

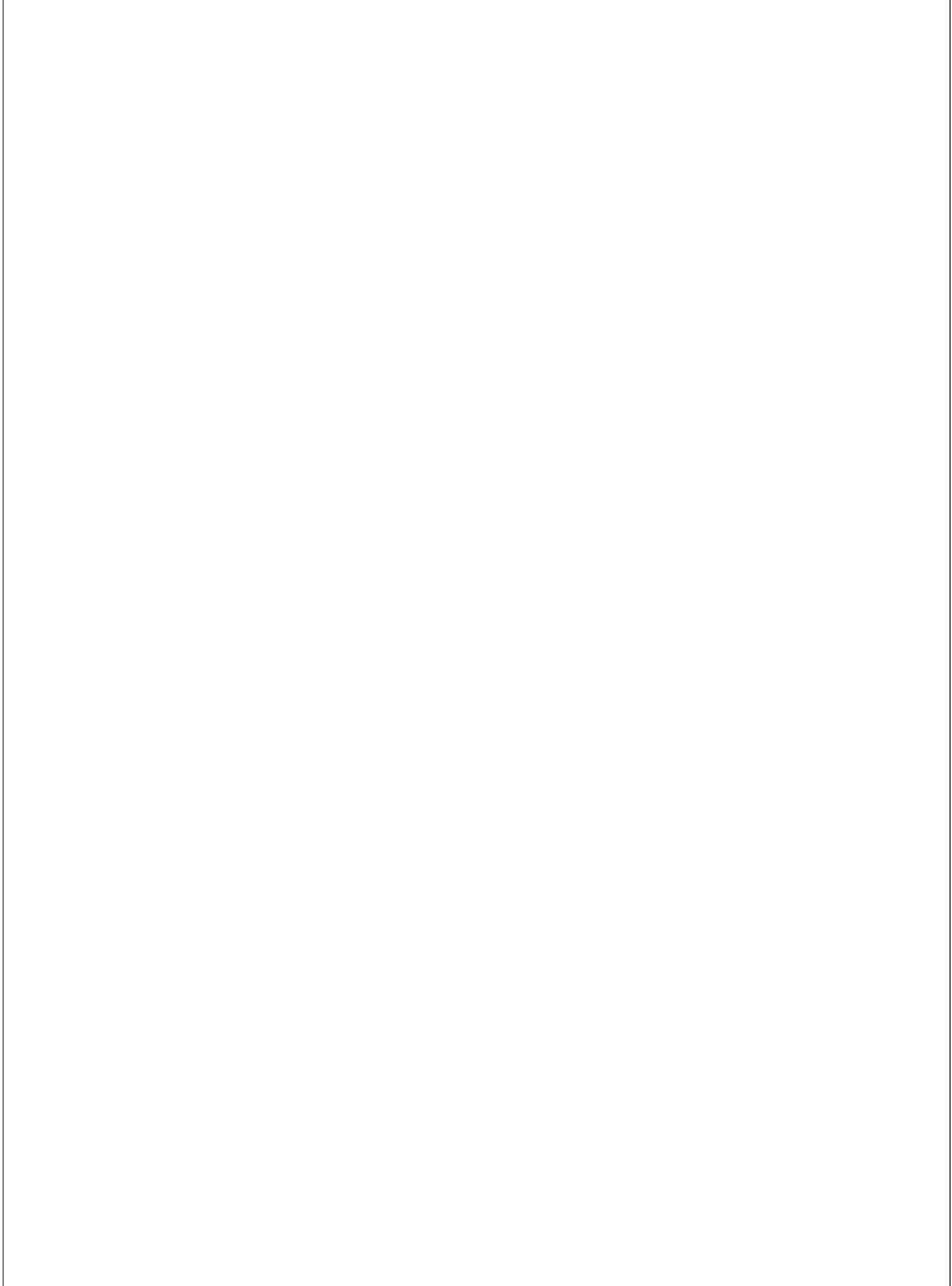


REGIONAL META-ANALYSIS REPORT
SOUTH ASIA



Tax Policy and Enterprise
 Development in South Asia





Regional Meta-Analysis Report

SOUTH ASIA

TAX POLICY AND ENTERPRISE DEVELOPMENT IN SOUTH ASIA

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About GINI

Governance Institutes Network International (GINI) was set up as a governance and policy reforms purpose organization registered under section 42 of Companies Ordinance 1984 in 2007 with its own board of directors.

GINI is a multidiscipline research oriented organization. Its underlying objective is to undertake policy, institutional & cultural analysis and action research advocacy as well as consultancy to facilitate politically owned institutional revival through networked research outputs and social communication through advocacy, workshops, seminars, conferences and media to create and increase awareness of the need or result oriented accountability for good governance.

GINI has established a Secretariat for its Regional International Network of leading think-tanks across South Asia, including the Beaconhouse National University (BNU) in Pakistan, Centre for Policy Dialogue (CPD) in Bangladesh, Institute for Integrated Development Studies (IIDS) in Nepal, Institute of Policy Studies (IPS) in Sri Lanka and the National Institute of Public Finance and Policy (NIPFP) in India, to study the impact of tax policies on enterprise development in South Asia. This research project is funded by the IDRC (Canada). GINI convened the Network, pursued the funding successfully and proceeded to manage and lead the research and advocacy activities of the Network. GINI also provided quality control and contract management services throughout the project's life cycle.

About the Research

This research examines the impacts of property tax, value-added taxes, and tax exemptions and concessions on small enterprise development in South Asia. The goal is to provide decision-makers with data and insights to support more informed policy formulation and implementation for inclusive growth, productive employment, and enterprise development. The research also aims to examine the issues as they affect women entrepreneurs, to promote positive learning experiences among the countries, build fruitful exchanges, and foster effective policy discussions in a regional context.

The targeted outcomes include five Country Study Reports as well as a regional Meta-Analysis report which draws on the country specific research conducted by the five network members namely BNU, CPD, IIDS, IPS and NIPFP in their respective countries.

The reports are published and widely disseminated at the policy engagement workshops. Other project outcomes are policy workshops in all five countries and workshop reports, as well as an interactive website to support research and advocacy.

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As this “Regional Meta-Analysis Report on Tax Policy and Enterprise Development in South Asia” is an integration of the individual country level research conducted in Bangladesh, India, Nepal, Pakistan, and Sri Lanka; the authors present their warm regards to the research teams of partner institutes for producing high quality Country Study Reports as well as for their invaluable comments and suggestions extended to authors which immensely helped in improving this report.

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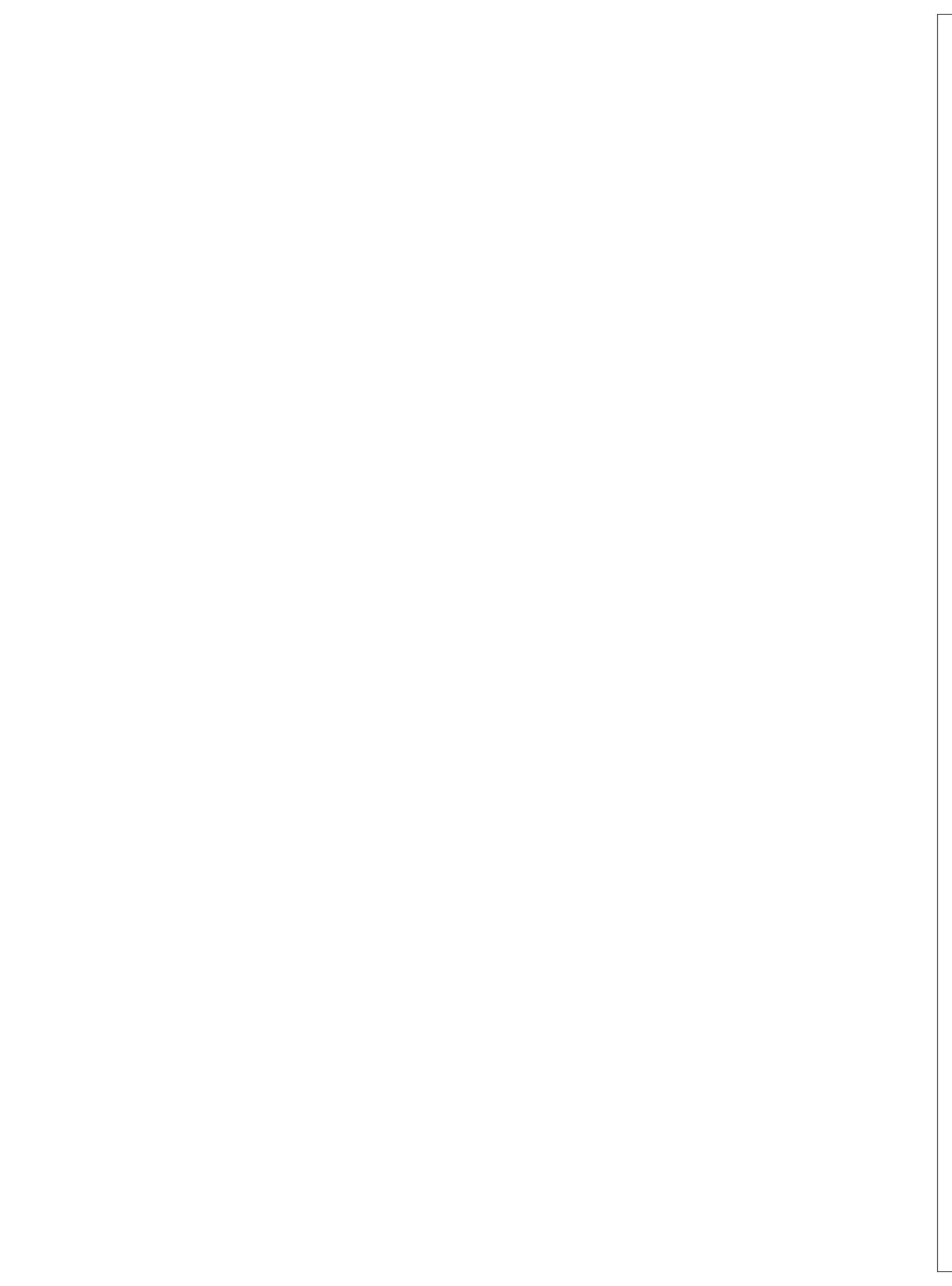


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List of Abbreviations & Acronyms

ATV	Advance Trade VAT
AIIMS	All India Institute of Medical Sciences
BNU	Beaconhouse National University
BOI	Board of Investment
BSCIC	Bangladesh Small and Cottage Industries Corporation
BTT	Business Turnover Tax
CAG	Comptroller and Auditor-General of India
CIC	Central Intelligence Cell
CENVAT	Central VAT
CMC	Colombo Municipal Council
CPD	Centre for Policy Dialogue
Crore	South Asian equivalent of 10 million
Delhi-NCR	Delhi National Capital Region
EDA	Exploratory Data Analysis
EPZ	Export Promotion Zone
FDI	Foreign Direct Investment
FBR	Federal Board of Revenue
FNCCI	Federation of Nepalese Chambers of Commerce and Industries
FGDs	Focus Group Discussions
FISME	Federation of Indian Micro, Small and Medium Enterprises
FNCCI	Federation of Nepalese Chambers of Commerce and Industries
GDP	Gross Domestic Product
GINI	Governance Institutes Network International
GST	General Sales Tax
HALT	House and Land Tax
IDRC	International Development Research Centre
IIDS	Institute for Integrated Development Studies

IEA	Industrial Enterprises Act
INR	Indian Rupee
IPT	Integrated Property Tax
IPS	Institute of Policy Studies of Sri Lanka
IRD	Internal Revenue Department
KIIs	Key Informant Interviews
Lakh	South Asian equivalent of 0.1 million
METR	marginal effective tax rates
MSE	Micro and Small Enterprise
MSMED	Micro, Small and Medium Enterprises Development
MSME	Micro, Small and Medium Enterprise
NCCSL	National Chamber of Commerce of Sri Lanka
NBR	National Board of Revenue
NGO	Non-Governmental Organization
NIPFP	National Institute of Public Finance and Policy
NPR	Nepalese Rupee
NSIC	National Small Industries Corporation
OBC	Other Backward Classes
OECD	Organisation for Economic Co-operation and Development
PBS	Pakistan Bureau of Statistics
PAL	Port and Airport Development Levy
PKR	Pakistani Rupee
RAMIS	Revenue Administration Management Information System
ROC	Registrar of Companies
ROF	Registrar of Companies
SC	Scheduled Caste
SCD	Society of Child Development
SEZ	Special Economic Zone
SIDBI	Small Industrial Development Bank of India
SLR	Sri Lankan Rupee
SME	Small and Medium Enterprises

SMEDA	Small and Medium Development Authority
ST	Scheduled Tribe
Tk.	Bangladeshi Taka
TMA	Town Municipal Administration
TT	Turnover Tax
VAT	Value Added Tax

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Executive Summary

Untamed labor market outcomes have pushed a lack of inclusivity in the growth of South Asian economies. Despite posting high growth rates, these economies have failed to mark a transition of labor force to higher productivity and wages. The stunted development of small and medium enterprises (SMEs) in these countries often comes to blame, and due attention is required to understand the role played by tax policy and its institutional environment.

This study aims to extract the perception of South Asian SMEs regarding tax policy and its impact on their development. Specific emphasis is laid on the varying role of tax concessions and exemptions, value-added tax, and property tax, in harnessing the growth of SMEs in five South Asian countries, namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. Propelled by the limited number of female entrepreneurs, a gender dimension to enterprise development has also been incorporated in the study. Research has been conducted by reputable policy institutes in their respective countries, through a uniformly structured set of methodologies including primary enterprise surveys, key-informant interviews, focus group discussions, and case studies of women-run SMEs.

For the primary enterprise surveys, around 1000 SMEs were purposively sampled, averaging around a modal number of 200 enterprises in each country. The key-informant interviews and focus group discussions were conducted with stakeholders involved in the taxation of SMEs, such as elected parliamentarians involved in tax policymaking; civil servants of various taxation departments; government officials assessing, evaluating, and administering, the taxation bases, procedures, and revenues; representatives of international donor communities assisting enterprises in their development; agents of real-estate and lending institutions; and spokespersons of various SME associations, representing the taxpayers. The case studies were formed out of open-ended interviews conducted with one successful female entrepreneur and another unsuccessful one in each country, in order to chalk out the impact of tax policies on development of women –run enterprises on both ends of the success spectrum. Using this array of methodologies, it was ensured that the three specified aspects of tax policy and their impact on enterprise development in South Asia are covered.

Findings of each research instrument, from all countries, bring to limelight a latent trend of similar issues faced across the region. A rampant lack of awareness regarding the complex tax filing procedures was observed, finding roots in the multiplicity of taxation policies and bureaucratic structure of tax departments in each country. Administrative misconduct was also found to be spread across the region with officials being corrupt in

their dealings and often indulging in rent-seeking practices. This flurry of issues leads to high tax compliance costs in South Asia, which keeps SMEs from becoming tax compliant, losing out on the benefits of formalizing. The growth of enterprises is stunted by this lack of tax compliance as it restricts their prospect of achieving credit through formal lending institutions, making lack of access to credit a problem felt across the region. These issues were observed to have a stronger incidence on women entrepreneurs who are hampered in their dealings with male tax officials and choose to operate informally, leading to their dependence on informal sources of credit.

Among the three aspects of tax policy that were studied, tax concessions and exemption, and value-added tax were found to impact enterprise development more strongly, and widely, as compared to property tax which was often an insignificant part of overall land-acquisition cost. This varied impact translates into the greater emphasis laid on the first two in policy recommendations. It is proposed that SMEs should be redefined in a sustainable manner which should encompass all sectors without being vague about their specific identities. Such a uniform definition should guide policies of various tax departments, and financial institutions in each country. Tax policies should be simplified for greater understandability, and e-taxation should be introduced to rid SMEs of corrupt tax collectors and lengthy filing procedures, both of which unnecessarily incur high compliance costs to entrepreneurs and expose women entrepreneurs to harassment by males. Even though becoming tax compliant after the reduction of costs involved would open credit sources for SMEs, banks should also soften their documentation requirements to facilitate entrepreneurs in borrowing formally. Schemes such as solidarity lending should be introduced to grant credit to entrepreneurs without leverage. With regard to tax policy itself, tax rates and number of taxes should be reduced, and revenues should be augmented through stronger enforcement and punitive measures against tax-dodgers instead. Tax concessions and exemptions should be reviewed to exclude the existing sector and scale biases, and regularly evaluated for their impact on sector's growth and productivity. Women entrepreneurs should receive special concessions to encourage them to formalize and mobilize other women to establish businesses. VAT should be reformed to make it scale-sensitive, and considerate of marginalized sectors, and its refunds should be claimable despite of informal links in the value chains to dismiss double taxation of tax-compliant SMEs. A final and most important proposition is for states to create tax-awareness with specific emphasis on the necessity of tax-compliance for enterprise growth, self-assessment of applicable tax policies, and procedures of filing returns.

The intricate relationship between tax policies and development of small enterprises has come to limelight through this study. It does not only fill in some of the research gaps in existing literature, but also reconfigures taxation into a tool to enhance the growth of enterprises instead of punishing them. It is concluded that a combination of adopting tax as tool for promotion of growth, and implementation of policies suggested after consulting all stakeholders, can become a key driver of inclusive growth in South Asia.

SECTION-I

Introduction

1.1 Problem Statement and Justification

Inclusive growth continues to remain a challenge for South Asian economies. The recent growth spurt experienced by Pakistan, India, Bangladesh, Sri Lanka, and Nepal has been accompanied (to varying degrees) by rising inequality (Pasha, 2007). This fact is also reflected in the poor poverty reduction performance of these countries. Despite being one of the fastest growing regions in the world, South Asia still accounts for about a fifth of the world's poor, with higher poverty rates than any other region (43%), including Sub-Saharan Africa (39%).¹ Experts now agree that the missing link between growth and inclusivity is labor market outcomes that generate well-paying and productive jobs. This is exactly where South Asian economies have a poor track record. Even for economies such as India, which have recently posted some of the highest growth rates in the world, the transition of the labor force from employment characterized by low productivity and low wages to more productive and well-paid jobs has been slow and difficult.

Most non-agricultural employment in South Asia is concentrated in small enterprises characterized by very low productivity and wages.² The development of small and medium sized enterprises (SMEs) in these countries is arguably lagging, and with it their potential for creating productive jobs. While there is a large and growing body of research on entrepreneurship and enterprise performance, the role played by policy and institutional environment in influencing innovation, job creation, productivity increases, and market performance is not clearly understood. In particular, the role of tax policy needs to be explored in this regard.

Research indicates that enterprise development and employment generation is strongly linked to tax policy. Tax policies provide the incentive/disincentive structures that determine compliance with the taxation system.³ Non-compliance places SMEs at a considerable disadvantage. First, SMEs not registered for taxation may not entirely escape taxation. In fact, they may bear an indirect tax burden that depends on the extent to which

¹Website of CIVICUS. Link:

<http://www.civicus.org/civicus-news/30-civicusnews/1029-south-asia-poverty-eradication-paradigms>

²Small firms are defined differently in each country according to the unique size distribution of firms in that country.

³Non-compliance here is defined as lack of compliance with tax registration requirements with relevant government authorities. Non-compliant enterprises are understood to be working in the undocumented economy i.e. outside the tax net.

they purchase inputs from registered enterprises, and this may raise their marginal effective tax rates to exceptional levels (FIAS, 2006). Even with direct taxes, non-compliance may not be costless. In India for instance, non-filer compliance costs amount to 3.4% of non-corporate income tax collections. Around 75% of these costs are due to foregone consumption benefits, 30% due to income loss from distorted investment, and 5% from expected non-filing penalties (Das-Gupta, 2002).

Second, the potential for growth is reduced for non-compliant SMEs. The need for advertising must be weighed with the need to maintain a low profile. Obtaining formal licenses, certificates, and permits from local and other government agencies becomes difficult. They may also lose the government as a potential client, due to the requirements of tax clearance certificates, and also find it difficult to transact with formally registered enterprises. Formal sources of credit may also be barred to them, given the lack of tax certifications which is a common requirement. This may force borrowing at extortionate rates and conditions from informal sources (World Bank-DFID, 2007). Non-compliant SMEs operating in the undocumented economy outside the tax net, therefore, become trapped in a subscale, inefficient work dynamic which weighs down their productivity levels to half or even less than that of their formally registered counterparts (McKinsey, 2004). Third, non-compliance with taxation may also distort competition by allowing inefficient enterprises to undercut the market share of more productive firms. Ultimately, this would hamper enterprise performance and entrepreneurship for the entire SME sector.

These findings are supported by business surveys carried out in developing countries. The World Bank's Paying Taxes Report finds that tax systems rank among the top 5 obstacles to the conduct of business in 90% of surveyed countries. Reasons include large number of taxes, complicated policy and administration, and high tax rates. The Report finds a direct relationship between inadequate taxation and the decision by enterprises to remain outside the formal tax net (World Bank-PWC, 2010). South Asia is a particularly poor performer in this regard, with one of the highest annual number of tax payments, time requirements for tax compliance, and tax rates as a percentage of firm's profits, worldwide. Sri Lanka for instance requires an annual 62 payments for an entrepreneur to pay taxes, as compared to 1 payment in Maldives. In Pakistan, firms must spend 560 hours per year preparing and filing returns and paying taxes, compared to 227 hours in East Asia and the Pacific. India levies taxes on entrepreneurs that constitute 65% of their profits, as compared to 32% in the Middle East and North Africa (IFC-World Bank, 2010). These factors raise compliance costs that may be regressive and put a disproportional burden on small businesses (World Bank-DFID, 2007). For instance, in Pakistan, 67% of SMEs term tax regulations as most problematic, while 28% feel that taxes in the country are too high. Smaller Pakistani firms find tax related issues more restrictive than larger firms; 69% of

SMEs, whose size of assets was less than PKR 1 million, face the greatest number of tax related problems. Many small firms claim it is not possible for them to maintain books as per law or hire a professional due to resource constraints (SMEDA Pakistan, 2013).

This may set in motion a vicious cycle where firms are pushed into non-compliance, forcing the government to collect more revenue from an ever-shrinking formally registered sector (Palmade and Anayiotos, 2005). All stakeholders in this equation will potentially lose out. Compliant enterprises would be further disadvantaged as the competitive edge of non-compliant businesses is magnified. The pool of after-tax earnings that can be re-invested to enhance productivity may also dry up (McKinsey, 2004). Enterprise performance and the productivity of entrepreneurial activity would thus be hampered. The government's capacity to fund adequate public services and social protection may be reduced (Schneider, F., and Enste, 2000). Under fiscal pressure, governments may resort to inflationary borrowing and unsustainable debt. This may in turn necessitate money supply reduction and increased interest rates which will hamper credit creation and investment (Kamal, 2007). This would make it difficult for small enterprises to grow and create the productive and well-paying jobs that can make inclusive growth achievable. Among the key taxation issues linked to the development of small enterprises and by extension the creation of productive, well-paying jobs in the South Asian context are: tax exemptions and concessions, Value Added Tax (VAT) reforms, and local property taxes.

First, tax exemptions and concessions are largely skewed to favor large enterprises. The ILO reports: "Supply-side support provided by the government [including] tax holidays... are normally biased in favor of larger industrial enterprises and may not only prevent smaller enterprises from developing their potential or gaining access to global markets, but may also lead to the displacement of informal operators and workers." Though officially designed to meet various policy goals, their efficacy becomes difficult to judge, as tax expenditures are not subject to the same scrutiny, political debate, or public attention as direct spending. This opacity creates the space for rent-seeking lobbies that serve the interests of large enterprises, at the expense of SMEs, especially those operating outside the tax net in the undocumented economy. This arguably impacts SME development, entrepreneurship, and reduces the opportunities for generating employment-intensive growth.

For instance, in Sri Lanka, tariff policies favoring the coir industry shifted the supply of coconut husks to mechanized units owned by men with access to credit, away from manual units owned by women lacking this access (ILO, 2002). In Pakistan historical and current tax policy evidently purveys rents to large-scale manufacturers. Frequently changing SROs favor large firms over smaller ones. Export rebates and other concessions

are largely inaccessible to small sub-contractors. Direct exporters are exempt from filing income tax returns, as banks will provide these services, whereas smaller sub-contractors must incur these costs, in most cases. Large firms located in special industrialized zones are waived customs duties and sales tax on import of inputs. Micro, small and medium enterprises are not afforded the same opportunities. There is even evidence of undue harassment of small firms regarding income tax assessment by tax authorities (Aftab, 2005). In India, small enterprises operating in the undocumented economy are provided a “special” rather than “level” playing field through the creation of Special Economic Zones that cater to large corporate entities (NCEUS, 2009). These Zones feature comprehensive tax holidays of 5 years, 50% tax exemptions for the next 5 years, and 50% exemption on re-invested profits for the following 5 years (India Briefing, 2010).

There is also evidence linking biased tax regimes to the emigration of entrepreneurs and skilled workers to friendlier tax climates. This may deplete the level of entrepreneurship with losses in productivity, reduce the potential for innovation, and the ability to create productive jobs associated with entrepreneurial activity. It may also amount to a ‘brain drain’ and deskilling of the labor supply in the country of origin, creating skill shortages, depressing productivity, and constraining market performance. In Pakistan, the emigration rate of individuals with a tertiary education to OECD countries is more than 7%. A recent Gallup survey reveals that 38% of working adults (skilled and semi-skilled) would prefer to settle permanently outside Pakistan (Dawn, 2004), some part of which might be propelled due to biased tax regimes. These figures do not take into account the growing outflow of skilled labor to the Middle East, particularly the UAE. Over 6000 Pakistani firms are now operating in this region. Similarly, over 150 Indian companies are operating in Hong Kong and mainland China, attracted by friendlier taxation laws.⁴

International experience suggests that policy processes in their political dimensions are as important as policy outcomes. Yet, analysis of revenue systems from political economy perspectives remains sparse in South Asian countries. Without it narrow interest groups with political influence may continue to capture policy agendas. Research needs to be conducted, which provides a detailed, explicit stocktaking of how SME development is affected by tax exemptions and incentives, the roles of lobbies and interest groups in this regard, and to explore the ways in which the welfare impacts of tax expenditures can be maximized for the SME sector, allowing them to create productive jobs to make growth more inclusive.

Second, enterprise development is affected by taxes such as the Value Added Tax (VAT). However, research on the nature and magnitude of this impact is on the whole ambiguous. Mainstream policy advice to South Asian countries has advocated the introduction of VAT

⁴Sourced from: <http://info.hktdc.com/imn/06121903/markettrends156.htm>

or raising VAT rates to compensate for the losses associated with liberalized trade regimes. However, research presents no straightforward endorsement of such reforms. Certain studies indicate that the introduction of indirect taxes (e.g. VAT, GST) pushes entrepreneurs toward non-compliance with the taxation system (Spiro, 1993). Small enterprises that are already operating in the undocumented economy will not be able to pass on the VAT to their consumers given that they cater to highly competitive and price sensitive markets. Research also finds that given the presence of a large undocumented economy, VAT reform reduces both welfare and revenue (Emran & Stiglitz, 2003). On the other hand, researchers argue that for non-compliant entrepreneurs, the VAT is in effect an import tariff, as they are not registered under VAT regulations, and so cannot claim input credits (Keen, 2007). Others argue that input credits themselves may entice enterprises to formally register (Bird, 2008). What may be reasonably concluded is that non-compliance would be reduced if the VAT reform is successful, as under a revenue neutral model, documentation of the economy would be necessary to generate more revenue.

But it is empirically unclear if tax compliance has been reduced or increased by VAT introduction in South Asian economies, which in turn raises questions concerning the success of VAT reforms. Pakistan is set to upgrade to a full-fledged VAT despite more than a decade of lack-luster performance under a quasi-VAT Sales Tax regime introduced in 1990 (World Bank, 2009). Commentators have already predicted that the tax would potentially lower collection receipts and push more enterprises into non-compliance with the taxation system (Fatima, 2002). The VAT in Bangladesh is a strong earner but with evidently regressive distributional impacts (Hussain, 1995). In Sri Lanka, experts have noted that the strong role of the non-compliant enterprises and the large number of undocumented transactions may have complicated VAT implementation (Kelegama, 2010). After 8 years of operation, VAT revenue performance in the country remains sub-par in comparison to the taxes it replaced (Kelegama, 2010). Experts have noted that in India, the large number of undocumented transactions implies that formally registered traders who invoice their sales may end up bearing the tax burden of the entire preceding informal value chain, under the VAT regime (Ayilavarapu, 2004). Thus far, the VAT has resulted in a loss of revenue for 10 states, and many manufacturers did not pass on the benefits of lower tax rates to consumers (CAG, 2010). This heterogeneity of experience with essentially the same tax regime across the region raises various questions.

However, there is little in the way of detailed economic analysis by governments, think-tanks, or independent researchers on the impacts of such reforms on enterprise development and labor markets. Without this knowledge, it is difficult to assess prospects for improving the regulatory and policy framework, ascertain implications for parameters such as growth and inclusion, entrepreneurship and productivity, and the creation of productive jobs in South Asia. Given this shared experience of VAT, there is added value in

collaborative research on this issue conducted by think tanks throughout the region. It will allow them to crystallize learning experiences, flag pitfalls for governments attempting new reforms, and share best practices on reform design, execution and sequencing.

