

## Evaluating the Impact of Income Tax Policies on MSME Units in Punjab

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### Abstract:

The Micro, Small, and Medium Enterprises (MSMEs) sector plays a crucial role in Punjab's economic landscape by contributing significantly to employment generation, industrial output, and regional development. However, tax compliance and the broader implications of tax policies on MSMEs remain complex and under-explored areas. This study aims to evaluate the impact of various tax policies—both at the state and national levels—on the operational efficiency, financial performance, and growth prospects of MSMEs in Punjab. Using a mixed-method approach that combines quantitative data from surveys and financial records with qualitative interviews of business owners and tax consultants, the study seeks to identify the key factors influencing tax compliance behaviour and administrative burdens faced by these enterprises. Particular attention is paid to GST implementation, digital filing mandates, and the availability of tax incentives, and how these have reshaped the tax landscape for MSMEs.

Findings reveal that while certain tax reforms have streamlined compliance and enhanced transparency, many MSMEs in Punjab continue to struggle with policy complexity, inadequate digital literacy, and limited access to advisory services. The study highlights that a significant portion of small enterprises view tax obligations as a constraint rather than a facilitator of growth, particularly due to frequent policy changes and lack of tailored support mechanisms. Recommendations include the need for more inclusive tax education programs, simplified compliance procedures, and region-specific incentives that acknowledge the diversity within the MSME sector. Ultimately, this research provides a comprehensive understanding of the intersection between tax policy and MSME sustainability in Punjab, offering valuable insights for policymakers, tax authorities, and business support organizations.

**Keywords:** MSME units, Tax Compliance, Tax Policies, Punjab, GST Implementation

### Introduction

Micro, Small, and Medium Enterprises (MSMEs) form the backbone of India's economy, contributing significantly to employment generation, GDP growth, and industrial output. They act as a vital bridge between the formal and informal sectors, enabling individuals from diverse socio-economic backgrounds to participate in entrepreneurial activities. MSMEs play a pivotal role in fostering innovation, technical advancement, and customer satisfaction. National initiatives like "Make in India" and schemes promoting financial inclusion have further propelled the sector's growth and integration into global supply chains. As per the MSMED Act 2006, businesses are categorized into Manufacturing and Service Enterprises. Manufacturing enterprises focus on the production of goods and are assessed based on investment in plant and machinery, while service enterprises offer various services and are classified based on investment in equipment. Examples of these enterprises range from engineering and auto parts to IT services and agricultural equipment servicing.

The Government of India classifies MSMEs using investment and turnover criteria. Micro enterprises invest less than ₹1 crore with turnovers below ₹5 crore; small enterprises invest between ₹1–10 crore with turnovers up to ₹50 crore, and medium enterprises invest between ₹10–50 crore with turnovers below ₹250 crore. According to recent statistics, MSMEs contribute around 30% to India's GDP and 45% to its overall economic production. They account for nearly 40% of the country's exports and comprise more than 63.4 million business units, ranging from large corporations to small, family-run operations. In Punjab, approximately 1.6 million MSMEs form a key part of the state economy. The Punjab government plans to launch 'MSME Punjab' under the Punjab Economic and Commercial Development Authority to tackle challenges faced by these enterprises and promote a more vibrant, growth-oriented MSME sector within the state.

To enhance competitiveness among MSMEs, the government emphasizes several key support strategies. These include ensuring easy access to credit, supporting technological upgrades, offering high-end testing equipment and performance certifications, and encouraging modern management practices. Development of new products, design interventions, and access to domestic and international markets are also priorities. Furthermore, policies aim to promote entrepreneurial growth, skill development, and capacity building through cluster-specific strategies. Alongside business development, tax compliance plays a vital role in economic growth by ensuring that enterprises fulfill their fiscal responsibilities. Tax compliance involves accurately entering and reporting financial information, calculating the correct tax amounts, and making timely submissions without needing external audits. It can be categorized into formal compliance—meeting official obligations—and material compliance, which includes the actual payment, filing, and reporting processes. Strengthening tax compliance not only supports government revenue but also fosters a more transparent and accountable business ecosystem.

### **Review of Literature**

Several studies have analyzed the relationship between tax policies and MSME growth, with specific insights applicable to Punjab. Sharma and Verma (2018) examined GST implementation and found that many MSMEs struggled with technological adoption. Singh et al. (2020) highlighted that high compliance costs discouraged voluntary registration under the GST regime. Kaur (2019) found that MSMEs in Ludhiana were reluctant to formalize due to fear of increased scrutiny. Arora and Mehta (2021) noted that while tax rebates exist, poor awareness restricts their use. Gupta (2022) found a lack of targeted communication from tax authorities. The Punjab Economic Survey (2022) observed an increase in GST registrations but highlighted gaps in compliance. Kumar and Dhillon (2017) stressed that tax policies need simplification for micro units. Jain (2021) revealed that many entrepreneurs view tax procedures as barriers rather than support mechanisms, reinforcing the need for MSME-specific tax education programs in the region.

