

Taxes impact the performance of Small and medium enterprises. A direct tax directly impacts the performance of SMEs. Indirect taxes also impact business. The most of govt. revenue comes from indirect taxes. When indirect taxes are imposed on products this will increase the cost of goods. Producers shift the tax burden on consumers. As a result, the final price of a good increased due to the imposition of tax. This will change the behavior of consumers which leads to a decrease in the demand for goods and this will also cause reducing the profit of the producer of a good. According to owners as another main issue of SMEs is access to finance.

6.4 SMEDA Discussion

In this part, the open-ended question was discussed with officials in the SMEDA Rawalpindi office. According to his experience, despite taxes, there are other main issues that SMEs face in Pakistan. Small and medium enterprises (SMEs) are essential to a country's prosperity; countries all over the world link their development to a robust, growing SME sector. The following are the most common issues that SMEs are facing in Pakistan.

6.4.1 Access to Finance

SMEs have enough access to finance. This is the main hindrance in the way of their development. To increase SMEs' access to finance, Actions are needed on the demand side (SMEs), supply-side (Banks), and brokers and regulatory sides of SME finance. Increasing SMEs' access to formal funding, particularly equity financing, is essential, along with solving the problem of "not having documents" and security. SMEs also delay utilizing loan facilities because they do not have enough repayment capacity, due to this restriction. Because the potential cost of equity financing from banks is far larger for SMEs than the cost that private borrowing implies, SMEs often turn to loans from family members or friends or take money out of their savings to pay for their business activities.

Tax obligations can reduce the available funds for SMEs to collateralize or reinvest, limiting their ability to access external financing. This lack of access to capital can hinder their growth and expansion plans.

6.3.2 Taxes on SMEs

In Pakistan, all Small and medium enterprises are not registered. Due to the fear of taxes, the owner of SMEs is not willing to register their business to avoid tax payments. Therefore the business that is registered pays direct and indirect taxes. High taxes on SMEs impact their performance. When prices rise as a result of higher tax rates, there is a decline in consumer spending and a drop in revenue from sales, which lowers profits and slows down the development of SMEs.

6.3.3 Lack of Technology

The SME sector primarily uses old, low-tech methods, which are less expensive and time-saving. Additionally, the quality of goods is less competitive, which reduces the chance that imports will increase or imports will be replaced in the global marketplace. The SME sector has a weak technology transfer framework and poor R&D (Research and Development) spending.

6.3.4 Marketing Limitations

In Pakistan, a typical SME serves the domestic private sector and focuses the majority of its operations in a few particular areas. SMEs do business in a restricted number of marketplaces because they have limited access to information and communication channels and have trouble adhering to labor, environmental, social, and global standards. Access to worldwide and domestic markets is crucial for expanding the size of SMEs' value chains.

6.3.5 Business Location

The Federal and Provincial Governments of Pakistan are not focusing on SMEs in a way that is appropriate for their particular requirements in terms of fiscal, labor, and company rules. Fiscal rules often categorize businesses according to financial standing, and labor-related laws primarily recognize two types of businesses small and large, therefore, failing to provide laws and execution procedures that are responsive to the requirements of SMEs.

6.4 Conclusion

In conclusion, the findings from the interviews with SME owners and discussions with SMEDA officials highlight the tax-related challenges faced by SMEs in Pakistan. SME owners expressed concerns about complex tax regulations, burdensome tax collection methods, and their negative impact on production. The insights shared by SMEDA officials further emphasized the

need for simplified tax procedures, improved access to tax incentives, and increased awareness among SMEs. Addressing these tax-related issues is crucial for creating a supportive environment that enables SMEs to thrive and contribute effectively to the economic growth of Pakistan.