Third, enterprise development is affected by weak local property taxation. Enterprises operating on informally developed land cannot access mortgage-backed finance. Informal land development itself can be reversed through effective property taxation in a number of ways. Levied on land value, property taxes can potentially pull the existing stock of serviced land to the market. Enterprises and workers excluded from social services and state attention would thus be brought into the formal sphere (Smolka, Martim O. and Claudia M. De Cesare, 2006). It may also bring down land prices through the capitalization effect, placing it within the affordability limits of entrepreneurs and SMEs (Bahl and Linn, 1992). Additionally, without effective property taxation to establish formal property rights, key opportunities to enhance employment intensive growth, which leads to more and productive jobs, become difficult to avail. For instance, the World Bank advocates the provision of access to housing finance to households in informal settlements as a key solution, which can trigger housing industry growth that may bring 3.2 million new jobs over the next decade. In India, such proposals are already in the pipeline with the potential to build houses for up to 28 million households (Press Release World Bank, 2010). However, without effective property taxation to establish formal property rights, housing finance will remain difficult to access. Research on the issue in the South Asian context is limited to a handful of studies on informal land and housing markets, despite the strong prevalence of these problems in South Asian countries (Roy and AlSayyad, 2004).

The gender dimension of enterprise development in South Asia has been ignored in policy and research. This is despite the significant statistical overlap between being a woman, working in the undocumented economy, and being poor, in South Asia. The link between informal employment and poverty is stronger for women. Not only are women over-represented in the undocumented economy, they are over-represented in the lower-income segments of casual wage or home workers. In the higher-income segments of self-employment or employers, their involvement is concentrated in sub-scale operations with less growth potential than those performed by men (Chen and Alter, 2001). Women entrepreneurs and workers are therefore relegated to unproductive, lower-paid employment options with inadequate legal recognition or protection, labor rights, social protection, and voice (ILO, 2002). Inadequate taxation policies may either perpetuate these contrasts or further sharpen them. In addition to the biases that shut out SMEs from tax exemptions and concessions available to large enterprises, SMEs managed or owned by women, especially those operating in the undocumented economy, must face a host of other difficulties.

For instance, in Pakistan, most women entrepreneurs are trapped in household-based, low-return, unpredictable markets where growth prospects are limited. Enterprises managed by women are largely characterized by higher closure rates, and lack sufficient access to essential inputs such as finance, skills, and marketing channels (Aftab, 1991); (GCU, 2004). A study conducted last year found that women in the undocumented economy did not figure largely (if at all) in tax policy and administration, and in budgeting and planning at the local, provincial and federal levels in Pakistan (Mumtaz. et al, 2010). These women are far more likely to be unpaid family workers than own enterprises, when compared to men. They are also found, overall, to work longer hours for less pay, and are motivated by poverty (Asad and Sohail 2001); (Shaheed and Mumtaz, 1981); (Hussain, UNHDR 2003).

In India, women entrepreneurs grapple with similar issues. They lack formal operating spaces and sufficient access to credit; and many additionally face harassment from local authorities (ILO 2002); (Nelson 1997). Overall, their work continues to remain a legal offshoot of their households rather than an independent entity. They must contend with a host of health and safety risks such as unsafe working environments and gender-based violence. And their productivity is limited by the non-availability of infrastructure, space and time (Chen et al. 2001). Women entrepreneurs in Bangladesh, generally face harassment in dealings with the government, banks, lenders, and clients (Shahdeen and Abed, 2007). Cumbersome legal and regulatory requirements such as obtaining tax certificates and trade licenses, (among others) are more difficult to meet for women entrepreneurs, limiting their potential for growth (Huda, Alam and Khan, 2009).

In Nepal's undocumented economy, only 17% of the female population owns productive assets, which makes institutional borrowing largely inaccessible and entrepreneurship improbable. Women workers work 77 hours a week compared to 56% for men (SAPPROS, 2000), with marked contrasts in wages for similar work. Lack of child-care facilities, and discrimination in terms of opportunities for employment, training, promotion, and credit availability are commonly faced difficulties. They may also be exposed to sexual harassment, exploitation and trafficking. Overall, women in Nepal's undocumented economy lack access to education and information, markets, safe working conditions, and face the "progressive loss of proprietorship" (ILO, 2004). In Bangladesh, women entrepreneurs are generally discriminated against at the family, market and community levels (Build, RMP, Care Bangladesh (2003). They are thus excluded from opportunities for entrepreneurship and productive work. These conditions may create entry barriers to entrepreneurship for women, and limit the development of women-led enterprises. In doing so, they may also constrict their potential for innovation, growth, and the creation of productive jobs.

1.2 Objectives and Significance of the Research

The general objective of the research study is to advance technical knowledge on the relationship between tax policies, development of small enterprises, and inclusive growth in South Asia through collaborative time-bound research by the leading think-tanks of the region, and inform policy formulation in these areas by governments in Pakistan, India, Bangladesh, Sri Lanka, and Nepal. Following are the specific objectives of this research:

Specific Objective 1: To develop country study reports that focus on the impacts of tax exemptions and concessions, value-added-tax (VAT) reforms, and property tax (respectively) on the development of small enterprises in South Asia, with particular emphasis on those operating outside the tax net in the undocumented economy, as well as those owned/managed by women, focusing on the national and regional levels.

Specific Objective 2: To organize a Policy Engagement Workshop in each South Asian country to disseminate the findings of the research and advocate for policy recommendations emanating from this research among key government officials responsible for formulating and implementing policies on taxation and enterprise development in Pakistan, India, Bangladesh, Sri Lanka, and Nepal.

While the knowledge area of enterprise development has received great attention recently, given the emerging consensus surrounding the importance of making growth more inclusive, previous literature has:

- Focused more on the determinants of size, which is equivocated with the ability to generate productive employment, rather than compliance with taxation systems
- Focused on policy areas such as trade and labor, not taxation which has strong empirical linkages to small enterprise development and the quantity and quality of jobs they are able to produce
- Not focused on the statistically significant gender dimension of small enterprise development and labor market outcomes
- Not focused on the South Asian region, which is unique in terms of economic socio-economic development and structure, policies and institutions, and experiences with enterprise development and inclusive growth, which presents opportunities for new insights to be gleaned from comparative analysis
- Generally not employed the level of sophistication in data analysis that this project proposes, to draw conclusions that are as statistically valid and reliable as possible

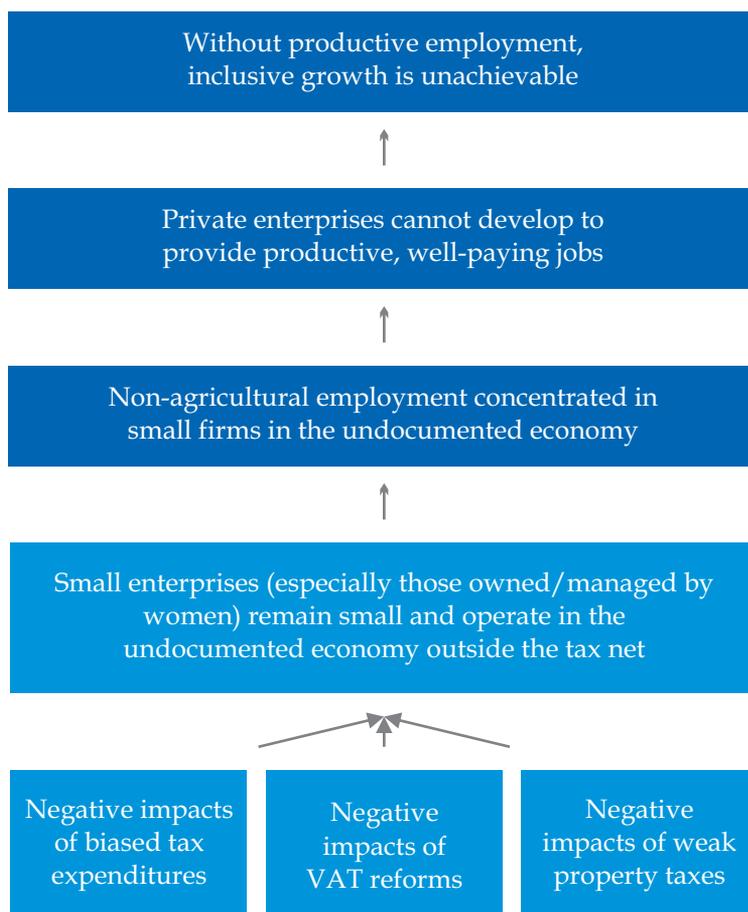
This research will make new and valuable contributions to scientific and technical knowledge on the subject. Also, this research will make explicit, concrete, and realistic policy recommendations based on the findings for all South Asian economies, relating to the following policy areas:

- Small enterprise development policy, will benefit from empirical evidence of the extent and nature of contrasts between enterprises operating within the formal tax net and those operating in the undocumented economy (where most SMEs operate) and what policy alternatives can be adopted to help them grow and create productive jobs
- Labor policy will be better informed of trends in concentration and productivity of labor, as well as the policy alternatives that when exercised will allow the creation of more productive, well-paying and secure jobs, particularly with regard to the neglected undocumented economy
- Taxation policy will benefit from:
 - An objective analysis of tax expenditures (weak and/or opaque in most South Asian countries), and the differential treatment of small enterprises in this regard
 - An assessment of the impacts of VAT policy and administration on small enterprises and their development and productivity
 - An exploration of the link between weak local property taxes and land informality and how it affects entrepreneurs (owning/managing small enterprises) and workers
- Women's empowerment policy will benefit from data on women's economic participation as workers and entrepreneurs (owning/managing small enterprises) in the informal economy and factors in the policy/institutional environment that limit their growth and productivity
- Trade policy, particularly with regard to export promotion will benefit from an appreciation of the difficulties faced by small enterprises who are excluded from the incentives available to other firms for accessing international markets to improve growth and productivity
- Business regulation policy will benefit from an identification of bottle-necks at the policy and administration level, that discourage entrepreneurship, encourage small enterprises to exit the tax net and remain outside it, and limit the potential for innovation, growth and job-creation for enterprises within the tax net
- Financial credit policy, particularly with regard to financial services at the micro-level will benefit from an indication of the ways in which access to small firms could be

expanded, as well as ideas for new financial products which enhance productivity and growth for these firms

- Education and human capital policy would benefit from an assessment of the demand for technical and professional/vocational skills among small enterprises, and the policies that would help supply them

1.3 Conceptual and Theoretical Framework



The above diagram depicts the conceptual framework for the research, and provides the basis for the following research themes and questions that this research project explored:

Theme 1: The Impact of Tax Exemptions and Concessions on Enterprise Development

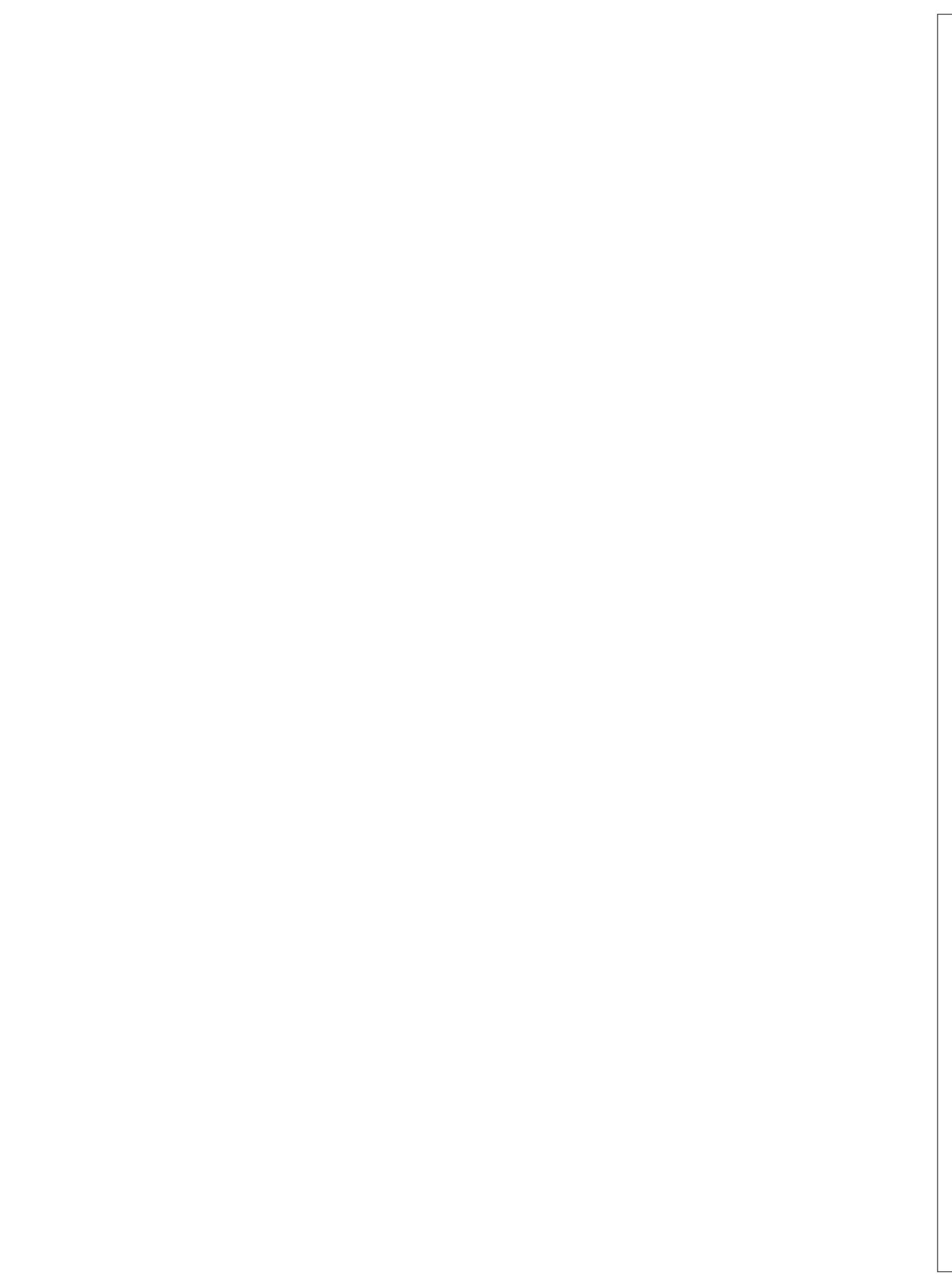
- What is the extent to which small enterprises face biases in tax exemptions and incentives?
- What is the extent to which these biases disproportionately impact small enterprises operating in the undocumented economy and/or those owned/ managed by women?
- What are the impacts of tax exemptions and concessions on entrepreneurs and SMEs in terms of enterprise performance and productivity, (including any disproportionate impacts on women informal entrepreneurs)?

Theme 2: The Impact of the Value-Added-Tax (VAT) on Enterprise Development

- What are the progressivity impacts of VAT burden on small enterprises and workers (particularly those operating in the undocumented economy), in terms of entrepreneurship and productivity at the bottom-income spectrum and in low value-added sectors?
- How are entrepreneurs (particularly those owning/ managing small enterprises in the undocumented economy, especially women entrepreneurs) treated by VAT administration systems, against indicators of compliance costs and taxpayer friendliness?

Theme 3: The Impact of Property Tax on Enterprise Development

- What are the weaknesses in property tax systems that create and/or sustain informal land markets at the local levels, (including weaknesses in policy, administration, capacity and resources)?
- What is the nature and magnitude of impacts of land informality on entrepreneurs (owning/ managing small enterprises) and workers (employed by small enterprises) operating in the undocumented economy (especially women)?



SECTION-II

Comparative Review of Literature⁵

2.1 SMEs in South Asia

There is no universally accepted definition of SMEs. Definitions of SMEs tend to be diversified and heterogeneous among countries which are prone to define an SME according to their own policy perspectives. Gibson and Vaart (2008), however, proposed a more generalised definition of SME for developing countries – “An SME is a formal enterprise with annual turnover, in U.S. dollar terms, of between 10 and 1000 times the mean per capita gross national income, at purchasing power parity, of the country in which it operates” [Gibson and Vaart, 2008; p. 18]. This definition can be very useful considering its single ruler approach, particularly for the purpose of cross-country analyses. However, a review of the wide-ranging literature and relevant policy documents shows that the threshold of the “number of employees” is the most oft-used criterion for the purpose of defining SMEs by national governments and statistical agencies. In developing countries SMEs account for an average 17 percent of GDP and employ 30 percent of the workforce.

In Bangladesh several policymaking bodies define SME in different ways. Among them, Bangladesh Bank defines SME in conjunction with SME credit policies and programmes, proposing separate definitions of SMEs for manufacturing and services sectors according to their fixed assets and number of employees. A manufacturing enterprise with fixed assets (including replacement cost and excluding land and building) of up to Tk. 300 million and number of employees up to 250 will be considered as an SME. For services and business related enterprises, the ceilings are Tk. 150 million and 100 persons respectively (Bangladesh Bank, 2012). To be identified as an SME, an enterprise will have to satisfy both of the aforementioned criteria. At present, there are about 0.9 million SME establishments in Bangladesh including about 0.8 million cottage industries. Indeed, about 99 per cent of the enterprises can be considered as SMEs in Bangladesh. Islam, Zohir and Hossain (2011) estimated that about 85 per cent industrial employment are provided by SMEs.

In India also, where SMEs are referred to as MSMEs, or Micro, Small and Medium Enterprises, these enterprises are classified in two similar categories. In their case, Manufacturing Enterprise is defined in terms of investment in Plant & Machinery. The micro enterprises’ investment in plant and machinery should not exceed INR 2.5 million, while the small enterprise can range from INR 2.5 – 50 million. The bracket for medium

⁵ Based on literature review submitted by partner institutes BNU, CPD, IIDS, IPS and NIPFP in their Country Study Reports

enterprise starts from INR50 million and extends up to INR100million invested into plant and machinery. Service sector MSMEs take in account the investment made in equipments and range from 0 – 1million INR for micro, 1-20million INR for small, and 20-50million INR for medium sized enterprises. The country has around 26million MSMEs, employing 40% of its workers, and contributing to 17% of the Indian GDP. It should be noted that the MSMEs definition varies even within different Indian government departments and private commercial banks.

Enterprises in Nepal are defined, as per the Industrial Policy of 1997, to be small if their fixed assets do not exceed NPR 30 million, and medium if they range from NPR 30-100million. The MSEs are estimated to employ 1.6 million persons, which is more than the 70 percent of workforce engaged in the non agriculture sectors, SMEs account for 96% of total industrial establishments and 83% of total employment generation by industrial sector. SMEs, however, contribute only 9% in the overall GDP.

In Pakistan, SMEs are defined in service and manufacturing classifications. A manufacturing concern with less than 50 full-time employees and productive assets of Rs30 million, a service provider with less than 50 workers and productive assets of Rs20 million, and a trader with less than 20 employees and productive assets of Rs20 million are considered as small enterprises. Similarly, a manufacturing unit with 51-250 employees and productive assets worth Rs30-100 million, a service provider with 51-250 workers and productive assets of Rs20-50 million and a trader with 21-50 employees and productive assets of Rs20-50 million falls in the category of medium enterprise. The number of SMEs in Pakistan is estimated to be 3.2 million, with the sector's contribution to the national GDP being around 40%.

In Sri Lanka, different state agencies use different definitions. A taskforce on SME development in 2002 took the first steps to fix this, and proposed that SMEs should be defined in terms the value of assets. It was suggested that a small scale enterprise is defined as enterprise with asset values not exceeding SLR 20 million excluding land and buildings, whilst an enterprise with an asset value of SLR 50 million excluding land and building is considered a medium scale entity (Government of Sri Lanka 2002). Subsequently, many other suggestions have been put forward, and according to the latest proposal, an enterprise with less than 100 employees and fixed assets of less than Rs. 150 million can be classified as small, and an enterprise with between 101-400 employees and fixed assets between 151-600 million can be classified as medium. However, there is yet to be a mandated new definition. This is currently being formulated, and will also be used for the country's Economic Census in 2014, which will capture SME data for the first time. SMEs in Sri Lanka account for roughly 80% of the total number of enterprises, nearly 35% employment of the total workforce, and contribute to about 30% of the national GDP.

2.2 Tax Exemptions and Concessions, and Enterprise Development

2.2.1 Bangladesh

The incentives and assistance provided to small scale enterprises in Bangladesh are rather limited both in number and the scale of support. In Bangladesh, under various provisions of existing policies/acts, small scale enterprises enjoy tax waiver and reduced tax rate benefits. Enterprises with a turnover up to Tk. 0.7million enjoy full tax waiver, while enterprises with a turnover of between Tk.0.7million and Tk.6million have to give tax at the reduced rate of between 2 to 3 per cent. At the same time, government's recent initiatives to expand the coverage of tax net targeting sectors and activities where small enterprises are predominantly involved may raise the tax burden of those particular enterprises, in spite of the fact that this may be helpful in terms of resource mobilization. No special incentive or support is provided to small enterprises in Bangladesh that are not registered. In general, the structure and composition of tax expenditure targeted to small enterprises demonstrates a narrow outlook and dismissive perspective as far as development of SMEs in particular and industrialization in general was concerned with regard to their promotion and sustainable development.

A study by the SME Foundation on the various types of SMEs in Bangladesh show that the entrepreneurs consider the payment of income tax and VAT as obstacles in running their business in Bangladesh. 74.71 percent and 88.23 percent of entrepreneurs from small and medium enterprises respectively under the light engineering sectors have considered the income tax payment as an impediment in their business whereas in case of large firms it has been only 50 percent (SME Foundation, 2004). Given the limited scale of reliable information and lack of research on impact of tax exemptions and incentives on productivity, efficiency and profitability of SMEs of Bangladesh, it is rather difficult to draw any conclusion in these regards.

2.2.2 Nepal

Nepal's tax structure revenues are buoyant, but inadequate to supplement development of SMEs. Tax rates are marginally high, with low tax elasticity. Due to that, voluntary compliance is low, resulting in a limited tax base. The rigidity of Income Tax Act 2000, and inefficiency and corruption of tax administrators is causing leakages in tax collection. Besides that, there is no consolidated record of property (land and building) with the Internal Revenue Department (IRD).

Agriculture sector is enjoying zero tax on income earned from agriculture and others industrial sectors have also been offered blanket exemption, deduction and concessions for the years, but have been unable to show a sustainable growth.

The report further mentions that current incentive schemes are biased in favor of large industrial enterprises and against Micro and Small Enterprise (MSEs). The Industrial Policy (1992) and the Industrial Enterprises Act (IEA) (1992) extend a number of incentive schemes to MSEs in the industrial sector only, while the revision of the Industrial Enterprise Act in 1996 and the new Taxation Act of 2002 has removed most taxation-based incentives. The current incentive system provides tax exemption for cottage industries and nominal custom duty for imported raw materials for export purposes. Regarding taxation, most MSEs are not able to enjoy tax exemption and tax deduction offered by the government due to the cumbersome processes.

2.2.3 Pakistan

There is limited existing literature on the impact of fiscal exemptions and concessions on the development of small and medium enterprises in the sector. However, some literature exists on the overall impact of the fiscal regime, which highlights that enterprise development is affected by the fiscal policy depending on the policy objectives.

Pasha and Bengali (1985) analyze the fiscal incentives for industrialization of the backward regions Pakistan. As the inequalities of income and opportunities between regions are increasing, governments in different countries are adding regional development goals in the national plans. Monetary and fiscal policies have emerged as the primary policy tools to induce faster growth of the backward regions. The methodology analyzes the impact of fiscal incentives in the form of customs duty exemption on imported machinery and a five year tax holiday on profits. The results of the analysis show that the incentives are successful in diverting investment rather than generating new investments. Also the incentives create a pattern of high degree of capital and import intensity with a low regional multiplier. Moreover, the negative impact of the incentives increases the welfare cost on the economy.

Masood & Ahsan (1997) explore the efficacy of tax concession policy in generating investment in underdeveloped areas in Pakistan. The authors suggest that no new investment has been generated in the areas because of the tax concessions. Most investment is diverted investment that would have taken place in another area in the country had the concession not been in place. Specifically, the analysis shows that the tax holidays at a micro level have been unsuccessful in raising investment in backward areas. The results also show that the depreciation allowances are more effective in increasing the

present value than the tax holidays concession. These results indicate that if the government wants to increase investment level in the underdeveloped areas, the tax laws should be amended in such a way to allow the acceleration of depreciation allowances in the tax holidays areas.

Ghaus & Pasha (2010) explores the reason why Pakistan has seen a downward trend in its tax-GDP ratio. Looking at the trend since the early 1990s she shows how the tax to GDP ratio declined by 4 percentage points because of the liberalization of the tariff regime. Though tax reforms were introduced, especially an increase in sales and direct taxes, Pakistan was unable to offset this loss completely. The author finds that the tax-to-GDP ratio of Pakistan has not been held back by slow growing tax bases but more by a policy of reduction in statutory tax rates and/or by exemptions and concessions on existing tax bases. Thus, despite the growth momentum in the early to mid 2000s and increase in foreign investment in Pakistan within the telecommunication sector, food industry, energy sector etc, Pakistan was unable to capitalize on it and increase its tax-GDP ratio as it exempted from taxes these sectors to attract investment. The author makes recommendations to improve the situation, including bringing the exempted sectors within the tax base, improving tax administration and the need political will and leadership for a better tax system in Pakistan.

2.2.4 India

The MSME units are given tax exemption up to the turnover of Rs. 1.5 crore. It is generally believed that MSME units do not expanded their capacity beyond the stipulated level of MSME definition to avail the benefit of tax exemption. Instead of expanding their capacity and reaping the benefit of economies of scale they set up new units to keep on taking the tax exemptions. A number of the KIIs therefore argue that tax incentives may not be useful for encouraging growth of the MSMEs.

Another opinion with regard to tax exemption is that tax exemption is no more lucrative for MSMEs operating in many industries. If the MSME units avail tax exemptions then they are out of the value chain. If the MSME units are producing inputs then the buyer would hesitate to buy from the units which are not paying VAT since they want to take input tax credit. The firms taking tax exemptions are cannot claim input tax credit. The benefit of the tax exemptions is very small it is less than 2%.

To incentivize the firms to expand their capacity, the government is taking steps like expanding all non-tax benefits of MSME sectors for three years to the units which have recently expanded their capacity and move out of the definition of MSME sector, while with the proposed GST regime, the exemption threshold is likely to be brought down to

bring units within the ambit of taxation and input tax credit.

In the present environment, given tax credit based regimes, firms would prefer to pay taxes. The firms do not want more tax exemptions but want compliance made easier. The only sectors which continue to rely on tax exemptions are recycling of steel, rubber, plastic and agro food processing - these are either sectors dealing with final consumption goods or manufacturers who work with other exempt manufacturers or dealers.

In cases where the firm produces products which face different rates of tax, or even a combination of exempt and taxable goods, the firm is required to maintain separate accounts for each of these commodities so that tax credit claims can be verified. So the book keeping cost increases. To keep the cost of book keeping minimal, many a times firms choose to forego tax exemptions.

2.2.5 Sri Lanka

The present income tax regime employs a tiered tax rate in the range of 10 percent, 12 percent, 28 percent and 40 percent applicable for different sectors and base on taxable income. The government however offers a host of fiscal incentives in its bid to achieve underlying socio economic objective. The introduction of an elaborate tax incentive regime administered by the Board of Investment (BOI) to support the attraction of export oriented foreign ventures was implemented during the late 1970s. At its initial stages concessions were confined to BOI-registered export-oriented foreign ventures operating within specially designated export-processing zone. Subsequently in 1982 and later on in 1990 tax incentives offered under the BOI Act Section-17 were gradually extended beyond the export-oriented sector to both FDI and local investors operating within and outside the EPZs aimed at general investment promotion. Incentives include tax holidays, concessionary corporate income tax rates, generous depreciation allowances, and import duty and excise exemptions.

Tax concessions offered by the BOI to new investments include full corporate tax holidays ranging from 4 to 12 years based on the sector and scale of the investment. Tax holidays have also been linked to the level of domestic value addition. In addition, importation of project related plant, machinery and equipment are exempt from VAT, Customs Duty, and other border taxes during the project implementation period. Investments identified as 'strategic import replacement projects' enjoy concessionary tax rates after the lapse of the initial tax holiday. Further, export-oriented ventures in addition to the tax holiday are exempted from duty on raw-material imports on fulfilling export performance requirements. Provisions have also been made to offer tax exemption for up to 25 years to projects identified under the purview of the Strategic Development Projects Act.

The government also introduced tax incentives for non-BOI registered companies. These incentives are focused on attracting investments in areas not covered by the BOI; however in recent years significant overlap has prevailed. Tax incentives extended under the Inland Revenue Act cover the following areas; the manufacture and export of goods deemed non-traditional exports; agriculture, fisheries, and agro processing; industrial tools and machinery; small- and large-scale infrastructure projects; rehabilitation of underperforming industries; and companies engaged in research and development (World Bank 2012a).

In terms of approving tax concessions; until 2012, the system prevailed such that the BOI approved concession to BOI registered companies under section 17 of the BOI act, whilst the IRD approved tax incentives to non-BOI registered companies. Since 2012 however, this system has been done away with. It is only the IRD that can now approve tax incentives to both BOI and non-BOI firms. The BOI can only recommend projects to the IRD for approval.