Further, research offers deeper insights into structural issues faced by Punjab's MSMEs. Bhatia (2019) emphasized the need for better integration of state and central tax systems for smoother compliance. Chawla (2020) analyzed tax incentives in industrial clusters and found mixed results, with smaller units benefitting less. Gill and Singh (2018) found that access to formal credit is closely linked to tax registration, suggesting indirect impacts of tax policy. A study by the Indian Institute of Public Administration (2021) revealed administrative inefficiencies hamper tax compliance among rural MSMEs. Malhotra (2020) found that fear of penalties discourages tax engagement. Randhawa (2022) noted positive effects of digital tax filing

platforms but cited digital illiteracy as a constraint. Bansal (2021) stressed the need for continuous stakeholder consultations. Finally, Sidhu and Kaur (2023) advocated for region-specific tax simplification and grievance redress mechanisms. Collectively, these reviews highlight the nuanced and region-specific challenges MSMEs face under current tax frameworks.

### **Objectives of the Study**

The primary objective of this study is to evaluate the impact of tax policies on the growth, compliance behavior, and operational efficiency of MSME units in Punjab. It aims to examine the extent to which current income tax structures influence the formalization, profitability, and sustainability of these enterprises. The study also seeks to identify the key challenges MSMEs face in understanding and complying with tax regulations. Furthermore, it endeavors to assess the effectiveness of existing tax incentives and suggest policy recommendations to create a more MSME-friendly tax environment in the state.

### **Hypothesis of the Study**

Null Hypothesis ( $H_0$ ):

Tax policies have no significant impact on the growth, compliance behavior, and operational efficiency of MSME units in Punjab.

Alternative Hypothesis ( $H_1$ ):

Tax policies have a significant impact on the growth, compliance behavior, and operational efficiency of MSME units in Punjab.

### **Research Methodology**

To evaluate the impact of income tax policies on MSME units in Punjab, primary data was collected from 100 enterprises across manufacturing, services, and trading sectors located in key industrial clusters of Punjab i.e. Ludhiana, Jalandhar, and Amritsar. A stratified random sampling method was employed to ensure sectoral representation. The study focused on key variables including income tax compliance behavior, business growth trends, operational challenges, and the perception of tax-related incentives. Regression analysis was employed to assess the influence of policy awareness on growth, compliance behavior, and operational efficiency among MSMEs, while ANOVA was used to compare differences in compliance levels across various groups based on firm size, sector, or geographical location. Qualitative data were analyzed using descriptive statistics to uncover patterns in perceptions and challenges encountered by MSMEs. Secondary data from government reports, industry publications, and tax records were also utilized. This triangulated approach strengthens the validity of the findings and offers a holistic understanding of the impact of income tax policies on MSMEs.

### **Data Analysis and Interpretation**

A one-way ANOVA was conducted to examine whether the tax policies significantly influences the growth, compliance behavior, and operational efficiency of MSME units in Punjab. Data was gathered from MSME respondents using a 5-point Likert scale questionnaire to assess their perceptions of tax policies and their relationship with growth, compliance behavior, and operational efficiency. The results revealed statistically significant differences in all the dimensions. For business growth, the ANOVA yielded an F-statistic of 6.73 with a p-value of 0.002, indicating that MSMEs perceiving tax policies positively experienced higher growth rates compared to others. Similarly, the compliance behaviour showed an F-statistic of 9.45 and a highly significant p-value of 0.000, suggesting that favourable perceptions of tax systems lead

to better adherence to regulations. The operational efficiency dimension also showed significant variation ( $F = 4.88$ ,  $p = 0.009$ ), reinforcing that MSMEs with supportive views of tax policies tend to manage resources more effectively. These findings reject the null hypothesis and establish a meaningful association between tax policy perception and business outcomes.

The post-hoc Tukey HSD test confirmed that MSMEs with positive Likert-scale responses had significantly better performance indicators compared to those with negative responses. Respondents who strongly agreed with statements like “Current tax policies are easy to understand” or “The tax filing process is assesse friendly” showed not only higher compliance behaviour but also more consistent business growth and improved resource management. These results imply that the perception of tax policy—formed through day-to-day interactions with the tax system—has a real impact on business outcomes. Negative perceptions, reflected in Likert scores, were associated with uncertainty, delays, and reluctance to comply, which can stifle MSME growth and efficiency. Therefore, the ANOVA findings strongly suggest that tax policy perception, as measured through Likert-scale responses, is a significant predictor of MSME performance. This highlights the need for simplified, transparent, and well-communicated tax systems that align with the practical realities of MSMEs in Punjab.

### Summary and Conclusion

The study investigated the impact of tax policy perceptions on MSME performance in Punjab using a one-way ANOVA, with post-hoc Tukey HSD tests providing further validation. Findings revealed statistically significant differences in business growth, compliance behaviour, and operational efficiency based on how MSMEs perceive tax policies. Specifically, MSMEs with a positive outlook toward tax systems—those who found the policies easy to understand and the filing process user-friendly—demonstrated higher growth rates, stronger compliance, and better resource management. The F-statistics and p-values across all three dimensions confirmed that these associations were not due to chance.

Post-hoc analysis reinforced that MSMEs with favorable Likert-scale responses significantly outperformed those with negative perceptions. Respondents expressing dissatisfaction with tax processes often reported operational challenges, compliance delays, and restricted growth. These results underscore the critical role of perception in shaping business behavior and outcomes.

In conclusion, the study establishes a clear, statistically significant link between MSME performance and their perception of tax policies. It highlights the importance of developing transparent, simplified, and accessible tax systems. For policymakers, these insights call for urgent reforms that align taxation practices with the operational realities of MSMEs, ultimately fostering a more compliant and growth-oriented business environment in Punjab.

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