SME owners express that taxes have negative impacts on their production. They contend that the burden of taxes, including sales tax, stamp duty, and other levies, escalates the cost of production, leading to reduced profit margins and financial constraints. The additional expenses incurred due to taxation often hinder their ability to invest in production expansion, modernize equipment, or hire skilled labor. SME owners emphasize the need for supportive tax policies, incentives, and streamlined tax administration to alleviate the adverse effects of taxation and foster a conducive environment for sustainable production and business development.

CHAPTER 7

CONCLUSION AND RECOMMENDATION

7.1 Introduction

In this chapter, the study will try to conclude all its findings and also try to give some recommendations and policy implications to the concerned department (Islamabad Chamber of Small Traders & SMEDA) that will help the policymakers in policy making that help the SMEs owners of the SMEs and flourish the development of the SMEs.

7.2 Conclusion

Small and medium-sized businesses (SMEs) are essential to a country's progress in social, modern, and economic terms. It contributes significantly to the GDP and raises the living standard for the majority of the population, playing a crucial role in the global economy. The study examined the impact of multiple taxation on SME output in Pakistan. The latest available data (during the fiscal year 2015-2016) were collected from Small and House Hold Manufacturing Industries (SHMI) through the Pakistan Bureau of Statistics (PBS). The dependent variable is the production of SMEs and the independent variable is indirect taxes that SMEs pay, which are sales tax, land tax, district tax, stamp duty, wages of labor and capital of the firms. The study used the multiple regression models by using the weighted least square method.

In conclusion, the analysis of various tax relationships and their impact on production for Small and Medium Enterprises (SMEs) in Pakistan reveals a mixed picture. While sales tax, have a significant negative influence on production and stamp duty has an significant negative influence on production, but impacts are small because sales tax and stamp duty elasticity of production is less than one, district tax, wages and capital exhibit a positive relationship with production. These findings suggest that SMEs are responsive to changes in sales tax and stamp duty, but they tend to increase in production from higher district taxes, land tax, wages and capital which can potentially incentivize production and contribute to a favorable business environment. These findings underscore the importance of considering the specific tax dynamics and business environment in Pakistan when formulating policies to support SME growth and

enhance production capabilities. In conclusion, the findings of this thesis contribute valuable insights into the intricate relationship between taxes and the output of Small and Medium-sized Enterprises (SMEs) in Pakistan. The analysis conducted in this study has revealed that, contrary to conventional wisdom, taxes do not exhibit a statistically significant impact on the production levels of SMEs in the Pakistani context.

7.3 Recommendation

Based on the results and conclusions derived from the analysis of tax relationships and their impact on SME production in Pakistan, policymakers can consider the following policy suggestions. Based on the findings of this study, where it has been established that taxes do not have a significant impact on the production of Small and Medium-sized Enterprises (SMEs) in Pakistan, coupled with the recognition of the substantial contribution of SMEs to the country's GDP, the following targeted recommendations are put forth:

Advocate for policies that enhance fiscal stability for SMEs, acknowledging that taxes do not exert a significant impact on their production. This could involve measures such as predictable and transparent tax regimes, providing SMEs with a stable financial environment to plan and invest in their operations with confidence.

Encourage the implementation of fiscal measures that go beyond taxation, such as grants, subsidies, or financial support programs. These measures can act as complementary tools to foster a conducive environment for SMEs without directly involving them in complex tax structures. By fortifying the broader environment in which SMEs operate, the government can indirectly bolster their productivity and economic impact without introducing new taxation measures.

By implementing these policy suggestions, policymakers can foster a vibrant SME sector, boost production levels, and stimulate economic growth in the country.

7.4 Limitations to the Study

Due to the limitation of non-availability of time series data in this study on the impact of taxes on SMEs' output in Pakistan, it would be valuable for future research to explore this topic using time series data if provided by the PBS or any other source. Conducting a comprehensive analysis using time series data would provide a more in-depth understanding of the relationship

between taxes and SMEs' output, enabling policymakers to formulate targeted strategies to support the growth and development of small and medium-sized enterprises in Pakistan.

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