In addition to tax incentive offered for general new investments, the 2012 budget witnessed widespread tax reform encompassing the introduction of a comprehensive tax incentives package targeted at SME promotion. Incentives include pre-establishment cost write-offs, tax holidays for both new investments and expansions ranging from 3 – 6 years depending on the volume of investment, triple deductions on Research and Development expenditure undertaken by SMEs and VAT and duty exemptions for selected manufacturing activities such as handlooms, agriculture processing, fisheries, poultry and rice milling to name a few. Whilst such incentives seem generous and a good first step towards promoting SMEs, as Wijesinha (2011) notes, eligibility criteria seems excessive given the size of an SME and thus needs to be revisited and reassessed. Meanwhile, a positive recent development has been the streamlining of some aspects of tax incentives, by bringing them all under the purview of the Inland Revenue Department, instead of having multiple bodies (including BOI) granting and administering tax holidays for enterprises.

2.3 Value Added Tax (VAT) and Enterprise Development

2.3.1 Bangladesh

Draft of VAT Act 1990 was prepared keeping a provision to introduce a single rate VAT system and the final version of the VAT Act was proclaimed as a bill in mid-1991. The bill came into effect as Value Added Tax Act 1991 from July 1991. Since then VAT remains the single-largest source of revenue for the Bangladesh government. At present, VAT is collected on manufacturing goods and services, both at import and local stages. It also needs to be mentioned that a number of items enjoy exemption from VAT. Furthermore VAT is zero-rated on exported goods. At present cottage industries are exempted from VAT. Small industries could avail full or partial exemption from VAT by fulfilling required terms and conditions. All other enterprises (with turnover above Tk. 8 million) will need to pay VAT according to the respective provisions.

VAT at import and local level together contributes about 37.9 per cent of total tax collected by the NBR in FY2013, which compared to its potential is still low in Bangladesh. The NBR is able to actually collect only about 61.0 per cent of the potential VAT in FY2009 (Faridy and Sarker, 2011).

The impact of VAT on SME development needs to be reviewed with caution. VAT is seen by policymakers around the world as a tool to collect at least some taxes from the SMEs (IFC, 2007), though SMEs in Bangladesh can be affected by policies with regard to VAT. Also, administrative burden to collect VAT from a large number of SMEs is rather high (IFC, 2002). Lack of willingness to register voluntarily for VAT may increase the marginal effective tax rates (METR) for SMEs which pay turnover taxes but acquire goods and services from VAT-registered enterprises (IFC, 2007). It is important to make sure that the threshold for compulsory VAT registration is set at reasonably high level to promote SME development (IFC, 2007).

In 2011, the IMF extended credit facility to Bangladesh on the condition that a new VAT law would be introduced. Hence, the VAT Act 1991 is going to be replaced by the new VAT Act 2012. Under the new VAT Act, the existing price declaration provision has been discarded. Instead the taxpayers will need to notify the current price and input-output coefficient. The procedural complexities of advance trade VAT (ATV) and VAT deducted at source for services have been eased in the draft. The draft VAT Act also includes a provision of single registration for the businesses which have several branches, and restricts the provision of tariff value and truncated base value. It is argued that the existing provision of tariff value and truncated base create distortions (Mansur, Yunus and Nandi, 2011).

2.3.2 India

Manufacturers perceive a distortion in the design of VAT – while VAT registration is mandatory for the manufacturer if the turnover is over INR 0.1million, for traders, VAT registration is not mandatory until their turnover exceeds INR 2.5 million. Since the manufacturers would be reflected in greater detail in the tax department’s database, they are likely to be subject to more intense scrutiny and even more regular audit than traders. This is often read as one of the many signs of the government not encouraging manufacturing in India.

In the sub-national VAT, sales within the same state are subject to VAT, while sales across state borders can either be subject to a concessional tax under the central sales tax regime or to the standard VAT in the exporting state. Since the rates of central sales tax are lower, firms would like to pay central sales tax rather than state VAT. But to avail the benefit of central VAT, the seller has to take a c-form from the buyer and submit the same with his tax return, as evidence of inter-state sales. The buyer in turn has to get this form issued by the tax department of the importing state. Each C-form is expected to cover all transactions between a pair of dealers over a quarter. It is reported that firms face difficulties in getting C-forms. If the c-form is not submitted to the tax department of the exporting state, the firm is liable to not only the regular tax in place of the concessional tax, but potentially some penalty/interest for delay in payment as well. In order to avoid this situation, firms may pay the state sales tax, and adjust the excess payment when C forms become available. But the firms make the loss in terms of interest because of excess payment.

The refund from the central government is done timely but in some states the state VAT department does the refund after matching the invoices of the raw material purchased and the invoices of the sellers. It takes lot of time.

2.3.3 Nepal

The VAT was introduced in Nepal in November 1997. This tax was levied in place of the Sales Tax, Hotel Tax, Contract Tax and Entertainment Tax. VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. Since the collection of both customs duties and income tax depends upon the effectiveness of VAT to the greater extent, it is expected to enhance revenue collection. The current threshold for VAT registration is Rs. 2 million. Those vendors whose annual turnover is below the threshold can, however, register voluntarily.

Afram and Del pero (2012) Tax Compliance Cost Survey found that about 35.4 percent of taxpayers having turnover of Rs 2 million to Rs 10 million and registered with Value

Added Tax (VAT) have been found not paying VAT for years. Most of these tax payers find that compliance to VAT is difficult as it increases the number of submission and payments significantly, thereby raising cost of doing businesses in Nepal. According to survey, overall average compliance cost is Rs 9382. There is significant increment in the compliance cost from below the VAT threshold to the to the initial VAT applicable slab. The surveys revealed that majority of businessmen do not have their own bank account. Tax payers lack knowledge about VAT, and businesses often overstate the actual expenditure in their tax returns by about 40 percent and hide the actual revenue by about 20 percent in order to evade the tax.

A small enterprise not required to register for the VAT may still be highly affected by the tax – and may even benefit from it. Even in the absence of VAT withholding such a firm will bear unrecovered VAT on inputs that it purchases from VAT-registered firms or imports. If it cannot pass this unrecovered tax along to the buyer, the real burden of the tax must be borne by the owners or employees of the enterprise.

2.3.4 Pakistan

Literature on the impact of VAT or General Sales Tax (GST) as it is called in Pakistan, on SME development does not exist largely because they are exempt and little focus has been given to research on VAT taxation on inputs in exempt sectors. An estimate, however suggests that the additional net revenues from replacement of GST and an expansion of VAT to services not covered under the GST regime could yield an additional Rs. 82 billion, in 2010-11, equivalent of 0.5 percent of the GDP (Institute of Public Policy, 2010).

Ahmed & Rider, (2008) suggest that to increase revenues governments often take actions in forms of increasing tax rates and efforts related to enforcement. Such actions may further distort the tax compliances and thus fail to impact revenue mobilization in a positive manner. This dilemma exists in many developing countries because of large informal sectors and low tax compliance. Pakistan's huge informal sector is due to large portion of out of tax net business activities, and this includes significant portion of services (Federal Board of Revenue, January – March 2009). There are more serious non-compliance issues with direct taxes than indirect taxes. This is one of the reasons why many countries are shifting to the indirect taxes, particularly the value added taxes.

The Case for value added taxes in Pakistan is based on the ground of high buoyancy and share of the services sector including wholesale and retail trade telecommunication and transport, most of which have a low taxable component. In case of retail and wholesale trade the individuals are in general from middle income group, and have greater scope of escaping from detection of non-payment of tax. This is also because the system of third-

party reporting is relatively weak in developing countries compared to developed countries.

2.3.5 Sri Lanka

In line with global developments as well as successful experiences of other countries with different tax systems, Sri Lanka shifted its indirect taxation regime from Business Turnover Tax (BTT,1964-1981) to Turnover Tax (TT,1981-1998) to Goods and Services Tax (GST,1998-2002) and finally to Value-Added Tax (VAT) in 2002. At the time of its introduction, VAT in Sri Lanka constituted a multi-rated structure. In addition to zero-rated items and exemption, there existed a 10 per cent concessionary rate and a 20 per cent standard rate (Amirthalingam, 2010). Subsequently, a number of changes to the VAT rate have been witnessed almost on an annual basis. As it stands currently, Sri Lanka adopts a single VAT rate of 12 percent, in addition to zero-rated items and exemptions. VAT is charged on the supply of both locally manufactured and import goods. Both imported and locally manufactured food items deemed essential are zero-rated. Selected raw-material and semi-processed inputs notably pertaining to agriculture such sector such as fertilizer, seed and plants are also zero-rated. In addition the imports of capital goods for key domestic enterprises are exempt for VAT. As noted earlier, project related capital import of BOI-registered enterprises during the project implementation period are also exempt for VAT. In order to open a permanent VAT file a company must record a minimum annual turnover of Rs.2.5Mn (approximately US\$18,000) (Inland Revenue Department, 2012). A VAT refund mechanism administered by the Inland Revenue Department is also in place, enabling VAT-registered entrepreneurs to claim VAT input credits.

Whilst there exists a handful of literature on the efficiency aspects of VAT in Sri Lanka, the equity implications of VAT on both households as well businesses is yet to be analyzed.

2.4 Property Tax and Enterprise Development

2.4.1 Bangladesh

Property tax is the main source of local government revenues in most good-practice countries (World Bank 2008, vide Nenova, 2010). However, but the situation in Bangladesh is totally different. More than half of the urban population lives in the four largest cities of Bangladesh (Dhaka, Chittagong, Rajshahi, and Khulna) and economic activities are also just as concentrated in the largest metropolitan areas (World Bank. 2007). Nonetheless,

collection of property taxation has remained rather insignificant in these areas.

There are three types of land-related property taxes in Bangladesh – one local tax (holding tax) and two other central taxes (land development tax and immovable property transfer tax) [CARE Bangladesh 2003; Stotsky and Yücelik 1995]. Holding tax is currently being collected by the local governments at different strata of public administration—City Corporation, Municipality (Pourashava in vernacular language), or Union Council (Union Parisad in vernacular language).

The knowledge gap is quite large and significant. The ongoing study aims to bridge this gap with a view to providing some policy direction in this regard. The impact of property tax on small enterprise development is expected to be appraised using a theoretical lens of the deterrence model of tax.

2.4.2 India

In India, property tax is assessed and imposed by the municipal corporation of a particular area annually or semi annually, and is based on the area, construction, property size, building etc. The instruments are set as such that the tax levied is almost negligible when compared to the land prices which have risen drastically over the last decade. Such that the primary concern of entrepreneurs is not the tax that they might have to pay annually, rather the initial investment that needs to be made for acquisition of land. Besides that, the process of buying land from non-government sources, in most places a sizeable portion of the cost has to be paid in cash. Since this part of the value is not reflected in the official documents for the transaction, it is not possible to access any bank finance for this component. In the process, individuals who do not have deep pockets find it difficult to set up a firm. Corruption is also recorded by agencies like the CAG in the allocation of government lands.

Facing high prices in the commercial heartlands, the investors are enticed to withdraw the money from real estate dependant business and convert it into even a simple financial instrument such as fixed deposit. In other words, the present system of high prices of real estate could induce a switch from manufacturing where lot of effort is required to real estate business or even a reliance on passive incomes such as interest incomes. Even if the firms consider moving into the hinterland, the costs of doing business and of accessing the market could be considerably higher due to lack of power and poor road connectivity. In such scenario, enterprise development faces hindrance from land being expensive, instead of the tax levied on it.

2.4.3 Nepal

Property tax in Nepal is applied only in major cities. It was first introduced in 1962 which was replaced in 1990, which was again replaced by the urban house and land tax in 1995/96. Currently there are two kinds of property tax: a) House and Land Tax (HALT) and b) Unified Property Tax or Integrated Property Tax (IPT). A new law on property tax has also been drafted. Once the law is implemented, it will compel all Nepalese to compulsorily declare and pay tax for property owned by them⁶. The new Property Tax Act would tag all undisclosed property as illegal possessions and provision stringent punishment to such property holders. Since an overwhelming proportion of SMEs in Nepal are based in rural areas, with property not declared for business purposes, the enforcement of this law might face them with additional property cost, which would hinder their development, but assimilate them into the formal sector.

2.4.4 Pakistan

World Bank (2006) highlights that property taxes have long history in Indo-Pak sub-continent. Lands were taxed by the way of land revenue. The property tax has essentially been the provincial tax; however the house tax was administered by the Local Bodies like Municipal Committees etc. The devolution plan of 2001 led to the transfer of number of functions from provincial to local governments. Along with others this includes the taxes/fees chargeable at different levels - District, Tehsil and Union Council - of local governments. (Social Policy and Development Centre, 2007) The principal source of revenue for TMAs is expected to be the property tax on annual rental value of buildings and lands and the tax on transfer of property. Union administrations have limited fiscal powers beyond the levy of some small fees. However, following the restoration of democracy, according to Nabi & Shaikh, (2011) proper devolution of the property tax is coupled with the broader issue of local government reform. Proper valuation of each property, however, is very difficult, especially where real estate market is not well established. Even where it is possible, exemptions and reduction are given generously through nepotistic undervaluation, causing distortions in the tax base by over-taxing the poor and under taxing the rich.

Due to these discrepancies, knowledge of the informal land markets or of the impact of property taxation on enterprise development in the informal sector is almost non-existent.

2.4.5 Sri Lanka

With the 13th amendment to its constitution, Sri Lanka witnessed the power of taxing

⁶ M. M. Sharma, "New Property Tax Act in the offing", Republica, dated September 3, 2012.

property being devolved down to the Provincial Council level. Property tax and stamp duty on the sale of property is a main source of revenue for Municipal Councils, Urban Councils and Pradeshiya Sabhas, which they use to carry out regulatory and administrative functions, and provide physical structures in the locality. The property tax is administered against an assessment made on the value of property and rent. The tax rate is determined by the individual provincial council. The Colombo Municipal Council (CMC) applies two different tax rates; commercial properties are charged at a rate of 35% and residential properties are charged at a rate of 25% of assessed property value. Of the enterprises paying property tax, 83% pay at the residential rate. So although it is meant to have a major bearing on enterprise development, commercial property tax is evaded by the majority of entrepreneurs.

SECTION-III

Methodology

Under each theme, research covered all five countries in South Asia, given that these themes hold relevance across the region. Five country studies are proposed, encompassing each theme (one focusing on each country), which were then drawn together for this meta-analysis report highlighting the similarities, differences, learning outcomes, and cross-cutting recommendations at the regional level.

For each country study, the research adopted both qualitative and quantitative methodology involving primary perception survey, key informant interviews (KIIs), focus group discussions (FGDs) and case studies involving women entrepreneurs (specifically designed to cover the gender dimensions of the research questions). The methodology for each research method is discussed in detail below:

3.1 Primary Perception Survey:

As the secondary data was not available uniformly across the region, it was not possible to conduct nationally representative survey based on probability sampling, with the owners/managers of the SME/MSMEs. Therefore, a perception based survey was selected where it was found that the purposive sampling would be most appropriate to balance data and resource constraints with research quality. The survey design was based on the sample size of 200 enterprises from manufacturing sector covering three or four cities in each country. Following are the survey designs employed by each country study:

3.1.1 Bangladesh⁷:

The primary survey conducted under the research program was a perception-based one. The key objective of the survey was to learn about the impact of taxation on the state of growth of SMEs in Bangladesh, covering only manufacturing enterprises. A total of 262 enterprises were surveyed in four districts of Bangladesh and 258 enterprises had their formal registrations. Among those surveyed 223 enterprises were SMEs with less than 100 employees. The other 39 enterprises were considered large in terms of number of employees (100 and above) which represented the 'comparison' group.

⁷ Cited from Country Study Reports – Bangladesh compiled by Centre for Policy Dialogue (CPD), Dhaka

A set of 37 enterprises (from the surveyed 262 enterprises) came from BSCIC specialized industrial park which represented yet another comparison group. The BSCIC industrial parks were established in a number of districts with a view to facilitate growth of small firms and generate employment. These special economic zones are equipped with basic infrastructure facilities; industrial plot is leased at a subsidized rate. 100 per cent export-oriented firms have also been set up in these parks. Narshingdi BSCIC (20 samples) was targeted to cover the SMEs belonging to this category. However, a few BSCIC samples were also drawn from Bogra (11 samples) and Dhaka (6 samples) BSCIC. A total of 26 SMEs and 11 large firms were interviewed from the BSCIC zones.

The survey covered four districts (Bogra, Dhaka, Chittagong and Narshingdi) in Bangladesh. Dhaka (101 enterprises or 39 per cent of total) and Chittagong (60 enterprises; 23 per cent) was considered to represent core business activity places while Bogra (70 enterprises; 27 per cent) is chosen for its peripheral location. Narshingdi (31 enterprises; 12 per cent) was chosen to cover SMEs located in the BSCIC industrial park. However, 30 per cent of the firms located in the BSCIC zone were found to be of large-scale nature.

The samples were chosen through purposive sampling, as per the requirements of the research study. The target respondent group comprised of manufacturing industries of all size categories available in Bangladesh spread over varied locations. Both compliant and non-compliant firms were visited.

3.1.2 India⁸:

The enterprises surveyed include micro, small and medium spread across Delhi-NCR, Coimbatore and Ahmadabad. The target respondent groups are all the manufacturing MSMEs (registered and non-registered both), both compliant and non-compliant with regard to VAT. However, purposive sampling method could not be done since there is no comprehensive listing of MSMEs. In the three cities, the survey team visited areas with a concentration of industrial enterprises. Of the enterprises located here, some were unwilling to spend the requisite two hours required for completing the questionnaire. The units surveyed finally therefore, were those located in the industrial areas and willing to devote the required time. It may be noted that units located outside the industrial areas would not usually be reflected in the sample.

Of the 200 enterprises, 100 are from Delhi NCR and 50 each from remaining two areas. This followed from the fact that Delhi NCR has a more diverse set of industries as compared to the other two cities. Out of total 200 enterprises sampled, there are 113 from micro, 70 from

⁸ Cited from Country Study Report - India compiled by National Institute of Public Finance and Policy (NIPFP), New Delhi

small and 17 from medium enterprises. However, as our samples of medium enterprises are too small vis-à-vis other two categories, thus, we have considered the small and medium units as a single category by clubbing them together for the exploratory analysis of the data.

3.1.3 Nepal⁹:

The primary enterprise survey has been conducted in small and medium scale enterprises of manufacturing units of three main business corridors of Nepal. The quantitative approach includes the enterprises survey of 202 formally registered SMEs of Nepal. The survey was conducted among formal businesses registered under the Inland Revenue Department (IRD), association of small scale and cottage industries, municipalities, the Department of Industries etc. This survey is focused on small and medium scale enterprises, and therefore large scale industries have been eliminated from the sampling procedure.

For conducting survey, the country is divided into three geographical regions namely eastern, central and western based on the industrial and economic activities of major cities. The western region includes districts like Kaski, Banke, Kailali and Rupendehi whose major industrial and economic cities are Pokhara, Nepalgunj, Dhangadi and Butwal respectively, contributing to a sample size of 50. The central region includes districts like Kathmandu, Lalitpur, Bhaktapur and Chitwan, whose SMEs constitute 100 samples in the survey. Similarly, the eastern region includes districts like Jhapa, Morang and Sunsari, whose major cities are Bhadrapur, Biratnagar and Itahari, respectively and add 50 more samples to the study. A total of 202 small and medium scale industries out of 3535 are selected for the study. It uses purposive sampling technique and focuses on five major cities. Since the central region consists of 55% of the total industries; approximately 50% of the total sample is drawn from it. 25% of the samples were drawn from each of the eastern and the western regions. The samples were selected from the list provided by the Federation of Nepalese Chambers of Commerce and Industries (FNCCI). Out of the total samples drawn women-headed enterprises comprise only 7%.

3.1.4 Pakistan¹⁰:

The primary instrument of data collection was a perception survey on a pre-designed and tested questionnaire of a stratified (by city, firm and industry group size) national random sample of 200 manufacturing SME units. The target districts were Lahore, Faisalabad and Karachi as they are the three big commercial hubs in Pakistan.

¹⁰ Cited from Country Study Report – Pakistan compiled by Beaconhouse National University, Lahore

The population of the industrial units was obtained from the Economic Census 2005, published by the Pakistan Bureau of Statistics (PBS). Once the sample distribution across cities was finalized, the individual sample units were selected from the population of units obtained from the Provincial Directories of Industries prepared by the respective Provincial industrial Departments. For each unit, the Provincial Directories give name, address, and year of registration and level of employment. The last variable enables the selection of small units.

The sample was acquired from Karachi, Lahore, and Faisalabad, which are the three most populated cities of Pakistan. The largest sample belonged to Lahore, followed by Faisalabad and Karachi, and was majorly employing less than 10 workers. 37.5% firms employed 10-50 workers, and only 10.5% employed more than 50 workers. In terms of turnover, an overwhelming 42% recorded revenues less than PKR 5million, followed by 32% firms earning PKR 20million and above. Between these two extremes, 12.5% firms made PKR 5 to 10million, and another 13.5% had revenues between PKR 10-20 million per annum. Almost 82 percent of the firms are registered under different agencies, while almost half of the sample units said they are registered with Federal Board of Revenue (FBR)

3.1.5 Sri Lanka¹¹:

A total of 150 enterprises have been surveyed, of which 89% were registered, and 11% unregistered. For formalized firms the sampling frame was drawn from a database of registered SMEs with the assistance of the National Chamber of Commerce of Sri Lanka (NCCSL). For the informal sector, unregistered firms the sample was drawn based on a database maintained by IPS, which was originally prepared for a project assessing the social welfare of Small and Medium Entrepreneurs. Prior to finalizing the survey and administering it, the study team carried out a pre-testing of the survey instrument to iron out any issues and streamline it. Since only 16.67% of the surveyed firms are women-owned and managed enterprises, to explore the gender dimension of enterprise development, the study team adopted exploratory case studies using open-ended interviews to examine the case of a successful female entrepreneur to reveal 'lessons learned' for policy making on taxation and enterprise development.

¹¹ Cited from Country Study Report – Sri Lanka compiled by Institute of Policy Studies (IPS), Colombo

3.2 Key Informant Interviews (KIIs)

In order to better understand the regulatory environment with regard to SMEs vis a vis tax policies, a number of interviews have been conducted with the officials of key stakeholders. The KIIs augmented the qualitative data gathered through literature review. Key informant interviews (KIIs) also helped to ascertain background information pertaining to both the contemporary tax regime and to obtain the perception of key informants relating to pressing issues across each of the three research themes under study. Both the literature review and the Key Informant interviews placed particular emphasis on sub-national variations in both de facto and de jure policy regarding tax expenditures, VAT, and property taxes, as well as industrial composition and levels of informality, particularly in the 3 Country Studies on Bangladesh, India and Pakistan, respectively.

During KIIs, boundary analysis (a problem structuring technique) was applied so that the number of ideas, opinions, and facts were exhausted. Also, to make this effort more targeted towards research questions the study employed snowballing technique where each Key Informant yielded new relevant contacts.

These Interviews targeted (at the national and sub-national levels)

- Serving and former civil servants (especially Customs & Excise and Income Tax Groups including personnel from revenue administration authorities, relevant Ministries, and enterprise development authorities, trade and export control authorities, etc.)
- Elected officials (especially research relevant parliamentary committees)
- Non-state actors including farmers /traders / professional associations, associations of home-based workers, Chambers of Commerce and Industry, Associations of Accountant Firms, NGOs active in this area, and scholars who have written on this issue.
- Representatives of the international donor community, including Program Officers, Chief Technical Advisors, senior managers of the development assistance departments in relevant embassies, etc.
- Government officials involved in assessments and evaluations of tax bases, setting and revising of rates, and administering property taxes at the local (and/or higher) levels
- Government officials involved in land administration, governing aspects such as land registration and record-keeping, tenure, use, rights, markets, etc. at the local (and/or higher) levels

- Non-state stakeholders of land markets, including real-estate agencies, banks and lending institutions, NGOs advocating for land rights, etc.

3.3 Case Studies on Women Entrepreneurs

Due to the limited sample of female respondents in the primary survey across the region to explore the gender dimension of enterprise development, the study adopted exploratory case study using open-ended interviews to examine one case of a successful female entrepreneur and one case of unsuccessful female entrepreneur to reveal 'lessons learned' for policy making on taxation and women owned enterprise development, which have thus far been ignored by policy and research in the region. Also the study was aimed to explore the 'Brain Drain' phenomenon potentially resulting from unsuccessful entrepreneurs fleeing regressive and/or burdensome tax regimes. Entrepreneurs were identified from the sample of survey respondents.

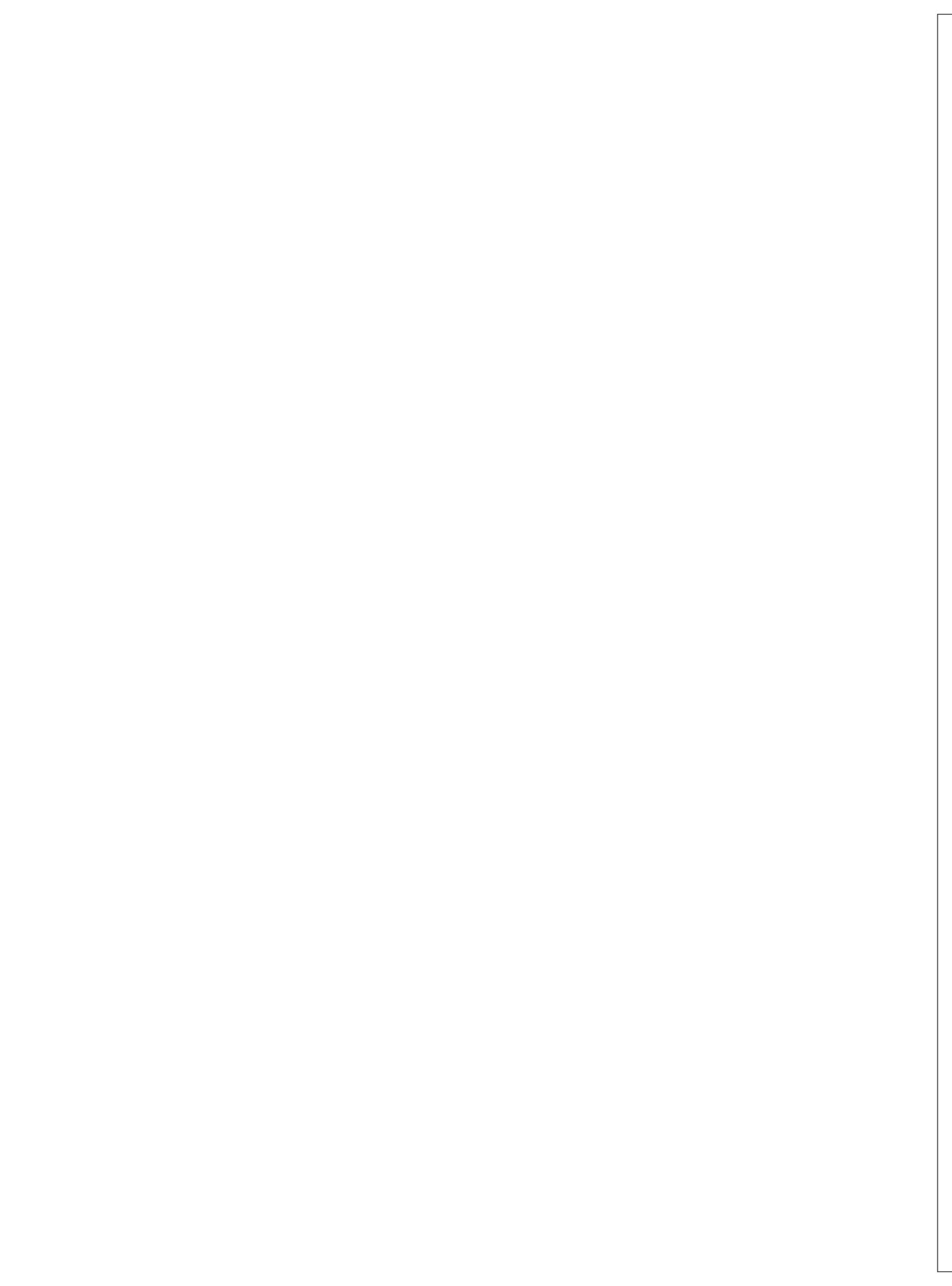
These case studies employed semi-structured interviews with entrepreneurs, her family members, enterprise staff, and external stakeholders with whom the entrepreneur has had dealings in the past. Also a review of documents was conducted to obtain relevant information (where available), including:

- Registration and tax certificates
- Financial accounts
- Organizational records
- Tax returns
- Credit agreements

3.4 Focus Group Discussions

Finally with the aim of soliciting feedback on research results from a policy perspective and to ensure that recommendations are reflective of ground realities focused group discussions were carried out with senior civil servants, tax consultants and industry/business chamber representatives. Sharing analysis and key results of the survey with key policymakers enhanced understanding of the exact measures to be taken

by responsible institutions (e.g. legislative reforms, regulatory adjustments, budgetary reallocations) so that recommendations can be concrete and actionable. FGDs were also aimed to gain insights into the likely political implications of recommended policies to formulate more realistic recommendations.



SECTION-IV

Key Results and Findings of Meta Analysis

4.1 Meta Analysis of Primary Enterprise Survey

4.1.1 Firm's Owners'/Managers' Characteristics

Characteristics of Firm Ownership

As can be seen from Table 4.1, ownership patterns of sample firms across the region are largely similar as in all countries most firms are owned by sole proprietors, ranging from a lowest of 63% in India, to highest 91% in Sri Lanka. On similar lines, limited companies are the second most observed type of ownerships in all samples with 21% in India, 15% in Nepal, and 13% in Pakistan. Their incidence in Bangladesh and Sri Lanka was lower with 4% each. Partnered firms were found to be highest in India with 17%, closely followed by Bangladesh and Nepal. They were found to be very few in Sri Lanka, and non-existing in the Pakistani sample.

Table 4.1: Ownership Pattern

	Pakistan		India		Bangladesh		Sri Lanka		Nepal	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Limited Company	26	13	41	21	9	4	6	4	31	15
Sole Proprietorship	142	71	126	63	183	82	137	91	147	73
Partnership	0	0	33	17	30	14	5	3	24	12
Co-operative	0	0	0	0	1	0	1	1	0	0
Other	32	16	0	0	0	0	1	1	0	0

Age of Entrepreneurs

Age of entrepreneurs in sample South Asian SMEs showed a greater leaning towards middle aged group (See Table 4.2). In Pakistan, India, and Nepal, the largest chunks of entrepreneurs lied above 45 years of age, while in Sri Lanka and Bangladesh, ownership of

sample firms lied largely with people aging between 36 and 45. The greatest representation of entrepreneurs below 35 years of age was found in Bangladesh with 28%, which was not matched by any other country closely.

Table 4.2: Age of Entrepreneur/Major Decision Maker

	Pakistan		India		Bangladesh		Sri Lanka		Nepal	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Less than 25	1	1	2	1	4	2	0	0	3	2
26 to 35	24	12	29	15	58	26	19	13	30	15
36 to 45	67	34	70	35	83	37	89	59	77	38
Above 45	108	54	99	50	77	35	42	28	92	46

Entrepreneurial Experience

South Asian SME entrepreneurs show a trend of having low experience in business. In Bangladesh, Pakistan, Sri Lanka, and Nepal, largest proportions of the surveyed entrepreneurs and decision makers quoted their experience to be less than 10 years (See Table 4.3). The trend varied in India where a majority of entrepreneurs (36%) had 11-20 years of experience. This experience group accounted for 34% entrepreneurs in Bangladesh and Sri Lanka. Pakistani sample exhibited the largest proportion of entrepreneurs (16%) having more than 30 years of experience, followed closely by India. The overall trend shows that the SME sector in South Asia is in its nascent years of development.

Table 4.3: Experience (in Years) of Entrepreneur/Major Decision Maker

	Pakistan		India		Bangladesh		Sri Lanka		Nepal	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Less than 10 years	86	43	52	26	116	53	90	60	112	55
11 to 20 years	52	26	72	36	74	34	51	34	58	29
21 to 30 years	31	16	49	25	20	9	6	4	22	11
31 to 40 years	27	14	23	12	8	4	0	0	9	5
Above 40 years	4	2	4	2	1	1	3	2	1	1

Educational Qualification of Entrepreneurs

Table 4.4: Educational Qualification of Entrepreneur/Major Decision Maker

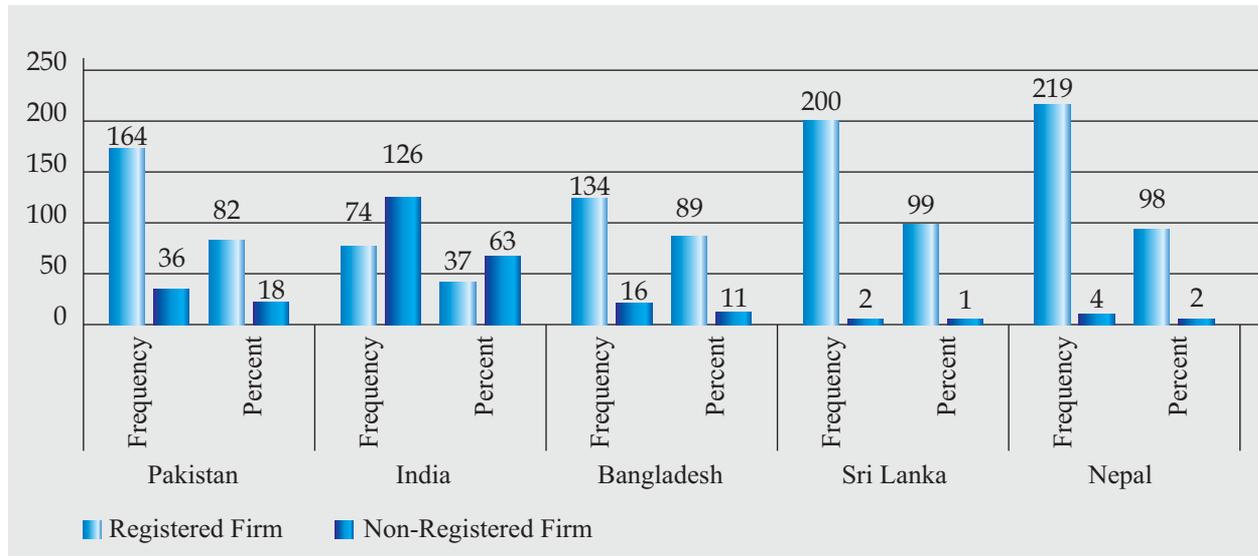
	Pakistan		India		Bangladesh		Sri Lanka		Nepal	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Less than Primary	9	5	7	4	18	8	9	6	10	5
Primary	33	17	14	7	49	22	49	33	29	14
Secondary	84	42	52	26	72	32	79	53	84	42
Graduate	56	28	100	50	53	24	9	6	71	35
Post Graduate	18	9	27	14	30	14	4	3	7	4
Illiterate	0	0	0	0	0	0	0	0	1	1

As per Table 4.4, the sampled SMEs displayed a clear trend of having less educated entrepreneurs. In Sri Lanka, Pakistan, Nepal, and Bangladesh, most entrepreneurs had only acquired secondary education. India stands as an outlier in this trend where 50% of the sampled entrepreneurs were graduates, though most of the remaining major decision makers were less qualified than them. Pakistan, Bangladesh, and Nepal also had large percentages of entrepreneurs having graduate qualification; though this was not true for Sri Lanka, where only 6% of entrepreneurs were graduates.

4.1.2 Firm Characteristics:

Formality Status

Out of 975 firms surveyed across the targeted countries only 184 firms are found to be non-registered with any type of legal authority. This registration trend is due to the fact that these firms belonged to the manufacturing category of SMEs and registration is necessary for smooth business operation in this category. Also, most of the manufacturing companies do operate in the special economic/export promotion zones in each country which mostly requires the registration of firms with some kind of government institution. However, in India, Pakistan and Sri Lanka the study was able to achieve higher numbers of non registered manufacturing firms i.e. 63%, 18% and 11% respectively as compared to Nepal and Bangladesh (See Figure 4.1). At the same time, the survey results of individual country study reports suggest that the large firms tend to be more formalized than the small firms.

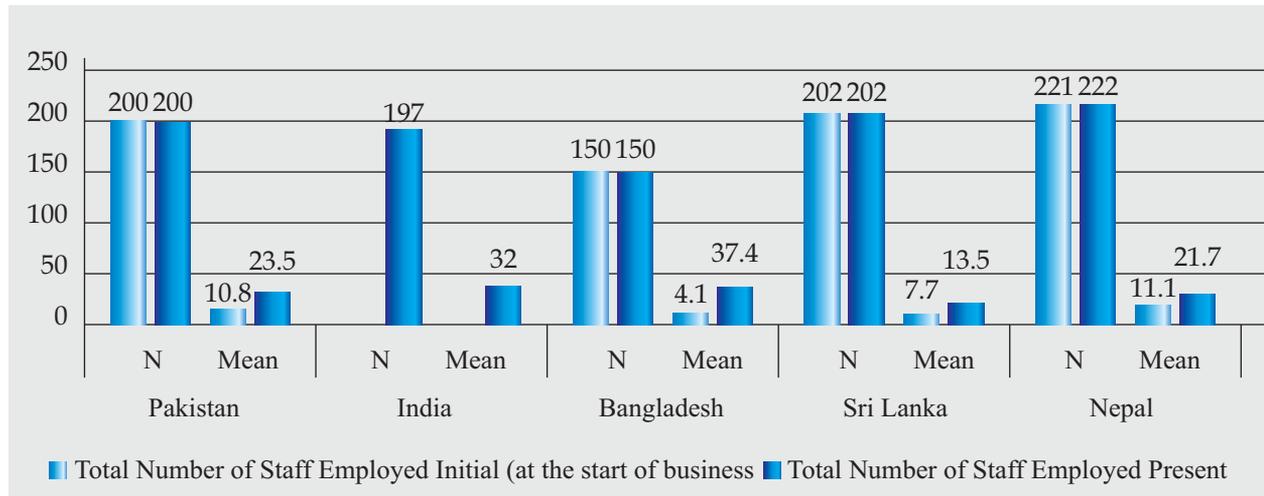
Figure 4.1: Legal / Registration Status

Firm Size

According to survey results (See Figure 4.2), the SMEs represent considerable growth in the employment over the years since their inception. The Sri Lankan sample SMEs show highest average employment growth from 4 employees at the start of business to 37 employees at present. Further, Bangladesh, Nepal and Pakistan reflect almost double increase in the average employment size at present as compared to what was at the start of business. In India, the SMEs were reluctant to disclose their initial employment size however it was found that on average 32 employees are on the payroll of a sample SME working in India. The highest number of average staff currently employed in a SME was found also found to be in Sri Lanka i.e. 37 employees per SME on average which establishes the SME sector as an ideal candidate for sustainable employment generation in Sri Lanka; it is also a reflection of SMEs in the Sri Lanka sample being labor intensive.

The lowest number of average employees per SME (almost 14) was found in Nepal and this can be attributed to various growth inhibitors such as seasonal nature of employment, lack of skill development facilities and technological drawback. Also, the financial considerations of an employee working in a manufacturing SME does matter as literature suggests that the financial rewards for working in the service sector are much higher.

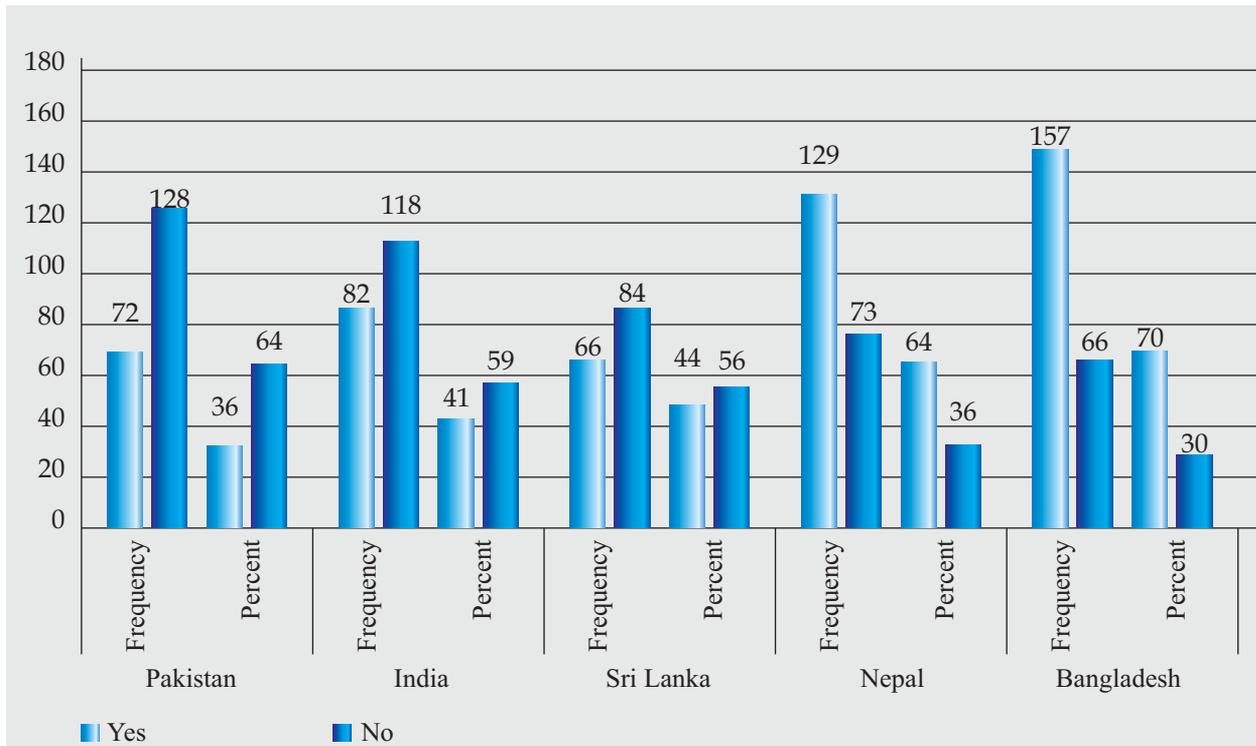
From survey data analysis, it is pertinent to assume that the job creation can be enlarged if SMEs receive increased support and priority from the governments across the region.

Figure 4.2: Total Number of Staff Employed.

*N = Number of Respondents

4.1.3 Access to Credit

The study faced challenges in getting financial data from SMEs as they were reluctant to provide most financial data due to the fear of future prosecution by government agencies or due to their personal administrative rules and regulations. As it can be seen from Figure 4.3, more than 50% sample SMEs have taken loan to finance their business during last five years. This trend is much higher in Bangladesh where almost 70 % SMEs took loans while in Pakistan and Nepal this figure stands at 36% and 64% as compared to 41% and 44% in India and Sri Lanka have taken loans.

Figure 4.3: Loans Taken during last 5 years

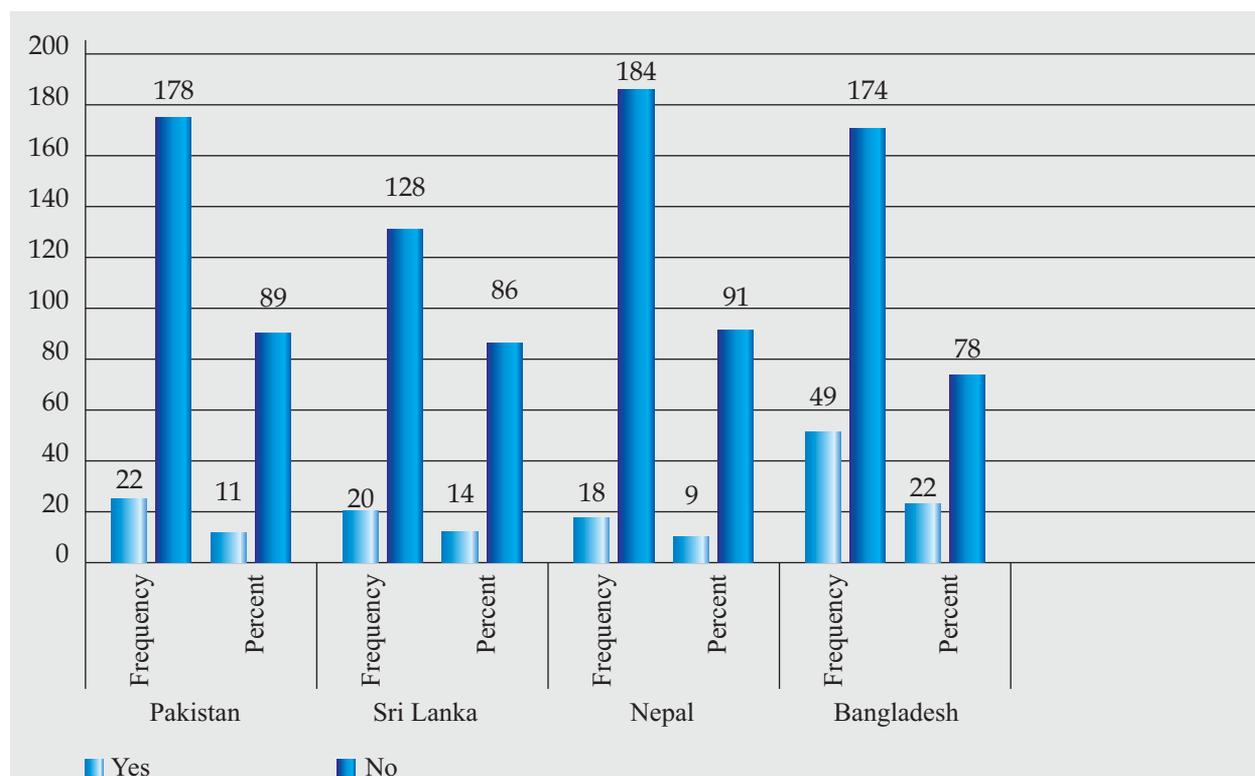
However, as per the survey data (See Table 4.5) most firms tend to open a line of credit with commercial banks in their respective countries. Results show that the Indian SMEs borrowed heavily from commercial banks, approximately \$ 0.16 million on average with the interest rate of 13.5% per annum, as compared to any other country. While the Bangladeshi SMEs mostly financed their business through availing credit facility from commercial banks, money lenders and self finance.

The interest rates charged by commercial banks are highest in Sri Lanka i.e. 18% pa while 13% pa interest rate is charged in Nepal. It is interesting to find that Pakistan's commercial banks interest rates are the same as for India. However, the mean borrowing by Pakistani SMEs is almost half (compared to India). Also, Nepal has even lower Mean borrowing despite the fact its banks charged the lowest interest rate. Also, it can be seen that the micro-finance institutes in Pakistan charge the highest interest rate among the three countries.

Table 4.5: Major Sources of Financing Business Since Business Startup

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Number of Respondents	Mean (\$)								
Commercial Bank (Amount)	200	89355.0	61	164902.4	8	22945.5	78	62834.9	121	42858.3
Commercial Bank (Rate of Interest)	200	13.9	65	13.5	5	18.0	78	13.0	120	15.5
Cooperatives (Amount)	200	5060.2	2	37425.1	1	384.0	5	6557.4	14	2729.5
Cooperatives (Rate of Interest)	200	7.5	2	13.6	-	-	5	14.8	15	15.4
Money lender (Amount)	-	-	1	1663.3	5	8640.6	11	5800.9	30	10220.4
Money lender (Rate of Interest)	-	-	2	15.5	3	17.3	11	19.1	29	11.0
Pvt. Finance Company (formal/Informal) Amount	200	6560.2	6	20514.5	-	-	25	11558.4	7	3130.0
Pvt. Finance Company formal/Informal (Rate of Interest)	200	10.2	7	11.3	-	-	25	16.2	7	14.7
Micro Finance (Amount)	200	1012.0	1	13306.7	-	-	-	-	1	1933.2
Micro Finance (Rate of Interest)	200	25.0	1	11.0	-	-	-	-	1	14.0
Self Finance (Amount)	200	9762.0	5	30272.8	15	2485.9	1	20751.2	9	10525.4

When asked that if the firms have applied for any loan during past fiscal year most of the firms (above 80%) in Pakistan, Nepal and Sri Lanka responded in a negative. However, 22% SMEs in Bangladesh, and 14% in Sri Lanka have applied for a loan in past fiscal year (Figure 4.4).

Figure 4.4: Application for loans or lines of credit in the last fiscal year

Further, the SMEs, who have not applied for loan, gave multiple reasons for their decision as it is evident from Table 4.6. Among those reasons following were the top three reasons for not applying for a loan:

- No need for a loan because enterprise had sufficient capital
- Application procedures were complex
- Interest rates were not favorable

Moreover, those SMEs who applied for loan and got their application rejected cite lack of collateral required as a main reason across the region except Sri Lanka where the rejected applicants also cite the non registration of their firm as a major reason besides collateral requirement.

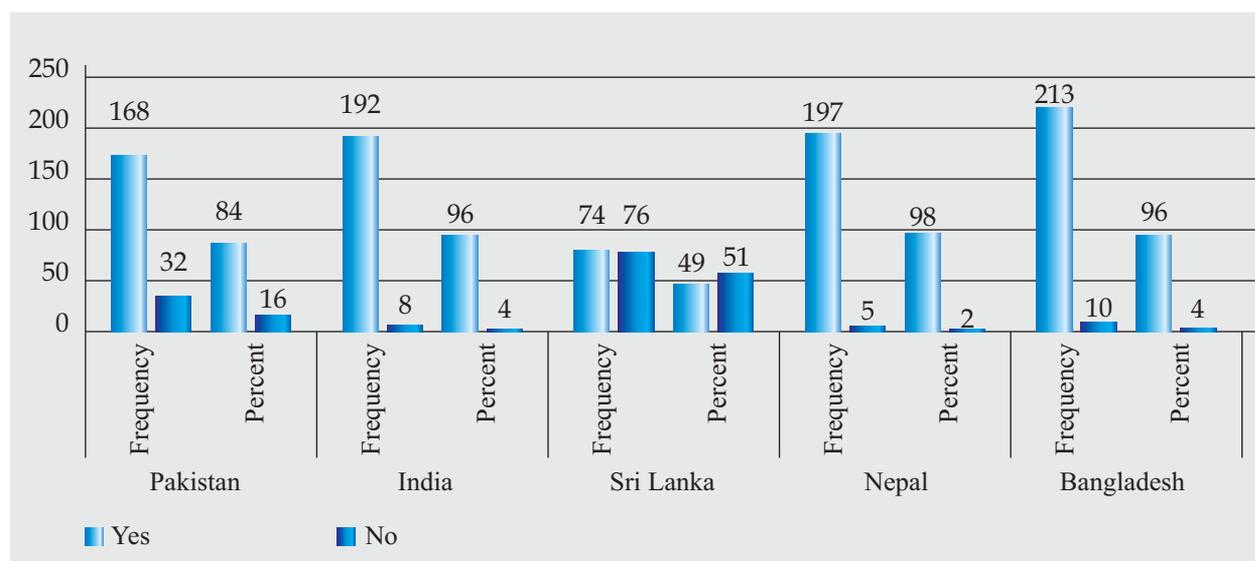
Table 4.6: Main Reasons for not Apply for any Line of Credit

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
No need for a loan - enterprise had sufficient capital	150	135	80	134	50	111	164	173	82	47
Application procedures were complex	12	11	9	15	28	62	18	19	64	37
Interest rates were not favorable	40	36	26	44	7	16	3	3	25	15
Collateral requirements were too high	9	8	3	5	2	4	3	3	39	23
Size of loan and maturity were insufficient	7	6	1	2	0	0	2	2	29	17
Did not think it would be approved	4	4	0	0	3	7	0	0	22	13

4.1.4 General Tax Behavior

Overall Tax Compliance

The survey results (See Figure 4.5) show that more than 95% of sample SMEs pay some kind of taxes in India, Nepal and Bangladesh. In Pakistan, almost 84% of Sample SMEs pay some taxes. However, in Sri Lanka almost 51% of SMEs reported that they do not pay any taxes and this is due to the fact that the turnover of these SMEs is below the taxable threshold.

Figure 4.5: Tax Compliance

Overall Tax Perceptions and Experiences

At the same time, the taxpaying SMEs across the region said that they pay various federal/national/central and provincial/state taxes annually which refer to the multiplicity of taxes which might contribute towards extra cost and time of the firms affecting their financial growth as later confirmed during KIIs in India. This is also reflected in the Table 4.7 below:

Table 4.7: Too Many Types of Taxes

	Pakistan		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Strongly Agree	83	49	57	38	21	11	102	46
Agree	81	48	87	58	128	63	72	32
Disagree	3	2	3	2	32	16	31	14
Strongly Disagree	1	1	1	1	5	2	4	2
Neither Agree nor Disagree	0	0	1	1	16	8	13	6

Further, more than 70% of the tax complaint respondents across the targeted countries perceive that the tax laws and filling procedure is too complex and cumbersome (see Table 4.8).

Table 4.8: Tax Laws and Procedures are Too Complex

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Strongly Agree	79	47	82	41	48	32	18	9	110	50
Agree	79	47	85	42	96	64	106	52	73	33
Disagree	9	5	17	9	4	3	52	26	22	10
Strongly Disagree	1	1	4	2		0	4	2	4	2
Neither Agree nor Disagree	0	0	12	6	2	1	22	11	13	6

When asked from the respondents that the tax collecting agencies have competent officers and the location of tax office is convenient, almost 60% SMEs in India, Sri Lanka, Nepal and Bangladesh either agreed or strongly agreed with the statement. However, almost 72% of SMEs in Pakistan feel that tax administration does not have competent officers and there is lack of easy access to the tax offices (See Table 4.9).

Table 4.9: Competent Tax officials and the Convenient Location of Tax Office?

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Strongly Agree	12	7	9	4	6	4	11	5	39	18
Agree	28	17	104	52	85	57	127	63	99	44
Disagree	69	41	0	0	2	1	34	17	51	23
Strongly Disagree	54	32	58	29	0	0	10	5	12	5
Neither Agree nor Disagree	5	3	29	15	57	38	20	10	22	10

Similarly, the respondents in Pakistan perceive that tax staff is not fair and respectful in their official dealings with them. And in other targeted countries, except Nepal, the responses are evenly matched where half agree and half disagree with the above mentioned statement. In Nepal, a majority (60%) agreed that the tax officials are fair and respectful as can be seen from Table 4.10.

Table 4.10: Fairness and Respectfulness of Tax Staff

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Strongly Agree	12	7	0	0	0	0	15	7	17	8
Agree	19	11	85	43	37	24	107	53	16	34
Disagree	75	45	115	57	1	1	50	25	90	40
Strongly Disagree	57	34	0	0	0	0	7	4	16	7
Neither Agree nor Disagree	5	3	0	0	112	75	23	11	24	11

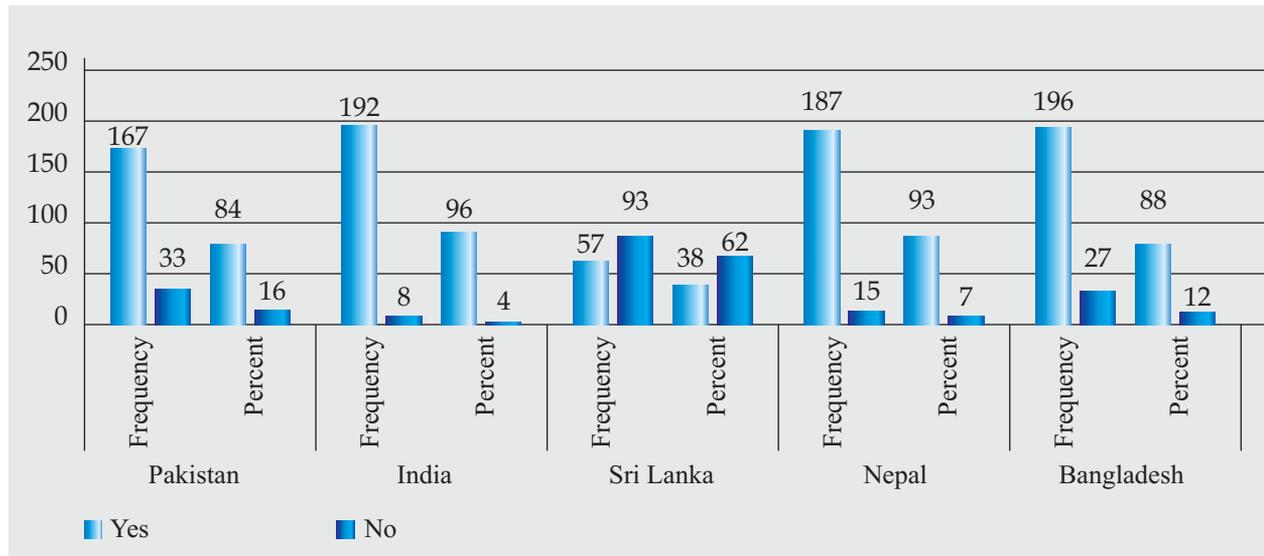
Also, 84% of sample SMEs in Pakistan somewhat or strongly feel harassed by the tax officials whereas this percentage comes down to 42%, 51% and 52% with regard to India, Nepal and Bangladesh (see Table 4.11). As far as the responses in Sri Lanka are concerned 84% of the firms neither agree nor disagree with the statement

Table 4.11: Perception about Harassment by the Tax Official

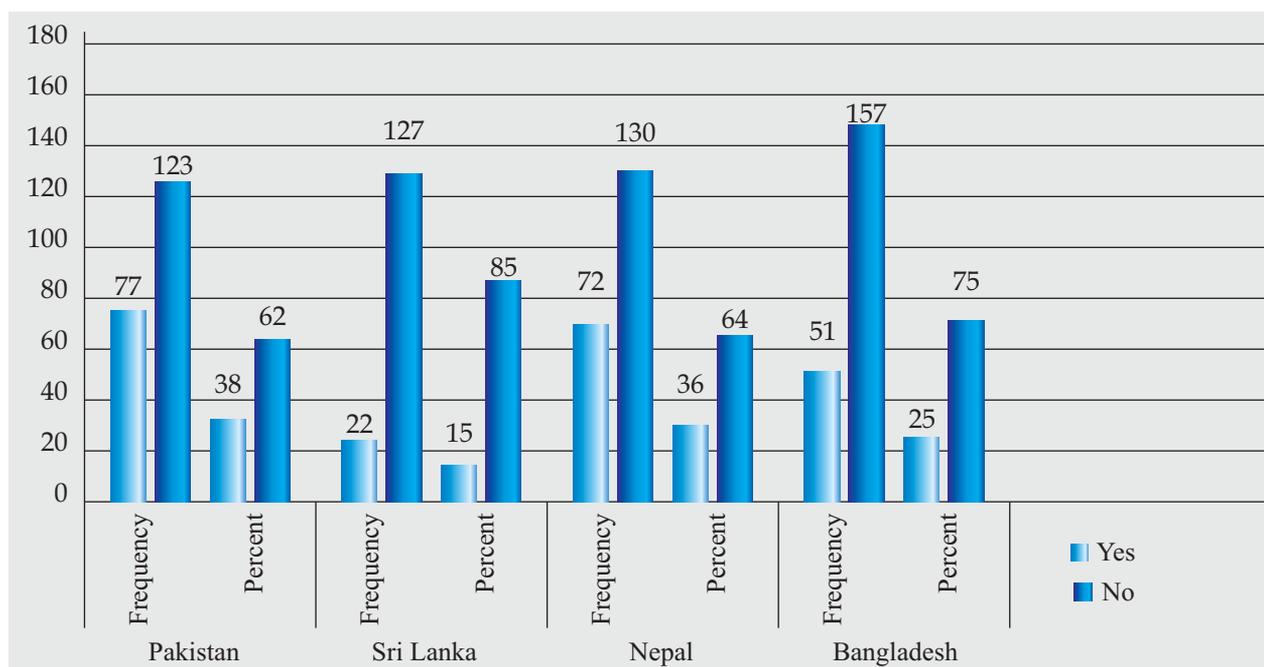
	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Strongly Agree	41	25	0	0	1	1	12	6	62	27.8
Agree	98	59	84	42	2	1	90	45	57	25.0
Disagree	19	11	116	58	20	13	69	34	62	27.8
Strongly Disagree	2	1	0	0	2	1	7	3	15	6.7
Neither Agree nor Disagree	7	4	0	0	125	84	24	12	27	12.7

Overall Cost of Compliance

Survey results (See Figure 4.6) show that almost 90% of the SMEs across India, Nepal and Bangladesh are registered with tax authority whereas almost 84% of sample SMEs are tax registered in Pakistan. However, in Sri Lanka only 38% of sample SMEs are registered with the tax authority this is due to the fact that in Sri Lanka registering with the tax authority is only compulsory after the SME crosses certain threshold of annual turnover in sales.

Figure 4.6: Registered with the Tax Authority

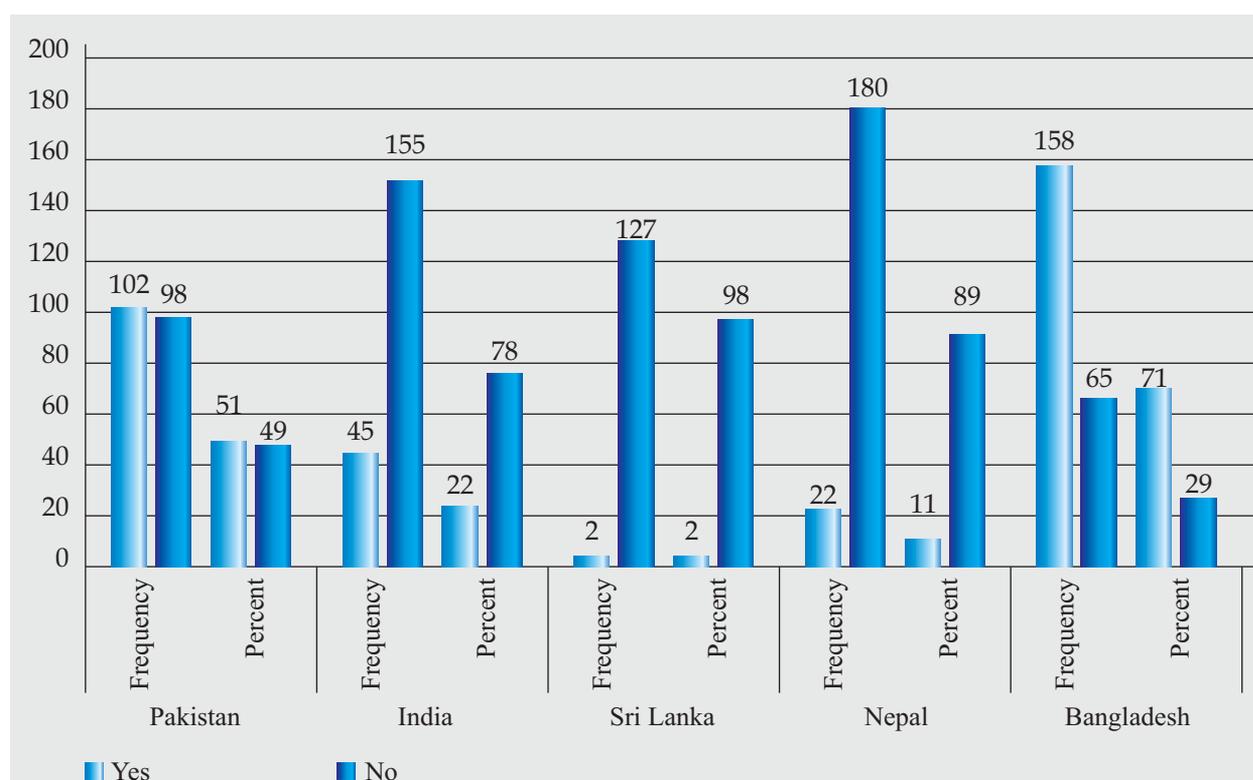
Further, the analysis of Figure 4.7 shows that some of the SMEs (38% and 36%) in Pakistan and Nepal have employees which are specifically dealing with the tax related issues such as documents preparations, filling of tax etc. This figure comes down to 25% SMEs employing specific tax related manpower in Bangladesh. However, only 15% SMEs in Sri Lanka have specialized manpower to deal with tax return filing and associated issues.

Figure 4.7: Employees Specifically Dealing with Tax Related Issues

Compliance Requirements and Willingness to Formalize

Despite the fact that tax-related benefits positively contribute to the businesses, firms were found to be less interested in dealing with these benefits. This may be related to the perceived hassles faced by the entrepreneurs (as depicted in Figure 4.8). About 71% and 51% of sample SMEs in Bangladesh and Pakistan reported that they are not interested in filling for tax benefits to avoid the hassles associated with the compliance requirements.

Figure 4.8: Not Interested in Tax Benefits to Avoid the Hassles Associated with Compliance Requirements

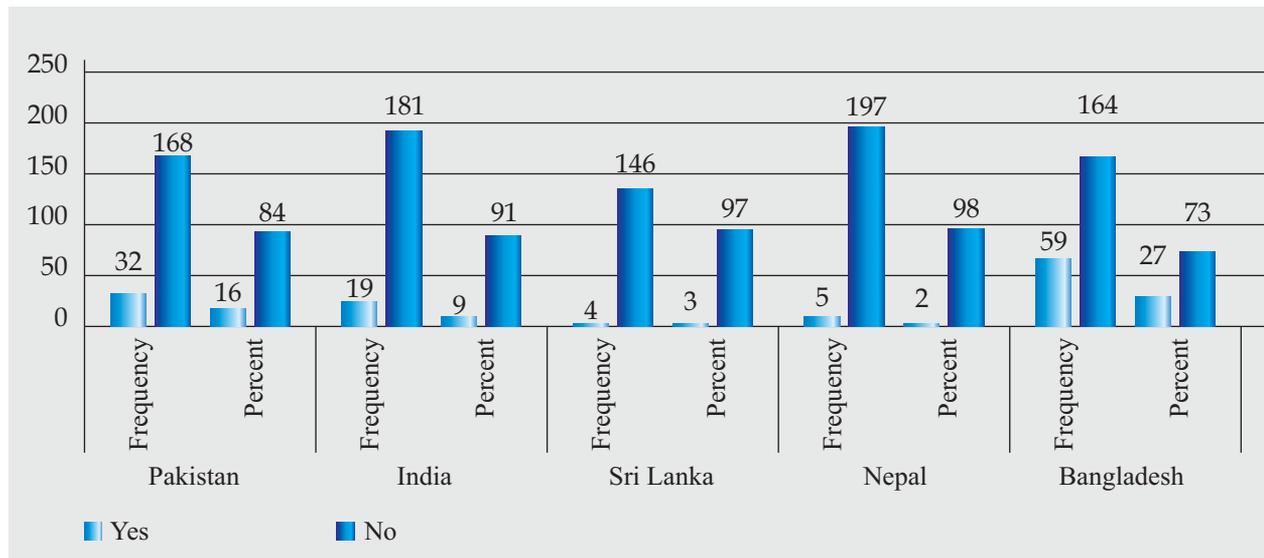


4.1.5 Impact of Tax Exemptions and Concessions

Only 12% (119 enterprises) of total 975 SMEs surveyed across the region perceived that they have got tax exemptions and concessions while most of them (almost 88%) perceive that they have not got any tax exemptions and concessions (See Figure 4.9). There is possibility that firms have not understood what actually a tax exemption is and what it implies. When tax exemptions operate such that the tax becomes applicable only above a certain threshold of turnover, since the exemption is available to all similar firms and does not require the firm to do anything to avail of the exemption, the firms might perceive it to

be a part of the normal tax regime and not a special scheme that reduces their liability. Especially in India, most indirect tax exemptions for small units are built into an exemption threshold. However, out of these SMEs who perceive that they got concessions mostly come from the sample of Bangladesh (59 SMEs), Pakistan (32 SMEs) and India (19 SMEs). This points out towards a comparatively lower awareness in Nepal and Sri Lanka as compared to fellow three countries.

Figure 4.9: Receiving Tax Exemptions and Concession



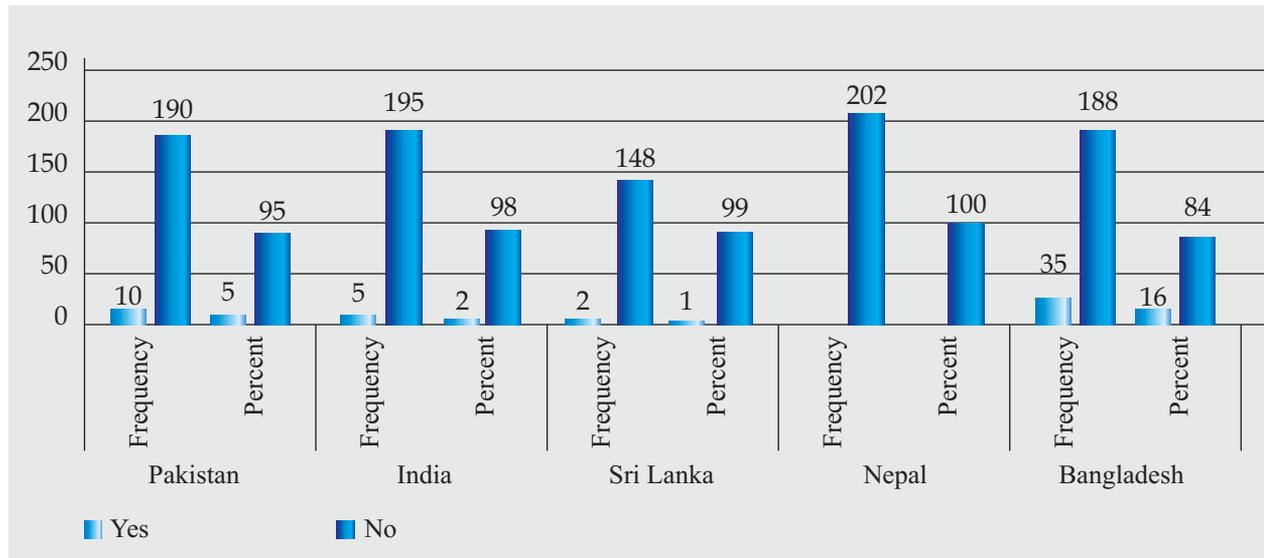
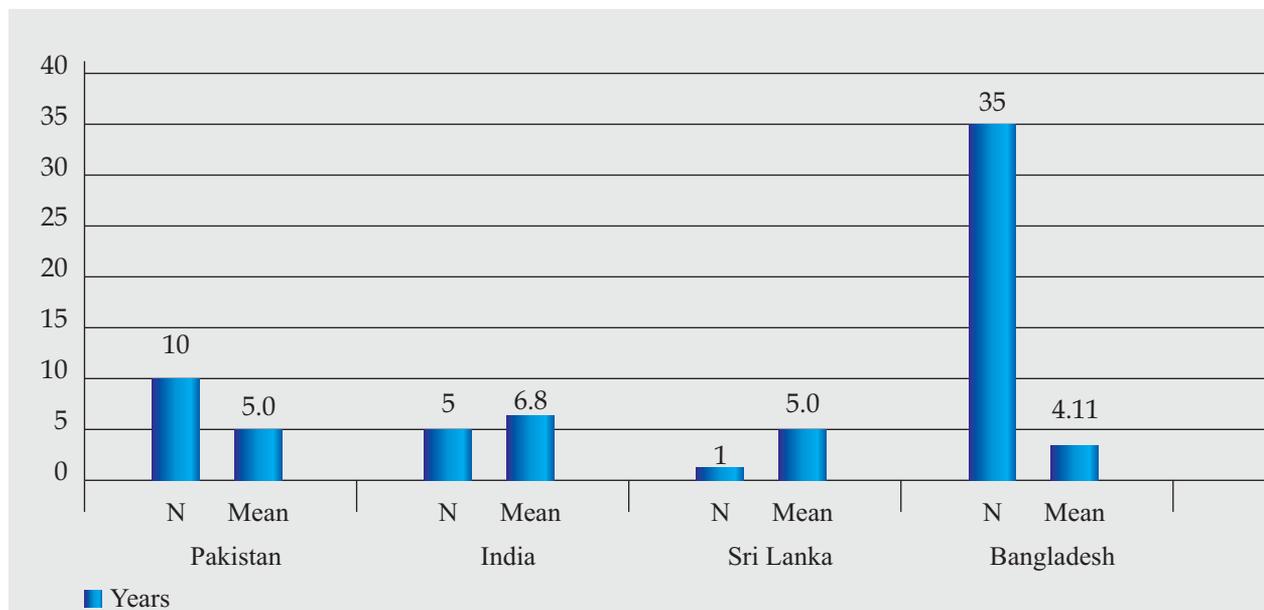
As majority of them perceive that they have not got any tax exemptions and concessions, thus it is difficult to assess their perceptions about exemptions' impact on the sales, productivity and competitiveness of these firms. However, Table 4.12 reveals that majority of them, across the region; perceive medium to high impact of tax exemptions and concessions on their firms in terms of: a) increase in sales, b) increase in productivity and c) increase in competitiveness. But in India and Nepal the low numbers of responses (19 and 5) make it difficult to infer any conclusion with regard to increase in sales. However, most firms in India perceive low or no effect of exemptions and concessions on their competitiveness.

Table 4.12: Impact of Tax Exemption and/or Concession on Firms

Increase in Sales								
	Pakistan		India		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
High	13	41	3	15	2	40	27	48
Medium	8	25	11	58	2	40	19	34
Low	6	18	3	16	1	20	8	14
No effect	5	16	2	11	0	0	1	2
Don't know	0	0	0	0	0	0	1	2
Total SMEs	32	100	19	100	5	100	61	100
Increase in Productivity								
High	9	28	2	11	2	40	29	52
Medium	14	44	12	63	2	40	18	32
Low	5	16	1	5	1	20	6	10
No effect	4	12	4	21	0	0	2	4
Don't know	0	0	0	0	0	0	1	2
Total SMEs	32	100	19	100	5	100	56	100
Increase in Competitiveness								
High	5	16	1	5	1	20	27	48
Medium	12	37	8	42	2	40	24	43
Low	5	16	1	5	1	20	4	7
No effect	10	31	9	48	1	20	1	2
Total SMEs	32	100	19	100	5	100	56	100

* The four Sri Lankan respondents who get exemptions did not provided any further information

Further as per Figure 4.10, it was found that more than 95 % of the sample SMEs in Pakistan, India and Sri Lanka has not received any tax holidays at the time of establishment of their business. Similarly, 84% in Bangladesh did not received any tax holidays, however, this response took up to extreme where none of the surveyed SMEs received any tax holidays at the time of firm's inception as can be depicted from Figure 4.10 . As per Figure 4.11, a handful of enterprises across the region that got the exemptions report that the average duration of tax holidays availed was almost 5 years.

Figure 4.10: Got Tax Holiday during Establishment of Firm**Figure 4.11: Average Duration of Tax Holiday**

Further, the study also investigated perceptions of SMEs on what kind of tax related government assistance is required for growing their business. Majority of them across the region perceive that government should first a) reduce tax rate, b) grant tax exemptions, c) grant tax holidays and then d) strengthen the service delivery of tax authorities towards SMEs (See Figure 4.11).

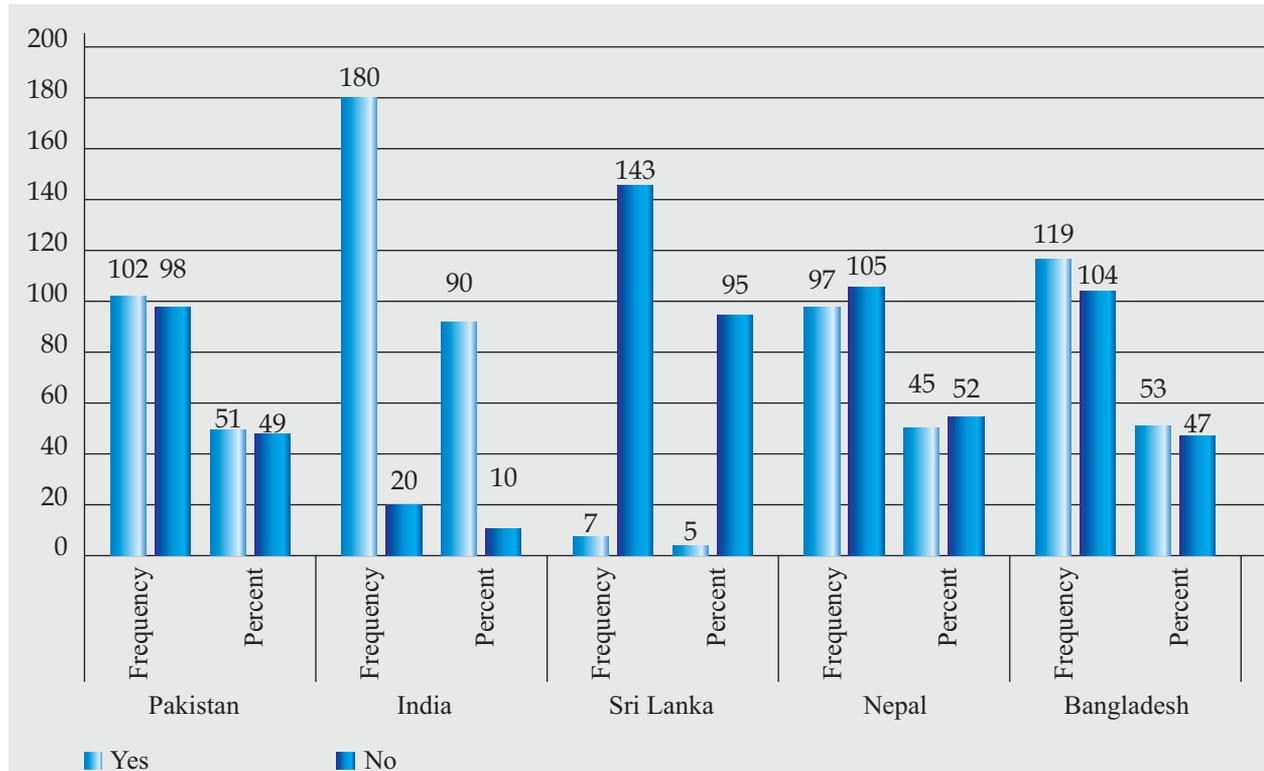
Table 4.13: Tax-Related Government Assistance for Growing Business - What They Want?

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Reducing tax rates.	145	64	171	87	144	56	142	70	117	53
Granting tax exemptions	105	44	79	40	127	49	25	12	74	33
Granting tax holidays.	106	45	88	45	125	48	106	53	84	38
Strengthen the services of tax authorities towards SMEs.	119	50	21	11	121	47	73	36	67	30

4.1.6 The Impact of Value-Added-Tax (VAT)

VAT Compliance

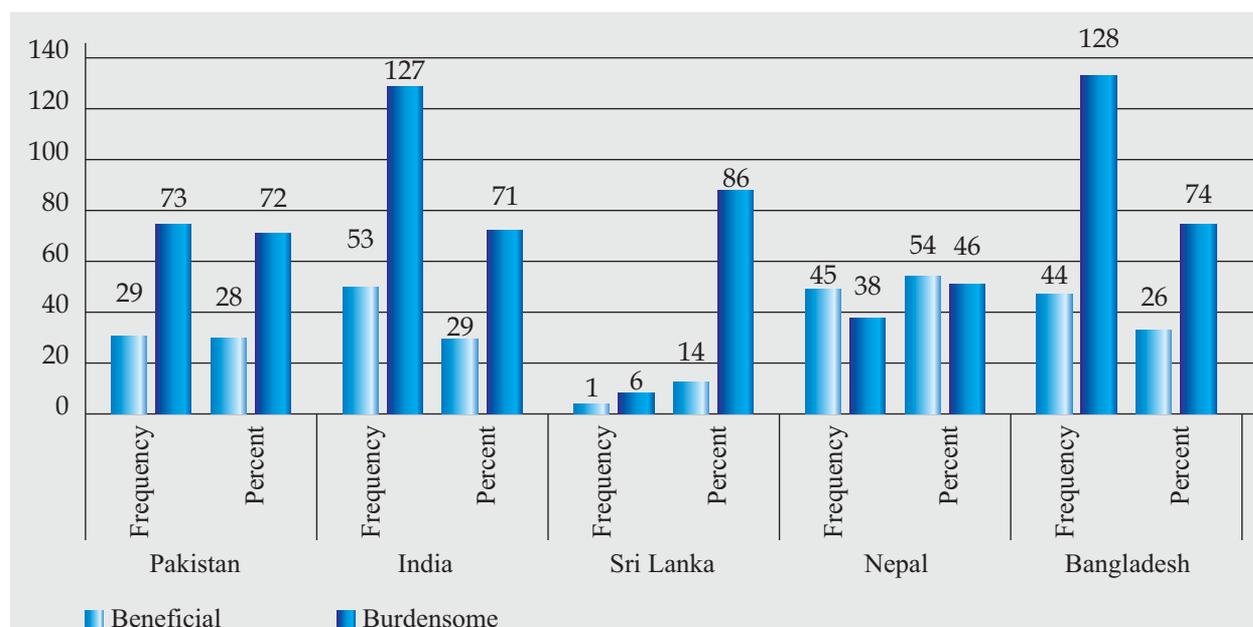
Survey results (See Figure 4.12) show that maximum VAT compliance exists in India i.e. 90% of sample SMEs are paying VAT there. Whereas, more than 50% of sample SMEs in Bangladesh and Pakistan are complying with VAT and this figure stands at 48% in Nepal. However, on the other side of the spectrum, only 5% SMEs in Sri Lanka are complying to VAT. This can be due the fact that VAT exemption threshold with regard to annual turnover is quite high in Sri Lanka.

Figure 4.12: Compliant to VAT

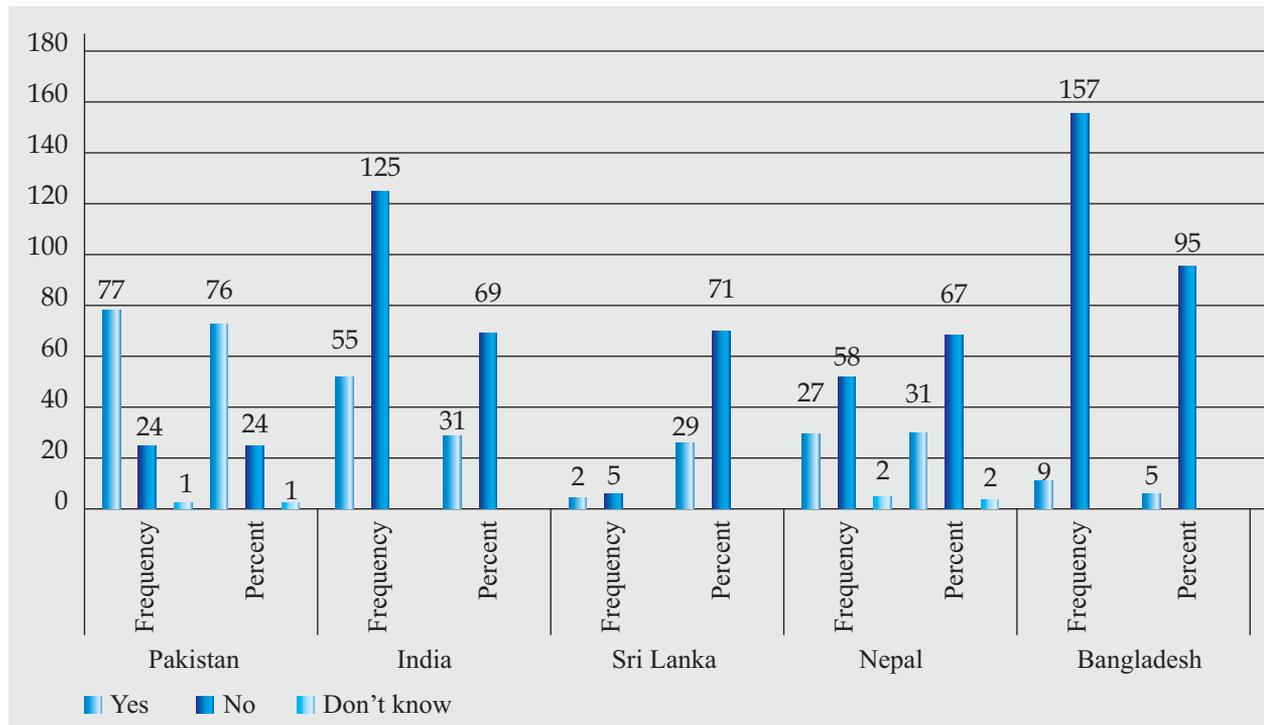
VAT Policy Experiences and Perceptions

The findings represent that majority of respondents across the targeted countries perceive VAT compliance is burdensome on their businesses. At the same time it is important to note here that some sample SMEs in each country avoided answering the questions under this section especially in Nepal, India and Bangladesh. The following results are based on the information provided:

In Sri Lanka 6 SMEs out of total 7 think that complying with VAT is cumbersome and negatively affects their business development (See Figure 4.13). Similarly, 72% respondents in Pakistan, 71% in India (127 out of 180 respondents) and 74% (128 out of 172 respondents) in Bangladesh perceive that VAT compliance inhibits their business development. But in Nepal, 54% respondents (45 out of 83 respondents) think that VAT compliance is beneficial to their business development which again is not significant as most of SMEs there chose to avoid these questions. This lack of information provision by sample SMEs again signifies the importance of Key Informant Interviews (KIIs) and other qualitative research tools such as FGDs and Case Studies.

Figure 4.13: VAT Compliance is Beneficial or Burdensome for your Business Development

The experiences as well as perceptions of sample SMEs across the region except Pakistan represent that obtaining VAT refunds is not quite difficult. The perception of SMEs in Pakistan does reflect towards the less matured and partially implemented VAT regime which causes difficulties in obtaining VAT refunds and this also relates to the findings of literature review. However, the responses in Sri Lanka are also ambiguous and are mere perceptions, where 29% of sample SMEs perceive obtaining VAT refunds is not difficult, as most of the sample SMEs (95%) are not VAT compliant (See Figure 4.14). Further investigation into VAT refunds was conducted during KIIs and FGDs which are discussed in detail after this section.

Figure 4.14: Difficulties in Obtaining VAT Refunds

Further, survey results show that lack of awareness, tax payer perception about no benefit of compliance and procedural complexity of VAT are the major reasons behind firms being non VAT compliant (See Table 4.14).

Table 4.14: Major Reasons behind SMEs / MSMEs not being VAT compliant

	Pakistan		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Lack of Awareness	105	48	21	23	93	55	78	45
No Benefits	138	63	129	132	77	46	51	30
Procedural Complexity	88	40	20	20	91	54	130	75
Problematic Behavior of VAT Administration	42	19	11	11	24	14	12	7
Possibility of Future Harassment	65	30	14	14	52	31	33	19
Others	1	0	1	1	1	1	10	6

VAT Administration Perception and Experiences

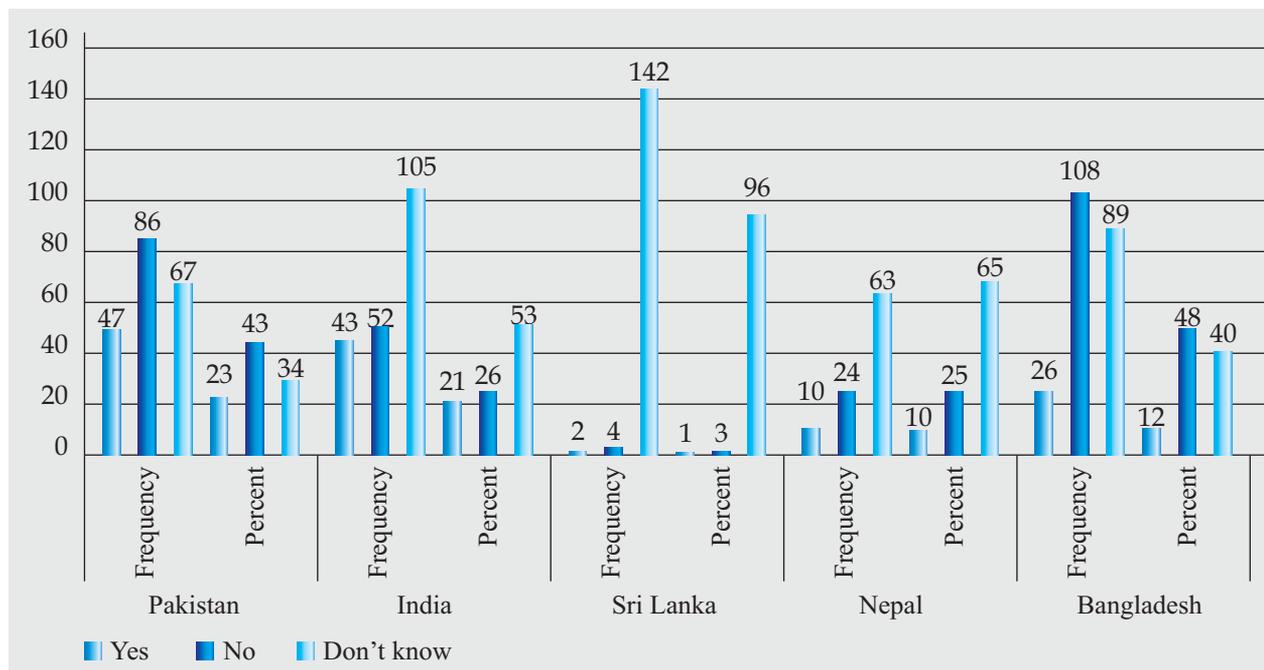
The sample SMEs in India, Sri Lanka and Bangladesh are indifferent in their perception about the performance of VAT officials. However, the majority of respondents in Nepal and Pakistan perceive that the performance of VAT officials is low. When asked about the friendliness of VAT regulations towards SMEs/MSMEs, most of the respondents except Bangladesh and Sri Lanka (where they were indifferent in their perception) rated it as low. The survey data (See Table 4.15) also shows that VAT officials, apart from annual visit at the firm's premises, do perform monthly, quarterly visits which are also a reason behind increased compliance costs in terms of hiring tax specialists to brief the VAT administration during their visit.

Table 4.15: SMEs' Perception and Experiences towards VAT Administration and Regulations

Perception towards performance of VAT officials is:											
	Pakistan		India		Sri Lanka		Nepal		Bangladesh		
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	
Very Low	39	20	5	3	1	1	8	8	5	2	
Low	110	55	49	25	4	3	51	53	33	15	
Indifferent	24	12	85	43	125	95	29	30	108	48	
High	27	13	55	28	1	1	9	9	68	31	
Very High	0	0	2	1	0	0	0	0	9	4	
Perception towards the Friendliness of VAT Regulations towards SME/MSME Development:											
Very Low	67	34	7	4	1	1	5	5	20	9	
Low	91	46	66	34	3	2	50	52	72	32	
Indifferent	26	12	86	44	128	96	34	35	77	35	
High	16	8	36	18	1	1	8	8	50	22	
Very High	0	0	1	1	0	0	0	0	4	2	
Frequency of Visits the Tax officials perform:											
Monthly	12	6	10	5.1	1	1	3	3	5	2	
Quarterly	82	41	24	12.2	1	1	7	7	48	22	
Biannually	26	13	19	9.6	2	1	24	25	57	26	
Annually	80	40	69	35	3	2	63	65	79	35	
Never	0	0	75	38.1	142	95	0	0	34	15	

As per Figure 4.15, the respondents across the region perceive that VAT regulatory authorities are not less administrative friendly to women entrepreneurs as compared to their male counterparts. However, further investigation was done using case study method whose results are discussed in detail in the coming paragraphs (see more on Section 4.3).

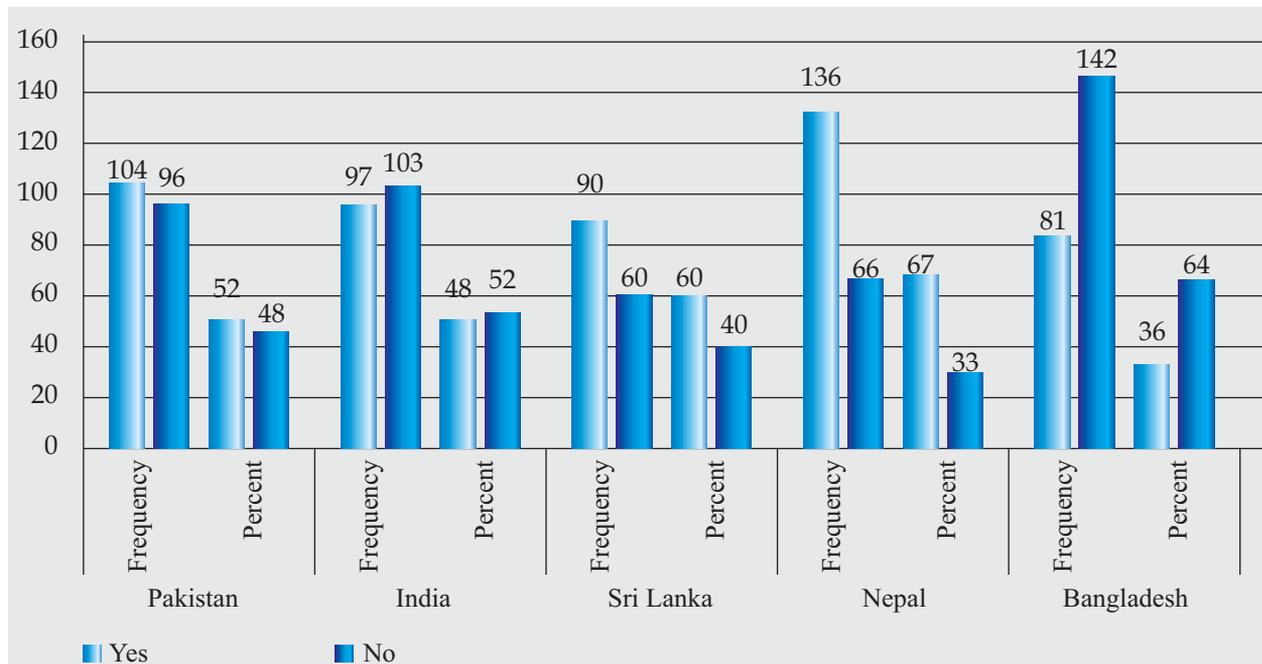
Figure 4.15: VAT Regulatory Authorities are less Administrative Friendly while dealing with Women Entrepreneurs



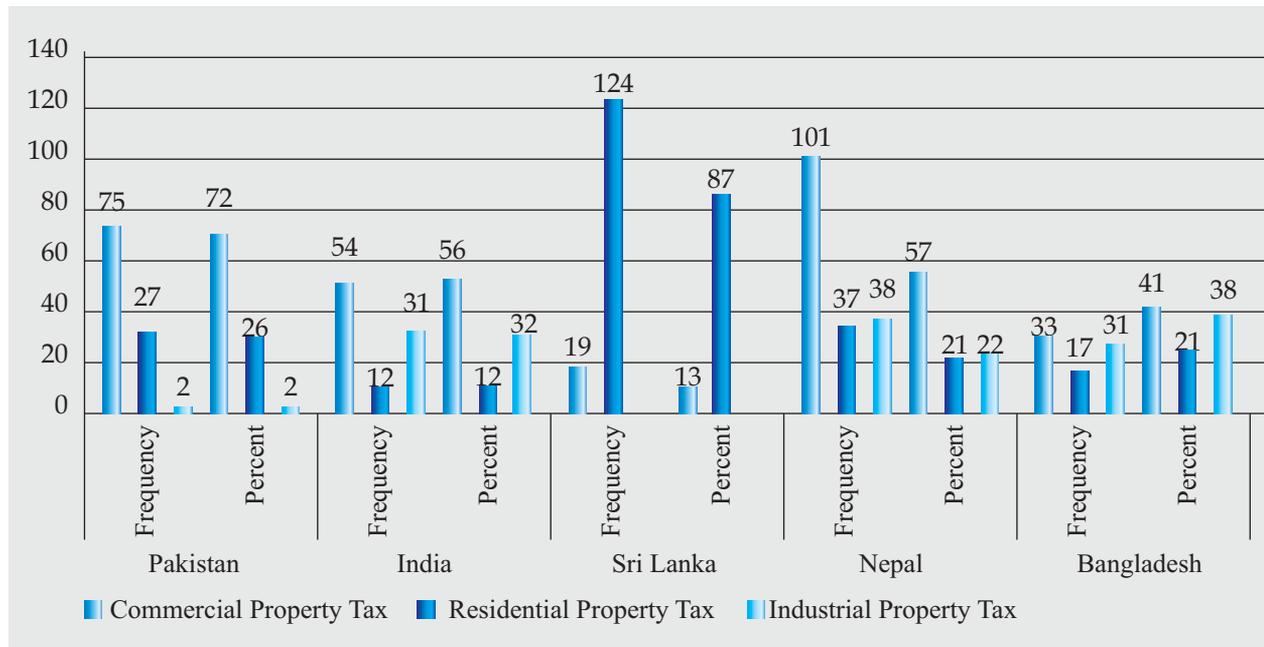
4.1.7 The Impact of Property Tax on Enterprise Development

Property Tax Compliance

Figure 4.16: Property Tax Compliance



Tax is levied on ownership of property in South Asia, but its non-payment is rampant among SMEs. With 67% enterprises paying property tax, SMEs in Nepal show highest compliance in the region. On the opposite end of the spectrum, only 36% SMEs in Bangladesh file property tax returns. Between the two extremes, property tax payments by enterprises are in 60% in Sri Lanka, 52% in Pakistan, and 48% in India (See Figure 4.16).

Figure 4.17: Type of Property Tax Paid

SMEs that pay their property tax can do so under one of the three property types, namely commercial, residential, and industrial. As per Figure 4.17, the largest proportion of this tax being paid as commercial property tax is in Pakistan with an overwhelming 72%. Of the remaining, 26% enterprises in Pakistan file returns as residential property, and 2% do so as industrial property.

SMEs in Nepal follows by paying 57% of their property tax under the commercial bracket, with 22% doing so in industrial, and the remaining 21% in residential. Of the SMEs in India, 56% pay property tax in the commercial bracket, 32% in industrial, and only 12% in residential.

In Sri Lanka, only 13% SMEs pay commercial property tax, while an incomparable 87% percent pay residential property tax. No SME surveyed in Sri Lanka was found paying industrial property tax. 41% of Bangladesh's SMEs pay commercial property tax, 21% pays residential property tax, and the highest percentage of 38% SMEs pay industrial property tax.

The results highlight that most of the taxpaying sample SMEs in Pakistan, India and Nepal are doing business on the commercial property whereas sample SMEs in Sri Lanka are doing business in residential areas. However, in Bangladesh almost equal numbers of SMEs are operating on both commercial and industrial areas.

Property Tax Administration Capacity

The perception of enterprises regarding the degree of property tax collection enforcement by tax administrations varies across the region from poor to strong. In Nepal, 29% respondents feel that the enforcement is somewhat strong, but with 47% Nepalese respondents feeling it to be poor, and another 24% considering it to be very poor, property tax enforcement in Nepal appears to be weak (See Table 4.16).

Table 4.16: Degree of Enforcement in Collection of Property Tax

	Pakistan		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Very poor	15	14	6	4	31	24	3	1
Poor	21	20	17	11	61	47	51	23
Somewhat strong	15	14	94	64	37	29	63	29
Strong	41	40	11	7	0	0	83	38
Very strong	12	12	20	14	0	0	20	9

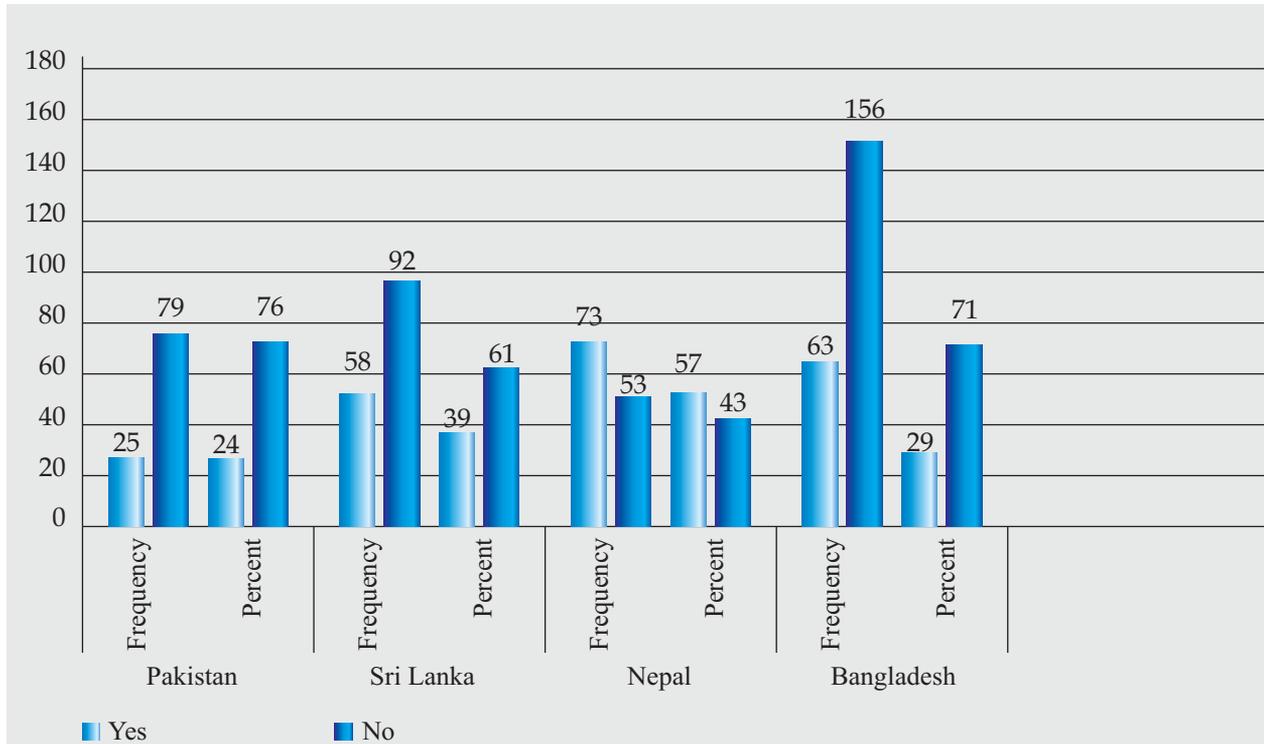
In Sri Lanka's case, an overwhelming 64% of the responses perceive that the enforcement is somewhat strong. Among the rest, the respondents who perceive it to be on the stronger side constitute a significantly larger percentage than those who perceive otherwise, which gives property tax enforcement in Sri Lanka a strong outlook.

With 38% respondents claiming it to be strong, and another 9% saying it is very strong, almost half of the Bangladeshi respondents give a strong perception of property tax enforcement in their country. Of the remaining, 1% thinks it is very poor, 23% poor, and a higher 29% believe it to be somewhat strong.

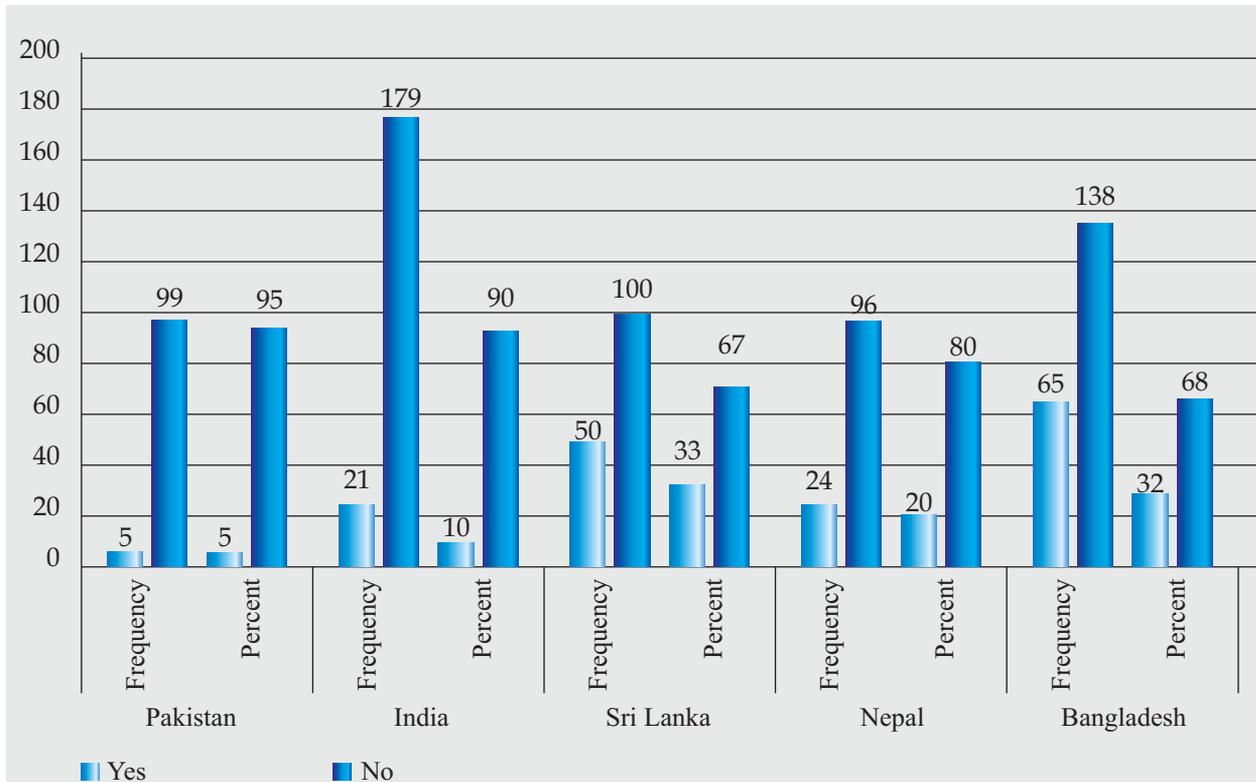
Pakistan appears to be the strongest of property tax enforcers in the perception of respondents as 40% of them think the enforcement to be strong, while 12% feel it's very strong. The opinions are spread across the spectrum with 14% and 20% believing it to be very poor and poor respectively. The remaining 14% of the respondents assigned a mid-tier mark of somewhat strong enforcement.

Property Tax Impact

Figure 4.18 : Role of Property Tax in selecting Location for Business



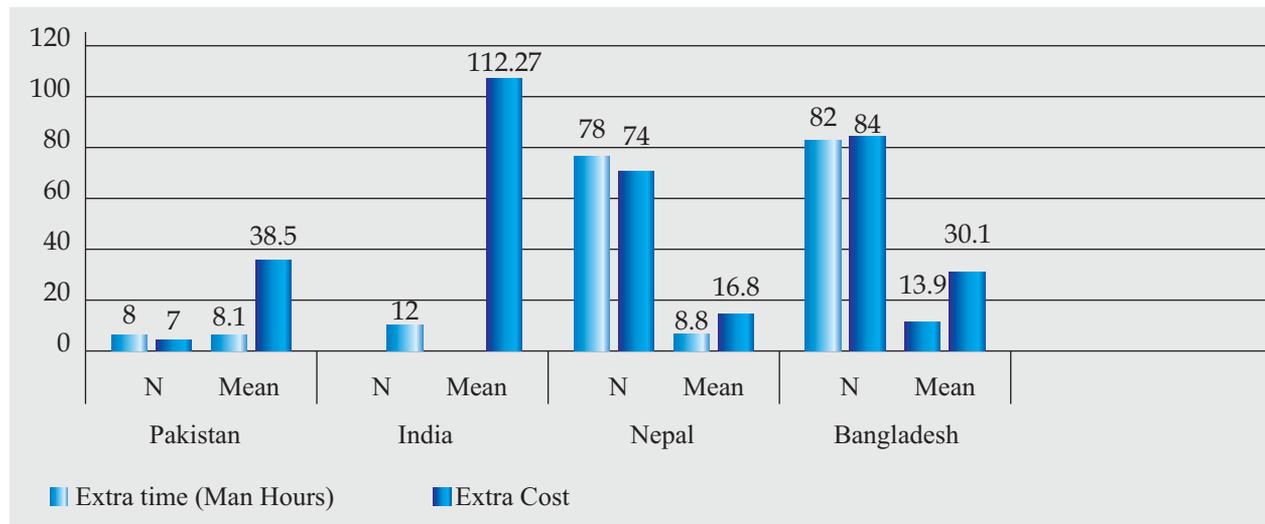
Property tax is often believed to influence the entrepreneurs in deciding over the location of setting up their businesses. As per Figure 4.18, this phenomenon works to a larger extent in Nepal only where property tax impacted the location of 57% enterprises. In other countries, the impact was much smaller, with location of 39% in Sri Lanka, 29% in Bangladesh, and only 24% enterprises in Pakistan are being influenced by property tax.

Figure 4.19: Type of Property Affect Decision to Develop/Expand Business

The type of property that the enterprises operate in affects the expansion decisions of only a small proportion. The highest percentage of those impacted is 33% of those in Sri Lanka, followed closely by 32% in Bangladesh. The proportion falls to 20% for Nepal, followed by 10% in India. SMEs in Pakistan are the least influenced with only 5% being affected in their decision to expand by the type of property they operate in (See Figure 4.19).

Property Tax Compliance Costs

Figure 4.20: Extra Time, Effort and Cost for Payment of Property Tax



Filing property tax returns in South Asia often becomes costly both in terms of time consumed and money spent due to procedural complexities and administrative malpractice. In this regard, data could not be collected from respondents in India and Sri Lanka as property tax there is not a pressing concern for entrepreneurs. Responses from Pakistan are also very low due to lack of book keeping in enterprises. The 8 entrepreneurs who responded on time consumed suggest that on average, 8.1 man hours are spent on paying property tax, while the 7 who responded on its financial cost suggest an average \$ 39 are incurred in doing so. With significantly larger number of respondents, Nepal stands at 8.8 man hours and \$ 17 spent on filing return on average. In Bangladesh, the largest number of respondents suggested that 13.9 man hours and \$ 31 are spent on filing property tax return on average.

Property Tax Administration Experiences

Enterprises in South Asia face numerous problems in relation to property tax (See Table 4.17) Only 31% of the Indian responded that they faced no problem for non-payment or payment at a little amount. Not facing problems for non-payment was common in Pakistan with 48%, Nepal with 34% and Bangladesh with 51% and Sri Lanka with the highest 83%.

The absence of self-assessment emerged as a major concern affecting a highest 43% of entrepreneurs in Sri Lanka, 26% in India, 19% in Nepal, and the lowest 18% and 12% in both Pakistan and Bangladesh respectively. Discretionary valuation of property troubled a highest 46% in Nepal, 44% in Pakistan, 20% in Bangladesh, 18% in India, and a lowest 17% in Sri Lanka.

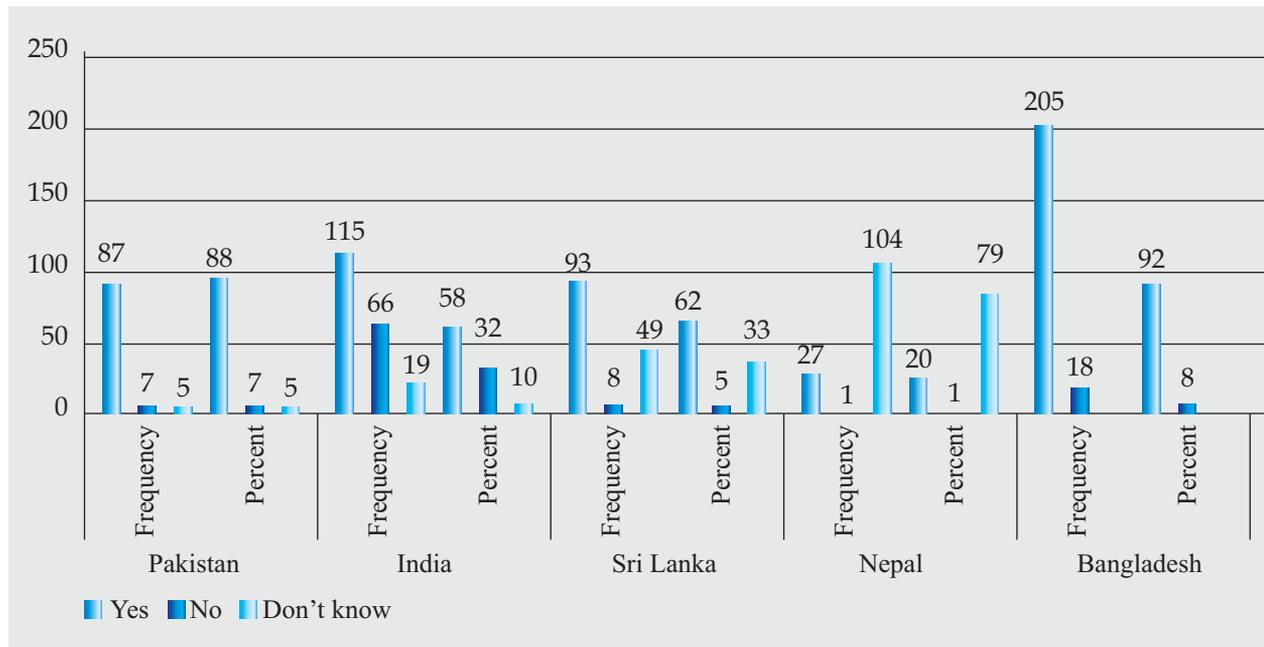
Table 4.17: Major Problems faced by SMEs during Property Tax Compliance

	Pakistan		India		Sri Lanka		Nepal		Bangladesh	
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
No problem non-payment or payment at a little amount	49	48	55	55	125	83	42	34	98	51
Absence of self-assessment scheme	18	18	26	26	64	43	23	19	23	12
Discretionary valuation of property by taxmen	45	44	18	18	25	17	57	46	39	20
Frequent asking for increased volume of tax	22	21	30	30	12	8	38	31	71	37
Frequent asking for submission of various documents	24	23	31	31	8	5	47	38	31	16
Frequent visits of tax officials causing business disturbance	27	26	15	15	2	1	20	16	3	2
Absence of dedicated revenue officer for collection of property tax	20	20	2	2	1	1	11	9	10	5

Frequent asking for increased volumes of tax was faced by 37% SMEs in Bangladesh, 31% in Nepal, 30% in India, 21% in Pakistan, and a lowest of 8% in Sri Lanka. Frequent asking for submission of various documents was experienced by a highest 38% of respondents in Nepal, 31% in India, 23% in Pakistan, 16% in Bangladesh, and a lowest 5% in Sri Lanka.

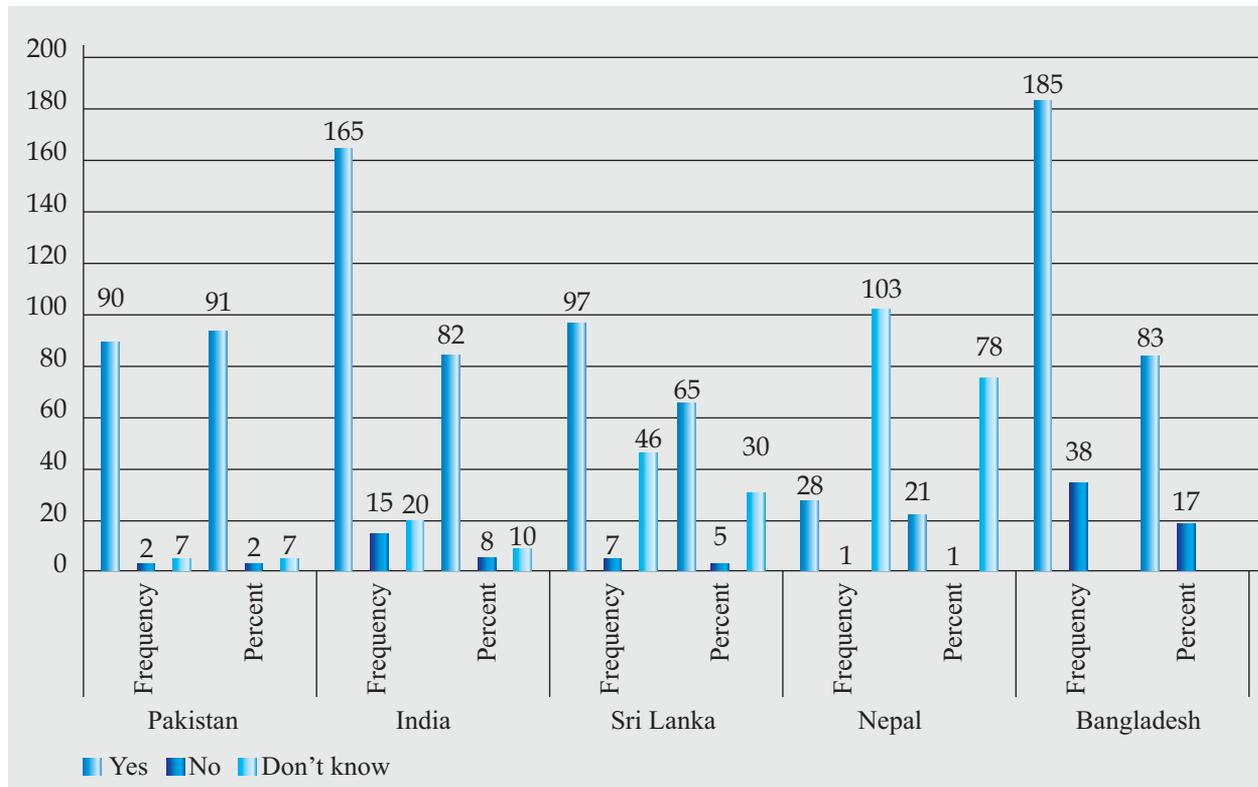
4.1.7 Land Acquisition and Transaction Costs

When asked about the complexity of land acquisition procedure, an overwhelming majority in all countries except Nepal suggested the procedure was complex. In Bangladesh and Pakistan, 92% and 88% respondents in each country felt the procedure was complex, and almost 8% in each said otherwise. In India, 58% said yes, 10% no, and a large chunk of 32% respondents weren't sure if the procedure was complex. In Sri Lanka, 62% affirmed the complexity of procedure, 33% denied, and 5% did not know. An outlier in the trend, Nepal had only 20% people believing in procedural complexity of acquiring land, 1 respondent did not know about it. While a sizable 79% felt the procedure was simple (See Figure 4.21)

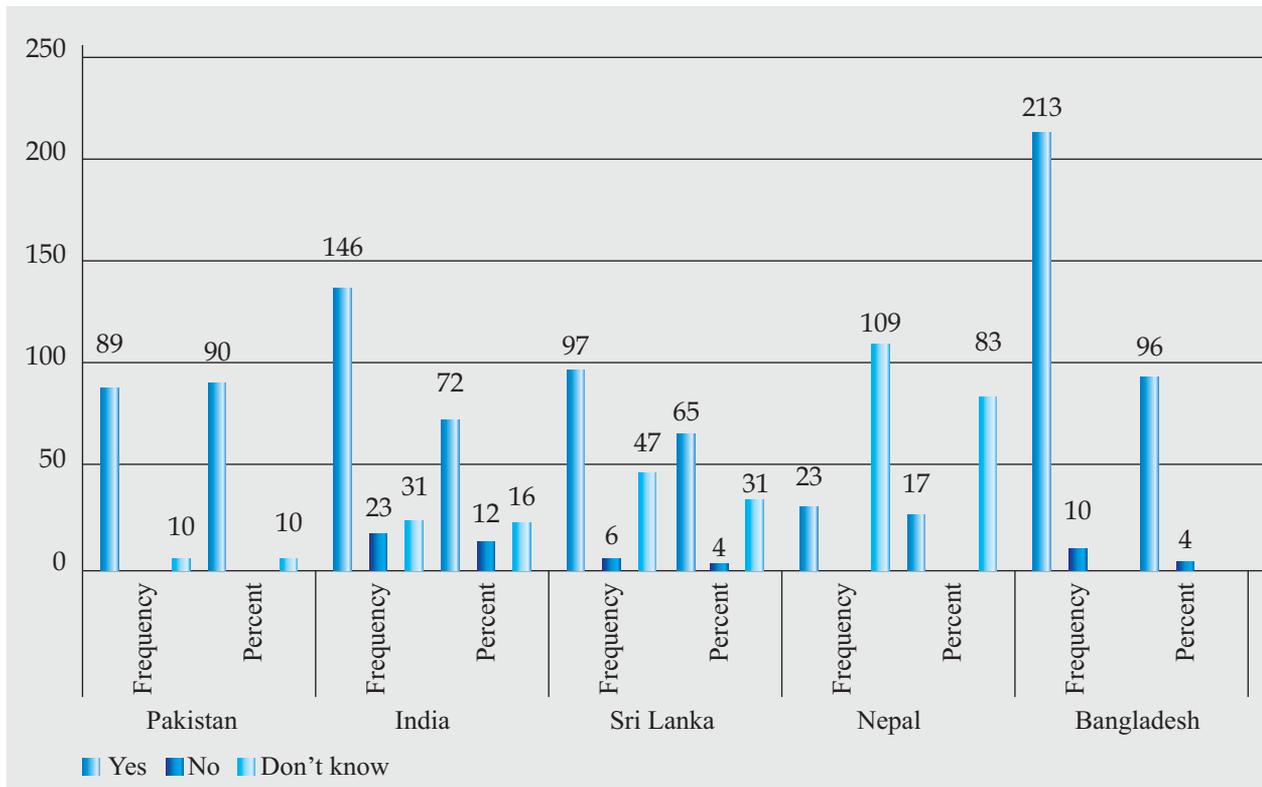
Figure 4.21: The Procedure of Land Acquisition is Complex

As per figure 4.22, costs involved in acquiring land for business have immense impact on their growth. Responding to the question of cost involved in acquisition of land, majority of SMEs in all countries, except Nepal, the costs were reported to be high. The largest proportion of respondents deeming it costly was from Pakistan with a significant majority of 91%. 2% of the respondents felt land acquisition was not costly, while 7% did not know. SMEs in India showed a similar concern with 82% respondents believing land acquisition to be costly, 8% thinking otherwise, and 10% being unsure. It was also considered costly by 83% of respondents in Bangladesh, where only 17% thought otherwise. Sri Lanka showed milder results, where 65% SMEs found land acquisition costly, 5% felt it was not, while 30% did not know. Results flip over in Nepal where only 21% of the respondents thought land acquisition was costly, 1% considered land acquisition not to be costly, and 78% respondents were unsure.

Figure 4.22: Land Acquisition involve High Cost



A majority of respondents in Pakistan, India and Bangladesh perceived there was corruption in land acquisition process however in Nepal 83 % of the respondents had no idea in this matter as can be seen from Figure 4.23. In Sri Lanka, 65% respondents perceived that there is some kind of corruption in land acquisition process.

Figure 4.23: Corruption in Land Acquisition Process

4.2 Meta-analysis of Key Informant Interviews

4.2.1 Access to Credit

Credit is the main hurdle faced by SMEs in their initial establishment and later expansion. Lending to these firms is largely hindered by their lack of collateral and missing documentation, both of which daunt their credit worthiness. All countries under study consider SMEs a priority lending sector, yet firms claim that credit remains a difficult issue.

The requirements to borrow through a formal credit line vary across the region. In Sri Lanka, for mobilizing finances from donor supported micro-finance facilities, government, or the formalized credit industry, most often the presentation of taxpayer identification numbers and a business registration certificate is required. Credit availability through financial institutions in Pakistan and Nepal is largely collateral or business cash-flow based, which cannot accommodate entrepreneurs initiating their

enterprise without collateral. In Bangladesh, the registration with local government (availing a trade license) would make an enterprise eligible for formal loan. SMEs in India by policy have access to collateral free loans but interactions with firms and credit institutions suggest that this does not work very smoothly – the banks seek upfront payment of credit guarantee fee which the firms feel adds to the cost.

With these stringent criteria in place, formal credit line is not available to enterprises that are not registered, or have entrepreneurs that lack collateral. In these circumstances, the enterprises have to resort on borrowing informally where interest rates are exponentially higher. Having larger payments to make in order to service their debt, entrepreneurs usually remain cash-strapped after borrowing from informal sources, which keeps them from reinvesting and stunts the growth of their enterprise.

A recent development in servicing new SMEs in Sri Lanka is community/cluster based lending, where banks through various industry/regional associations offer credit to SME members. By replacing tangible collateral with social collateral, cluster based lending depends on the guarantee of other members of the clusters for the servicing of loans. In this approach, greater credence is given to project feasibility in terms of market potential, technical feasibility, profitability etc, and applicants' management and technical skills.

Another effort to address the lack of credit to MSMEs is made by the Indian government. Countering the problem of collateral, and at the same time protecting the balance sheets of the lending institutions, the government has introduced a credit guarantee scheme where in the event of a default on MSME loan, the bank can recover its dues from the central government. Under this scheme, the firm has to pay credit guarantee premium of about 1.5% of the quantum of loan. This credit guarantee needs to be cut down as given the high interest rates faced by the MSME units, addition of the premium of credit guarantee increases the cost of borrowing even further. In Bangladesh also, there is a dedicated programme by the Bangladesh Bank for SME credit which is opening a new department called the "SME and Special Programmes Department" which sets an indicative target for loan disbursement for small medium and women enterprises with least formalities and an "Area Based Approach". There is also a "women Entrepreneurs Dedicated Desk" and priority will be specially given to small and women enterprises.

4.2.2 The Impact of Tax Exemptions and Concessions

Scale Bias

A major concern found across the region is the bias against SMEs in accessing the tax benefits instituted under tax policies. In Bangladesh, availing tax benefits requires the

entrepreneurs to show record of their turn over estimates and VAT copies for previous several years which are very difficult for the small entrepreneurs to maintain, while large enterprises can easily manage that. So a newly set up firm is unable to apply for any exemption unless its production starts. Similarly, in Pakistan and Nepal, the granting of exemptions and concessions reveals an anti-small enterprise bias and a visible orientation towards big businesses, which aggravates further the competitive disadvantage of small enterprises. Despite their existence in Sri Lanka, tax concession favor large enterprises over SMEs as the minimum investment size of SLR 50million to qualify for fiscal incentive package is well beyond the reach of SMEs.

This bias can be understood by Sri Lanka's example where the lobbying power of the large players as well as the collective bargaining power of particular industry groups can influence taxation policies. In such an unlevelled playfield, which is shared by all countries under study, small entrepreneurs may refrain from investing in a business as they have to face the hassles of tax payment and undergo the expenditure on tax related issues at the initial phase of establishing firms.

Administrative Conduct

The conduct of tax administration in dealing with taxpayers and their issues is an eminent concern in the South Asian region. In Pakistan, the government is not trusted with tax payers' money, and the tax departments and their officials are believed to be corrupt. The disconcertment extends to a point where even if tax officials approach SMEs for providing incentives, they are assumed to be trapping the entrepreneur. Small entrepreneurs in India also face the problem of harassment at the hands of tax collectors. Allegations of tax administration being corrupt are also rampant in Sri Lanka where bribery is a common practice, while harassment by tax officials instigates entrepreneurs to stay out of the tax net in Bangladesh as well. In Nepal, there have been cases where registered and honest tax payers have been penalized for no appropriate reasons, which in turn have created an environment for deception. Such administrative malpractices drive down enterprises' willingness to formalize and forces them operate under the radar, losing access to the tax benefits provided by the state and hampering their enterprise growth in doing so.

An essential part of administrative conduct, the response of tax officials to dispute arising in taxation processes has its impact on small firms' decision to become tax compliant. Tax related litigation in South Asia currently goes through the civil courts system. As it currently stands, the courts system is heavily overburdened and litigation drags on for years. Sri Lankan government in 2012 through the Tax Appeals Commission Act No.23 of 201, established an Appeals Commission empowered to hear all appeals in respect of matters relating to imposition of any tax, levy or duty by the Commissioner General of

Inland Revenue, prior to going into litigation. It was a commendable step except that the present committee panel members are not very well conversant with tax laws leading to misinterpretation and may not serve the purpose of the commission effectively. Furthermore for a dispute to be validated a 25% of the tax assessment in question needs to be deposited with the IRD. This precondition especially from the view point of SMEs is unrealistic. Most often already cash strapped SMEs may not be in a position to make the deposit to validate the dispute. However, if made more SME-friendly, this system can be become a model to be replicated in other South Asian countries.

Compliance Cost

A shared discomfort throughout South Asia is that of high costs of complying with the tax system. The costs can largely be considered in two categories – finances spent and time consumed. In India, the firms have to deal with multiple tax agencies and lot of document is required. Despite taxes like CENVAT having facility of online payment and e-filing of returns, hard copies of returns are required to be submitted to the department, which consumes time and money. Similarly, the deficient tax structure in Bangladesh is putting the taxpaying entrepreneurs in the discomfort of having to deal with an array of taxes and long submission procedures which make the process complex. Faced with such situation in Sri Lanka as well, SMEs most often have to rely on the services of tax consultants to file returns, leading to additional costs. Pakistan and Nepal also require numerous documentations to comply with the provisions of tax waiver and concession, which might cost higher than the concessions being availed.

Another compliance cost faced by SMEs in India arises from the provision for audit of the accounts of the firm. Firms feel that auditing is not an effective mechanism for catching evasion, but can only verify clerical mistakes. However, audit requires considerable time and involvement by the employees of the firm thereby imposing additional cost on the firm. Given the existence of such complex systems across the region, cash strapped SMEs in South Asia opt to stay informal rather than going through the hassle of compliance.

The tax officials of the central government are of the opinion that compliance cost has come down drastically. Though still, in view of redressing issues relating to compliance, the tax system needs to be completely overhauled. The number of taxes and levies should be reduced in order to make it more comprehensible to laymen especially SMEs and the system of compliance be simplified and automated. In this way enterprises should only need to interact with one department for registration, filing of returns and payments, saving them both time and money.

Exemption Threshold and Growth Stagnation

Since SMEs receive tax exemptions and concessions on the condition of being under a threshold of annual turnover or total capital investment, their instinct to grow is killed. A case in point is that of the MSMEs in India which receive exemption up to the turnover of INR 15million. To keep availing tax benefits, these units do not expanded their capacity beyond the stipulated level of MSME definition. Instead of expanding their capacity and reaping the benefit of economies of scale they set up new units to keep on taking the tax exemptions. This stunting of growth is a serious hindrance to enterprise development in South Asia, and was answered by a policy change in India in which firms which were getting the benefit of MSME sector would continue to get those benefits for three more years even after increasing their capacity. The benefits included under this policy are non-tax benefits like credit guarantee schemes, credit linked capital subsidy scheme for technological up gradation etc. Other countries should also formulate targeted policies to revive the growth instinct of SMEs.

4.2.3 Impact of Value-Added Tax

Procedural Constraints

The SMEs that choose to formalize, and fall under the purview of VAT laws face various procedural constraints that make their dealings difficult and discourage them and other firms from complying. These include the administrative misconduct of tax officials by means of harassment and rent-seeking as has already been mentioned in the case of availing tax exemptions and concessions. Costs in terms of complex paperwork, lengthy filing procedures, and audit requirements lay constraints to VAT compliance as well. In Sri Lanka, VAT exists as a duplicate indirect tax to the Nation Building Tax. SMEs find it absurd to pay two indirect taxes when they could be incorporated into one. Also, the system entails filling a number of different forms with a number of different departments, leading to duplication of work. In Nepal, improper maintenance of records by SMEs and multiple, non-transparent VAT assessment criteria used by tax department lead to constraints in the smooth functioning of filing procedures.

In addition to these, complexity of VAT laws and filing procedures is a major concern for SMEs across the region. The complexity associated with the SVAT system which was introduced in Sri Lanka under the pretext of assisting SMEs, has itself become a hassle. In India, sales within the same state are subject to a sub-national VAT, while sales across state borders can either be subject to a concessional tax under the central sales tax regime or to the standard VAT in the exporting state. Since the rates of central sales tax are lower, firms would like to pay central sales tax rather than state VAT. But their decision is impeded by

the requirement of a C-form that the seller has to take a C-form from the buyer, and submit with his tax returns, as evidence of inter-state sales. The form is to be availed from tax department of the importing state, in which firms face difficulties. In case of non-submission, firm faces penalty in addition to the regular tax. So the filing procedure is not only tricky and cumbersome, it may also lead the firms to face the brunt of administrative weaknesses of tax departments.

In Bangladesh, the procedure is eased down for SMEs through the introduction of Package VAT which does not require any formal ledger accounting.

Sector Bias

In some countries of the South Asian region, a prominent bias exists in the favor of large enterprise and the service sector in the sense that no concessionary laws exist for the SME. In Nepal, industries whose annual transactions exceed Rs. 2 million Nepalese rupees, irrespective of whether they are large or medium or small, must be registered with VAT. The manufacturing sector in India faces a distortion in the design of VAT. While VAT registration is mandatory for the manufacturing sector if the firm's turnover is over INR 0.1million, which would cover most of the MSMEs, for traders it is not mandatory until their turnover exceeds INR 2.5 million. Due the imbalance created by a 25 times stricter turnover policy for manufacturers, they would be reflected in greater detail in the tax department's database, and hence are likely to be subject to more intense scrutiny and even more regular audit than traders, which displays Indian state's discrimination against the manufacturing sector MSMEs.

In Bangladesh, however, two special provisions are in place for the small entrepreneurs. Firstly, the cottage industries are fully exempted from VAT. Secondly, turnover tax gives preferential provision to the small enterprises by allowing a lower rate of 3% to firms with annual turnover below Tk.8million. In Pakistan, GST on SMEs is sector-blind, but there exists a need to make specific tax laws for each sector due to the heterogeneous nature of the industry.

VAT Refund

A major consideration for SMEs that formalize is the ease of getting VAT refunds. In Pakistan, most of the firms do not receive it, which lets the tax departments generate a revenue larger than they should. The refund from the central government in India is done timely, but in some Indian states, the state VAT department does the refund after matching the invoices of the raw material purchased and the invoices of the sellers, which takes a lot of time. The hindrance to VAT refund in Sri Lanka is induced by rent-seeking of tax

officials when firms make claims.

In Bangladesh, VAT refund is not possible unless the whole value chain is VAT compliant. Without taking input from a 'registered' supplier, one cannot claim VAT refund benefit against its input VAT, which exposes SMEs to a harsh form of double taxation.

In Nepal, the VAT refund policy is stricter than that in any of the South Asian countries. Refund can only be claimed by enterprises who export 40% of their products each month. Being a landlocked country, with the saturated Indian economy its only export market, Nepal provides little room for its SMEs to sell their goods internationally. In such a situation, being able to export almost a half of their products every month is not possible for most of the rurally-located small firms. This unattainable refund eligibility criterion is a strong factor keeping SMEs in Nepal from formalizing and complying with the VAT laws.

VAT Reforms

Across South Asia, though more in some countries than others, there is a need for VAT reforms to make them more favorable towards the SMEs to ensure their formalization and development. Bangladesh, in this regard, has taken commendable steps. The VAT Act 1991 is going to be replaced by the new VAT Act 2012. In the formulation of the new law, which is to be implemented in 2015, conscious efforts are being made to minimise the procedural constraints which keep firms from compliance. NBR officials said that the new law will ensure justice to the SMEs. Their word gains credibility from the softening of thresholds of turnover tax over the years; starting from SMEs being taxable on a turnover of or beyond Tk. 2million per annum, to it being gradually raised up to Tk. 8million by 2013.

Sri Lanka has also introduced reforms in making VAT more SME-friendly. The scheme introduced a Simplified Value Added Tax with the aim of eliminating the hassle of enterprises to go through the process of obtaining VAT refund on intermediary inputs. Under this scheme, where trade takes place between two VAT registered companies SVAT voucher is exchanged in place of paying money. This keeps the SMEs from facing capital shortages which adversely affected their day-to-day activities.

A procedural reform introduced in India has automated the CENVAT, allowing central VAT to be paid online, freeing firms of time and money wasted in making payments in person. Similarly, by introducing the Package VAT, Bangladesh has eased down the requirement of having a formal ledger accounting which not only reduces paperwork and audit costs for SMEs but also makes formalisation possible for firms run by less-educated entrepreneurs.

These reforms have eased the path of SMEs to formalization, and serve as examples to be replicated in all the South Asian countries. Other measures that may be considered to reach an ideal VAT program with regard to SMEs must ensure progressivity of tax and simplifying of procedures.

4.2.4 Impact of Property Tax on Enterprise Development

Land Prices

The property tax levied on these businesses varies immensely according to the value of land, and its placement in commercial or residential area. Since commercial property itself is more expensive than residential property, and tax levied on the former is much higher, cost of operating in commercial areas rises exponentially. Since initial taxation on transfer of land deed is collected as a proportion of land value, firms in Nepal purposively devalue their properties to pay less registration fee. The phenomenon reverses in Bangladesh. Since property tax very low, firms often overstate their land value as it enhances their collateral for getting credit. In Sri Lanka, where commercial properties are taxed at an enormous 35%, as compared to residential properties that are charged at 25% only, the practice to informally base firms in residential areas is rampant. The same issue is often addressed in Pakistan by declaring industrial property as residential property instead of commercial property.

The case in India is entirely different. Land prices in India have gone up so drastically that the impact of property tax on enterprise development has become negligible as compared to that of land acquisition cost. Even if the firms decide to locate themselves away from commercial heartlands, the lack of power and poor road connectivity in hinterland increases the cost of doing business and accessing market. Having little solution for the high prices, and allured by the high nominal interest rates, entrepreneurs find it better to withdraw the money from real estate or from the associated business and convert it into even a simple financial instrument like a fixed deposit. Such a situation can lead enterprise development to a slump by inducing a switch from manufacturing activity to real estate business or even a reliance on passive incomes such as interest incomes.

4.3 Meta Analysis of Case Studies on Women Entrepreneurs

SMEs in the South Asian region face various issues that have disproportionate impact on enterprises run by women entrepreneurs. The case studies conducted on women-run enterprises in the five countries under study highlight the issues of lack of awareness of taxation policies, misconduct by tax official, and limited access to credit, wavering family support, and lack of governmental support. The onslaught of these problems faced by women entrepreneurs vary from country to country, and has been discussed in the sections below. Also, the study provides a brief description of type of business these entrepreneurs operate. Further, the table below presents pseudo names where ever it was applicable as per the desires of entrepreneurs under this study.

Country	Woman Entrepreneur	Type of Business
Bangladesh	Ms. Taslima	Manufactures handicraft items based on jute and bamboo
	Ms. Waheda Akhter	Manufactures processed food items for local market
India	Dr. MadhumitaPuri	Manufactures various items ranging from ladies' bags and purses to pen stands and show pieces, by recycling waste material.
Pakistan	Ms. Shubana	Designing and stitching clothes for buyers in her vicinity.
	Ms. Zil-e-Batool	Manufactures artificial jewelry for local market.
Sri Lanka	Mrs. Sandra Wanduragala	Handloom company which manufactures and exports textiles, textile-based toys, and handicrafts to 18 countries.

4.3.1 Lack of Awareness of Taxation Policies

Women across the region are unaware of the various policies regarding tax returns, the exemptions and benefits involved, and the procedures to be followed. Female entrepreneurs exclaimed that the multiplicity of taxes, and the rules and regulations involved, complicate the procedure of filing returns.

Entrepreneurs in Nepal, did not know about any exemptions or concessions that their SMEs might be eligible for, which exhibits the consistency of lack of awareness among women businesspersons in the region. In Bangladesh, Waheda had to depend on her husband for opening her tax file, and submitting tax returns as she was not sure about the procedures, while Taslima sought legal advice of a hired lawyer. The limited education of these women might be a primary reason behind their hindrance in comprehending tax laws. In India and Sri Lanka, where the interviewed women entrepreneurs were highly educated, issues with understanding the tax policies, and glitches in tax returning procedure were not faced.

This hypothesis, however, would fail in Pakistan's case where both the female entrepreneurs were highly educated, yet they thought taxation was complex. Zil-e-Batool did not formalize due to the inherent fear of procedural complexities. On her encounter with tax officials, she was forced to avail the services of a tax lawyer once every week, which incurs a large, recurrent cost.

4.3.2 Tax Official's Misconduct

A major issue that troubles women entrepreneurs in South Asia disproportionately more than to their male counterparts is the misconduct of tax officials. Most women that were tax compliant complained about the harassment experienced at the hands of male collection officers. This issue takes root in the lack of awareness of women entrepreneurs about taxation procedures, which lets them be exploited.

In Pakistan, women generally do not have knowledge of different kinds of taxes and tax related rules and regulation, and end up paying bribes to the tax officials in order to get rid of the hassle. Harassment and rent-seeking was found to be rampant in Bangladesh as well where Taslima had to pay Tk. 2000 to the tax officer to open her tax file, only to find out later than no there was no record of her payments and was not even assigned a Taxpayer's Identification Number. Waheda in Bangladesh was taken filed a case against by tax official for not paying due amount of VAT even though she had all the VAT receipts as proof.

Situation in India was different where the female entrepreneur, Dr. Puri had never been harassed by any officials, but was instead respected for her gender and cooperated with. Similarly in Sri Lanka, no harassment was reported by Mrs. Wadurangala. This however, is actually due to her lineage from an influential aristocratic family, unlike to the women of humble background that faced harassment in other countries.

4.3.3 Limited Access to Credit

Women entrepreneurs in South Asia face difficulty in securing credit through formal institutions, which hinders the initial setup, and stunts the eventual growth, of their enterprises. Lacking the basic knowledge of banking, women find the procedures involved in acquiring loans to be too complicated. In most instances, fulfillment of fundamental banking prerequisites, such as the maintenance of financial statements, becomes a hurdle.

One female entrepreneur in Pakistan claimed that she applied for loans repeatedly, only to be denied every time, while another did not apply in the first place due to the lengthy and complexity of processes involved, and resorted to borrowing informally from her

relatives. In India, Dr. Puri relied on donations from her network of supporters, but getting regular financial assistance is difficult and leads to an inability to visualize the sustainability of her work. Mrs. Wadurangala, in Sri Lanka, was able to instill trust in banks to lend her due to her position on the lawyer panel of a number of reputed banks, but entrepreneurs without such credibility are not able to get loans. Situation in Bangladesh is supportive of women entrepreneurs where both the enterprises studied could avail loans from public and private banks on grounds of business viability.

4.3.4 Wavering Family Support

Since women are tied into familial roles in the South Asian society, support from their family members is important for the establishment and growth of their enterprises. Throughout the region, women were observed to have received family support before starting their businesses. This support however, only extended till the point where the businesses were not faced with legal constraints; as seen in the case of Ms. Waheda in Bangladesh, where instigated by the biased tax regime her husband suggested that the enterprise should be closed down. In such a situation, it is not possible for women who depend on their husbands for financial kicks, product marketing, and tax return procedures, to continue without family support.

4.3.5 Lack of Government Support

In a male-dominated economy, it is necessary for women to be supported by the state in establishing their businesses and running them efficiently. However, this governmental support is missing in many South Asian countries.

Women entrepreneurs in Pakistan felt they could do better with the support of concerned state departments. Zil-e-Batool attended many meetings and workshops at Chamber of Commerce and other organizations but did not get any technical or financial support in expanding her business. Waheda felt that the Women Chambers in Bangladesh could play a supportive role for the small women entrepreneurs in dealing with tax related issues, and undertaking initiatives in negotiating with the government for adopting and implementing policy measures targeted towards the growth of women-operated SMEs. In Sri Lanka, a duty-rebate scheme which helped Mrs. Wadurangala in expanding her business is no more under implementation. Women entrepreneurs in Nepal, like other countries, have to depend upon middleman to sell their commodities, which causes significant reduction in profit margins, which the government can revamp by buying products from them directly at reasonable prices. In general, there is a pressing need for governments in South Asia to provide technical training to women entrepreneurs, spread awareness of taxation policies and procedures, and intervene to ensure for them a healthy profit to help them grow.

4.4 Meta Analysis of FGDs

4.4.1 Defining SMEs

Definitions of SMEs in South Asia vary not only across countries, but also between the different departments of state and financial institutions, within each country as well. FGD participants in Bangladesh opined that the absence of a common SME definition in all regulations including tax related legal frameworks, industrial policies and credit incentives is a major impediment towards implementation of policies for SME growth and creates confusion. Most of the stakeholders opined that there is a need for a common set of criteria and a single definition for SME. In Sri Lanka, it was recognized that lack of a sound definition of what constitutes an SME has raised issues relating to the efficacy of targeting tax exemptions and concessions at SMEs. However, the need for industry specific definitions, in addition to a broad, national definition of SMEs, was also expressed. Even though it was not emphasized in the FGDs, other countries in the region face similar problem with the coherence and sustainability of SME definitions.

4.4.2 Compliance Cost

With constraints in taxation procedure, and limited tax knowledge, entrepreneurs in South Asia have to bear a recurrent cost in being tax-compliant. Tax administrators in Bangladesh did not put forward any comments on compliance cost, as they think the amount that has to be spent by SMEs is almost negligible as compared to that by large enterprises in this regard. However, the entrepreneurs claim that when scaled to their profit margins, the incidence of this cost is much harsher for SMEs as compared to their larger competitors. In Sri Lanka, most firms do not have competent personnel in house to attend to compliance matters. All participants were in consensus that they have to rely on consultants who charge high amounts. They were hopeful that once the automated Revenue Administration Management Information System (RAMIS) is implemented, it would minimize compliance costs as enterprises would be able file tax returns without money in hiring consultants, and spending time visiting the Inland Revenue Department. Similar systems need to be implemented in other countries to rid entrepreneurs of the high compliance costs that hinder their enterprise development.

4.4.3 Administrative Conduct

Rampant corruption and unfriendliness of tax officials are major problems observed in the South Asian countries, which make entrepreneurial dealings with these personnel difficult. Entrepreneurs and other non-state actors in all countries expressed that this behaviour of tax administration obstructs the operation of SMEs specially. A dichotomy

was expressed to exist in the behaviours of these officials in Sri Lanka, who were either very corrupt, or exceptionally honest; both of which did not prove beneficial for those entrepreneurs who themselves seek benefit from administrative malpractice. It was suggested that decentralising the tax collection system by establishing local collection bodies can reduce the problem for SMEs as they would be able to maintain closer relationship with the tax officials and informally influence them to act more friendly. A similar suggestion of decentralisation was made in Bangladesh as well, but with greater emphasis on compliance cost reduction. In Nepal too, administrative loopholes are exploited through under declaration at customs check posts and under invoicing of transactions to evade excise duties and income taxes, and through counterfeit billing to claim tax refunds. Malignant tax payers are also gaining wrongful benefits by manipulating transactions with ignorant customers.

4.4.4 Creating Tax Awareness

Tax concessions and exemptions in South Asia often fail to create the impact perceived by policy makers due to the lack of tax awareness of small and medium entrepreneurs. Participants in Sri Lanka suggested that the efforts being made by government to create tax awareness needs to be amplified, even though some steps have already been taken. Although programs like ‘Tax Week’ are useful, they do not provide information all year long, nor is setting up ‘one-stop shops’ that are only reachable by a few entrepreneurs. A more effective measure proposed was to provide training and advice in workshops arranged for entrepreneurs through public private partnership between Inland Revenue Department and the relevant industry’s chambers. This can be complemented by setting up tax information centers within the regional offices of business chambers/associations or local councils to provide continuous advice on tax related matters to SMEs at nominal rates. In Nepal, the advice was that tax payers’ education is quite essential to raise awareness among general taxpayers otherwise efforts on government’s end would remain futile.

4.4.5 Implications of VAT for SMEs

VAT has been implemented in South Asian countries with the perspective of higher revenue mobilization and its incidence on SMEs has found varied responses across different stakeholders. In Bangladesh, while the tax officials were of the view that there are a number of benefits within the VAT system, including turnover tax and exemption for cottage industries, the entrepreneurs suggested that these provisions are difficult to avail at the ground level. For example, it is not easy to get the registration as a cottage industry, as the process involved is too bureaucratic. SMEs also cannot avail the VAT facilities due to their operation in the informal market, where across the value chains transactions cannot

always be formally documented, hindering them in availing tax credit and hence being double-taxed. In Sri Lanka, participants from the revenue administration claimed that this type of tax structure is not too harsh as most SMEs only have to deal with paying the three main taxes, and that the administration puts little emphasis on compliance of SMEs as of now, which should be changed to enhance the tax net in their country. Entrepreneurs however suggested that VAT falls harder on SMEs as a major proportion of existing tax exemptions and concessions are biased in favor of large enterprises as minimum investment threshold to qualify for tax breaks is set at SLR.50Mn. Besides that, there is double incidence of tax even though Nation Building Tax could be done away with or amalgamated into the VAT as they are both similar indirect taxes. In Nepal, the budget introduced in FY 99-00 reduced VAT threshold to Rs 2 million from 4.5 million, forcing it on a larger number of SMEs, and was found unwelcomed by the entrepreneurs as it soaked out their finances.

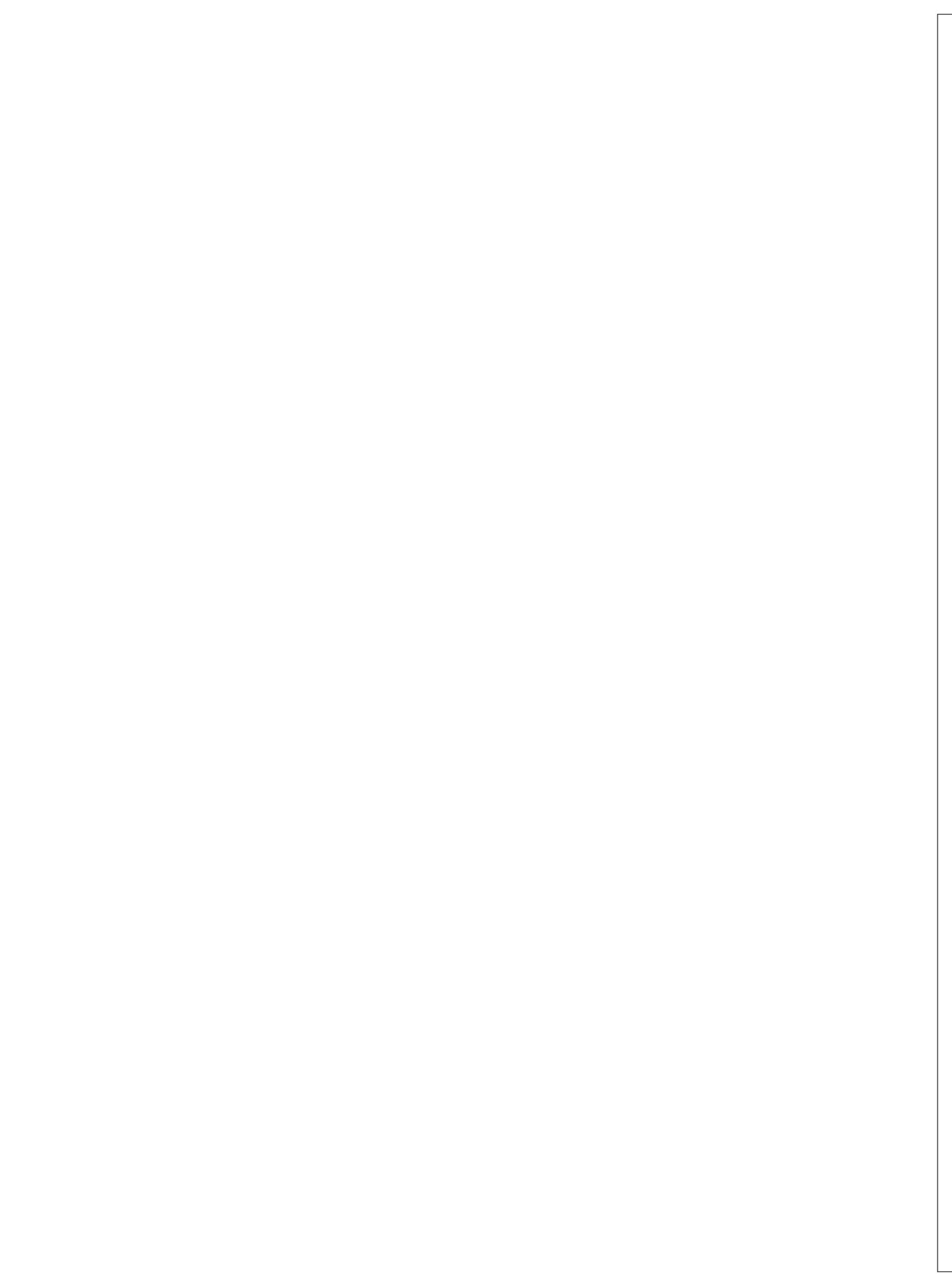
4.4.6 VAT Reforms

All stakeholders in South Asia believe that there is a need to introduce reforms in VAT, especially to simplify the procedures involved and reduce the costs incurred in becoming compliant. In Sri Lanka, both taxpayers and collectors felt positive about the automation of VAT filing procedures through the Revenue Administration Management Information System (RAMIS). It was agreed by all Nepalese participants that without enhancing administrative capacities smoothly operating VAT in Nepal was very difficult. There was consent in Bangladesh on the need to identify complex procedures and simplify them. The members of National Board of Revenue mentioned this as being catered in the new VAT law under formulation in Bangladesh. However, since the law would require SMEs to readjust considerably, the entrepreneurs hoped that the implementation deadline would be extended. The participants had varying takes on state's intent behind this law. The state members were at odds with the non-state participants' opinion that the new VAT framework was being formulated from the perspective of higher revenue mobilization from SMEs.

4.4.7 Property Valuation

Property tax significantly impacts enterprise development in countries where it is calculated as a large chunk of the total property value. This is done majorly in countries where land value is low to maintain certain revenue for the state, while in countries where property value is high it formulates a rather small proportion and become insignificant. In Bangladesh, Government may fix a small property tax rate based on actual transaction value primarily considering the protection of existing revenue only. Later, the Central Intelligence Cell (CIC) at NBR that determines real transaction value at a regular interval

and then those values are prescribed and updated. It was suggested that increasing formal taxpayers who will disclose all expenditures and asset acquisition at actual might be a step to resolve valuation related problems, as property in rest of the vicinity can be evaluated accordingly. But for this to be handled efficiently, competency of human resources in the tax administration and incentives for collection of taxes should be ensured. Similar issues regarding fair valuation exists in countries like Nepal and Pakistan where property tax is a significant amount when compared to property value. In Nepal, absence of property records at taxation offices was mentioned, and the need to accentuate book-keeping practices was also emphasised upon in Bangladesh.



SECTION-V

Conclusion and Key Policy Recommendations

The studies conducted on Tax Policy and Enterprise Development in South Asia have come up with policy recommendations which despite varying from country to country, entail some commonalities defining a larger strategy for the region. The similar recommendations made by the five countries, including Bangladesh, India, Nepal, Pakistan and Sri Lanka broadly cater to the need of public awareness regarding taxation, automation of tax authorities and introduction of e-based taxation procedure, training of tax officials, increased tax incentives to enterprises and their impact assessment, formulation of a sustainable and uniform definition of SMEs and MSMEs, and their assimilation into the formal sector. Country-specific recommendations were put forward in the shape of lowering taxes on SMEs, introducing tax holidays for new businesses, providing taxpayer services at the doorstep, creation of tax compliance history, punitive action against tax-dodgers, methods of tax valuation, specialized credit-options and tax benefits for women entrepreneurs, record of tax expenditures incurred by state, streamlining of tax design, coordination between taxation departments, development of tax compliance indicators, adjustment of tax exemptions, extent of uniformity of VAT rates across sectors, availability of credit options, capacity-building of entrepreneurs, and vocational training of labor. There are following major recommendations emerging from Meta analysis:

5.1 Redefining SMEs

There exists a general consent across the region regarding the redefinition of SMEs and MSMEs in an all-encompassing manner, bringing small and medium enterprises from all sectors/industries, formal or informal, into the fold. Industry specific definitions of SMEs may be also important as reflected in the FGD. It is also held by all, that the definition should be sustainable so that it provides ground for long-term planning regarding these enterprises in various sectors/industries.

5.2 Improving Tax Awareness

The five countries commonly address the need for an extensive awareness campaign regarding tax compliance, and the benefits of entering the formal sector. It is proposed that through tax fairs, and seminars, firms can be educated about the procedures of filing tax and the options it opens up for acquiring loans for expanding operations. Sri Lanka specifically suggests a Public-Private Partnership in organizing these campaigns where the state officials, with the help of tax-paying entities, and taxation consultancies, can disseminate information regarding tax laws in the country and their variance from sector to sector. Along with Sri Lanka, Nepal also believes that taxpayers' services including procedural information and payment services should be provided at the doorstep. The case studies on Women Enterprises also reflect that specific tax awareness programs should be implemented in countries such as Nepal, Pakistan and Bangladesh. In these countries women have very little idea about tax and have to depend on others due to the complex nature of documentation.

5.3 Implementing E-Taxation

A common recommendation from across the board has also been made regarding the need to fully automate the taxation system. An e-based tax collection is suggested to simplify the practices of filing taxes as many firms are reluctant to pay taxes due to complicated and time-consuming procedures, and hence avoid being assimilated into the formal sector. This proposal is complemented by Bangladesh and Nepal's recommendation regarding training of tax officials in dealing with tax related matters and instructing taxpayers with the taxation system put in place.

5.4 Reducing Tax Rate and Number of Taxes

There exists a broad agreement on lowering taxes levied on SMEs, increasing tax benefits to these enterprises, and formulating a mechanism for assessing the impact created by each incentive provided. By doing so, the state can monitor and evaluate the extent to which each incentive is able to benefit the firms and include them into the formal sector. Nepal, however, is critical of not letting this extend tax concessions to firms, while India suggests moving the focus away from tax exemption especially in sectors that entail long value

chains as it might hinder the growth of MSMEs. Instead, India suggests that reforming GST to streamline tax design and administration should reduce compliance cost and attract firms towards formal sector. Similarly, growth can be accentuated by Indian state's initiative to establish clusters and industrial estates with common production facilities and provide them on lease to businesses. As this would formalize SMEs, getting credit would become easier for these businesses, resulting in their growth. A recommended follow up is the formulation of tax compliance indicators for tax payers in a similar scheme as the credit scores maintained by financial institutions. Sri Lanka is also of this view, and they both jointly propose the creation of a tax compliance history, along the lines of credit history, to reduce the cost incurred and time consumed by case wise certification. This can be done through closer monitoring of the scheme ensuring the honoring of bank's claims in a timely manner.

5.5 Relaxing Tax Holiday and Enforcement Strategy

While both Bangladesh and Nepal press on the usefulness of tax holiday being provided to new businesses, with the former suggesting to extend it up to 10 years, and the need for input from all stakeholders once the enterprises become taxable, the two also stress upon adopting punitive action against taxable entities not submitting their tax returns in due time. This would take shape of an exemplary measure to not only force these firms to file timely returns, but also push others by setting precedent. Bangladesh particularly suggests adopting and campaigning on the punitive measures for enterprises practicing illegal activities through misuse of the tax benefits.

5.6 Tax Administration and Compliance

A set of proposals have been presented in the Indian report to reform tax administration in a manner to make it easier for the state to carry out, and for the taxpayers to comply with. Firstly, administration can be made effective through periodic visits as against case-wise certification, which would also make tax compliance less complicated. Secondly, there is a need of increased coordination between district administration and the firm to ensure that unless there is change in the land use pattern there is no need for revalidation of certification.

Thirdly, it was also suggested in the FGDs that the tax administration system could be

decentralized by establishing local tax offices. This could facilitate close friendly relationships between firms and the tax officials. Lastly, there needs to be a mechanism of pre-announcement of tax exemptions, so the units which potentially face a phase-out, can plan a transition and thereby manage costs of transition. If that is not possible, firms should be allowed to minimize book keeping cost by forgoing tax exemption and paying a flat rate.

5.7 Introducing VAT Reforms

A set of recommendations from Nepal aims to reform VAT in the country. This is prescribed through increasing tax thresholds while at the same time diversifying VAT rates from their current state of high uniformity. It is also established that discretionary form of valuation of taxes should be replaced by scientific valuation which is market-oriented and area based. This is to be done in synchrony with defining minimum and maximum rate of property tax and demarcating municipal land parcels on the basis of property tax payments.

The policy recommendation from India, however, aims at introducing uniformity in VAT rates. Currently, VAT rates in India vary immensely from sector to sector and cause confusion to the point that enterprises choose not to formalize in order to save the money paid to tax consultant who determines the bracket in which the entity falls. So making the VAT more uniform would ease the procedure for MSMEs and they would not feel hindered in entering the formal sector.

Sri Lankan report emphasizes on the amalgamation of similar indirect taxes into VAT. The case is made using the example of Nation Building Tax in Sri Lanka which can be completely done away with if absorbed into VAT which would simplify taxation.

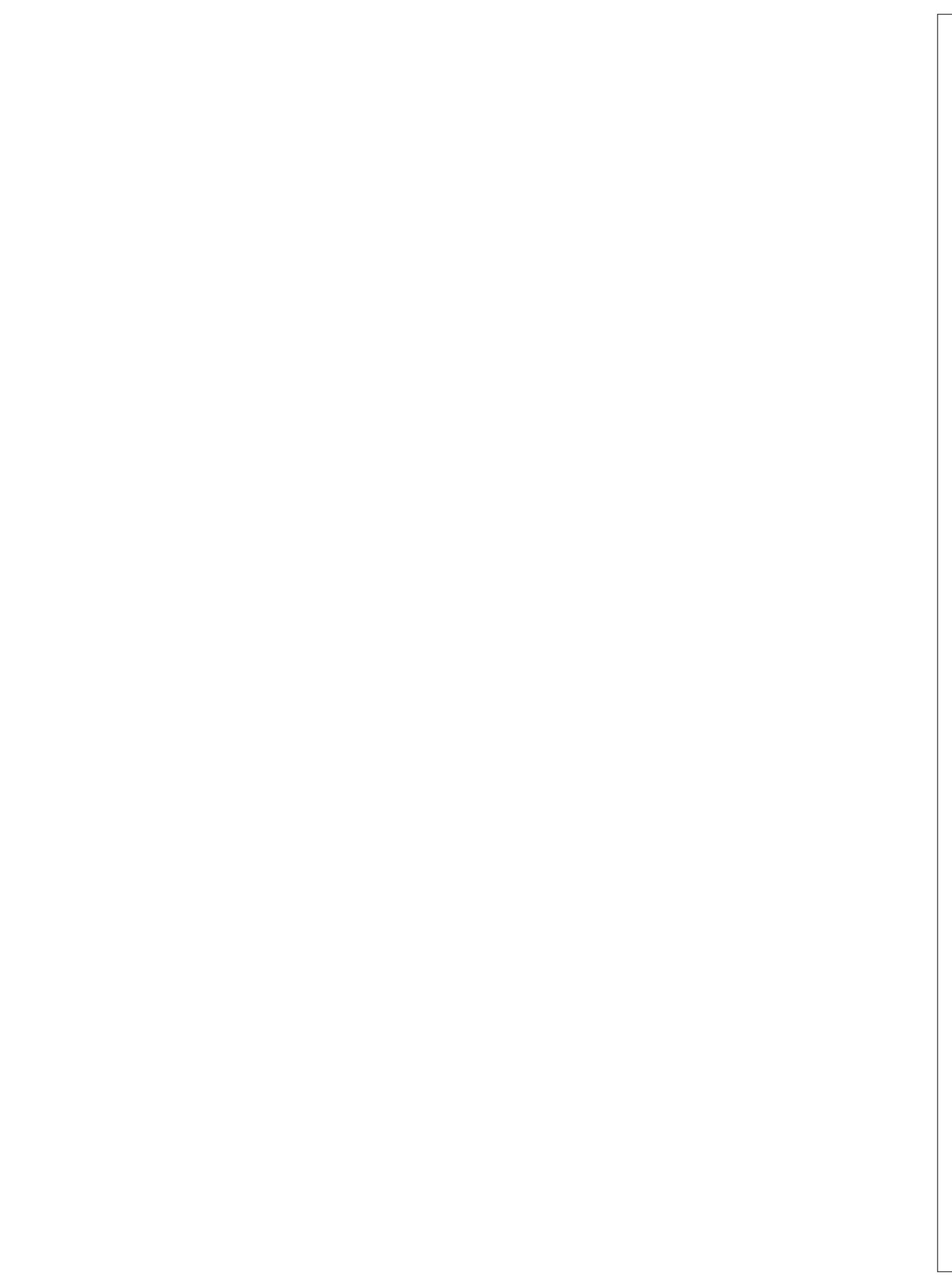
5.8 Facilitating Women Entrepreneurs

The need to facilitate women entrepreneurs has been emphasized in reports from all countries. As a policy, access to credit of women entrepreneurs has been stressed upon. A large number of women in the South Asian region are running small, sustainable businesses in the informal sector. In order to make their enterprise grow, disbursal of loans needs to be very effective, and can only be triggered in the formal sector. Provision of loans

in this case would formalize their enterprise and broaden the tax base. Bangladesh and Nepal have specifically proposed to enhance the reach of these women entrepreneurs to tax exemption so that they are not hindered in formalizing their SMEs for availing credit.

5.9 Capacity Building of Enterprises

A two-fold emphasis on the capacity building of enterprises has been made in the Sri Lankan report. One of the target areas suggested is building the management capacity of entrepreneurs to enhance their administration skills and accentuate their growth instinct. The other issue addressed is the lack of skilled labor, which is hampering the growth of SMEs. Vocational training programs should be arranged with the specific purpose of transforming unskilled or semi-skilled labor into skilled labor to increase the productive capacity of workers and the enterprises.



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Annexure

Country-Specific Recommendations

Bangladesh¹²

Tax Exemptions and Concessions

The deficiency in the existing tax structure of Bangladesh in targeting the growth of enterprises is mainly reflected in its incapability of defining and categorizing enterprises. The inadequate focus on incentivizing the industrial structures of various sizes have led to the insufficient safeguard and promotion measures for the SMEs. Despite the prevailing scopes for using various kinds of tax related instruments for SME growth, these enterprises are being unable to attain their entitled benefits. The incapability can be attributed to the lack of awareness and negative perception of the entrepreneurs about tax regime and thus remaining outside the regulatory environment. In addition to this, a more proactive role of the government is missing in transforming the negative perception of the SME entrepreneurs into optimistic views regarding the existing tax structure and administration.

During the course of the study recommendation has been obtained from entrepreneurs and stakeholders based on which criteria can be developed under which SMEs can get access to government tax benefits. According to the entrepreneurs of SME sector, major emphasis should be given on enhancing government's proactive role in facilitating the process of simplifying the tax structure and enhancing other facilities from the government. These facilities include ensuring access to land for setting up separate SME zone, facilitating marketing of SME product and creating new SME market agencies. Regarding the development of the tax structure, recommendation has been given on making rules and regulations easier, extend easy loan and strengthen rules and regulation against bribery. Enhancing monitoring activities is regarded crucial for encouraging SMEs to follow tax related rules and regulations.

In the Country Study Report – Bangladesh, a number of changes have been suggested in existing tax related regulations for SMEs. Major proposed changes include reduction of tax rates, making rules easier for loan processing and tax payment procedure.

¹² Cited from Country Study Reports – Bangladesh compiled by Centre for Policy Dialogue (CPD), Dhaka

Biasness against SMEs is reflected in a part of SMEs remaining undocumented, complicated compliance rules and in addition to this, the compliance cost for remaining under the tax net, as perceived by these enterprises. Stakeholders opined of various policy guidelines for revising the existing tax policies and simplifying the tax structure for making it more convenient and helpful for the small and medium enterprises. Table 37 would reflect the recommendations provided by various stakeholders on tax related aspects.

Table 37: Recommendations for Removing Inefficiencies at the Institutional and Operational Level and Modification of Tax Regime

Addressing Issues	Objective	Measures to be adopted
Development of Institutional Mechanism for Ensuring Compliance	Simplify tax payment and availing tax benefit procedures	<ol style="list-style-type: none"> I. Deployment of sufficient manpower. ii. Recruitment of competent tax officials in the regional offices and training of these officials in dealing with tax related aspects. iii. Adopt punitive measures for the taxpayers not submitting their tax return in due time iv. Organize public awareness programs such as tax fairs, seminars etc. to enhance the compliance level v. Full automation of the tax authority
Increasing Awareness and Ensuring Spontaneous Response from Entrepreneurs	Transforming the negative attitude of tax payers towards optimistic nature	<ol style="list-style-type: none"> i. Initiate campaigning on the tax payment and other procedure through the media. Significant campaigning required on the incentives and benefits for SMEs in the Industrial policy 2010. ii. Ensure easy access of women entrepreneurs of small to the tax benefits entitled for them according to the Industrial Policy 2010. iii. Tax holiday facility should be extended to 10 years to encourage investment in the sector by potential investors (subject to the potentiality of sectors and impact assessment) iv. The NBR may adopt initiatives for simplifying the tax payment procedures and application procedure for exempting the SME entrepreneurs. As the first step, it is required to arrive at a uniform definition of SMEs. v. The government along with the private sector stakeholders, such as associations and media can actively participate in jointly initiating various programs to support the SMEs, majorly focusing on building awareness among them regarding tax issues. vi. SME Foundation should undertake initiatives to raise the taxpayers' awareness on complying with the tax legislation. Proper guidance may be provided to the entrepreneurs in dealing with tax related issues through trainings and workshops.

Incentives for Increasing Compliance with Tax Regulations	Fostering enterprise growth through ensuring access to the tax benefits	<ol style="list-style-type: none"> i. Identify incentive measures for growth of enterprises through research and development ii. Identify sectors in need of supportive measures iii. Incentives may be provided to the enterprises based on certain criteria, such as, possessing good environmental performance. iv. Keep special incentive structure for women entrepreneurs in the regulations
Record Keeping	Systematic record keeping of the total tax expenditure	<ol style="list-style-type: none"> i. Prepare list and keep record of the various tax expenditure measures for the industrial sector ii. Prepare database of the amount of tax expenditure incurred by the government in each fiscal year
Monitoring and Impact Assessment	Enhance the compliance level with tax regulations and identify the those in actual need of supportive measures	<ol style="list-style-type: none"> i. Adopt a uniform definition of SMEs to identify appropriate policy measures for their development. In this case, the definition of the Industrial Policy 2010 can be considered to be the proper definition. ii. Proper initiatives may be undertaken for monitoring and impact assessment of the various benefits provided to the enterprises. iii. Recruitment of skilled manpower and inspectors in field offices required for efficient monitoring of tax compliance and tax benefits
Punitive Measures for fraudulent practices	Controlling distortion of competitiveness caused by illegal activities	<ol style="list-style-type: none"> I. Adopt and campaign on the punitive measures for enterprises practicing illegal activities through misuse of the tax benefits
Promulgation of tax exemption and concessions	Enhance knowledge of small enterprises on tax benefits they are entitled to	<ol style="list-style-type: none"> ii. The NBR may take initiative in promulgating information on tax benefits for SMEs through arranging fairs and special programs in media
Training Facility	Increasing knowledge of entrepreneurs on tax related issues and capacity building of tax officials	<ol style="list-style-type: none"> i. Adopt initiative for organizing trainings for the SME entrepreneurs emphasizing the problematic tax related issues faced by the entrepreneurs ii. Training may be provided by the SME Foundation in keeping records of their tax related annual cost iii. Regular training for tax officials for clarifying their concepts on procedural issues and building their capacity for being informative and more cooperative with the tax payers

Value-Added Tax

The sensitivity of the present VAT regime in Bangladesh does not adequately address the issues concerned by the SMEs. In connection to this a number of following policy recommendations may be considered to establish a SME friendly VAT regime in the Bangladesh context.

First, the forthcoming new VAT regime needs to recognise SMEs with an explicit definition in the VAT law. The definition needs to commensurate with the definition placed by the other concerned polices (e.g. industrial policy, BSCIC).

Second, the VAT related act and rules needs to incorporate SME related special provisions in a clear and well-articulated manner. In connection to this the special VAT provisions (including in the forms of turnover tax and package VAT) may use the measure of a firm's capital instead of using the sales or turnover value. At the same time, it is also important to streamline the loopholes in the VAT law as regards benefits for SMEs.

Third, the VAT laws and procedures are often found to be complex. A more committed effort will be required to identify and simplify these laws and procedures.

Fourth, for SMEs in Bangladesh costs as regards VAT compliance is found to be higher. The tax administration needs to ensure a better service delivery to SMEs. Indeed, to ensure that the tax administration is strengthened, its institutional capacity and the services to SMEs must be enhanced. Towards this end, decentralisation of tax administration should be a priority.

Fifth, the tax administration will be required to ensure fair enforcement to establish a level playing field for the compliant SMEs.

Nepal¹³

The Country Study Report - Nepal makes following policy recommendations based on the findings of enterprises survey, key informant interview, focus group discussion and case studies:

- The SMEs should be imposed lower amount of taxes so that they will have enough funds available for other economic activities that will help to enhance growth in business sector. Moreover, it will provide opportunities for the SMEs to be better equipped in the competitive environment.
- The Government should think of increasing tax exemption and tax incentives so that it will not only help to attract potential investors to invest in SMEs sectors but also encourage voluntary compliances. Particularly, it will generate enough revenue for the government and promote formalization of the SMEs sectors by increasing tax incentive, rebates and exemptions.
- All the stakeholder should work together to develop harmonious tax policies that should benefit both the government and SMEs sectors. The government of Nepal should provide tax holiday to the newly established businesses especially SMEs sectors to be more self sufficient and independent in the long run. Thus these sectors will be survived from the tax burden in the initial phase of their operation. This will not only create a positive attitude for tax payment also help to thrive SMEs sectors at the end.
- The study recommended that establishments of taxpayers Service offices at the doorsteps of the taxpayers will enhance services quality. At the same time, stringent legal actions to the tax dodger will also discourage tax evasion. Besides, experts recommended for simplification of tax procedure through application of e-based system, scaling up investment for ICT sophistication, reorganizing and restructuring of the organization etc as it was mentioned in Koirala(2012). Some FGD participants suggested that cutting down of exemptions list might reduce distortion in tax system. While other participants advocated that applying multiple VAT rates will make VAT more comprehensive and progressive as it was suggested in Dahal(2009). They also recommended for discouraging under invoicing, IRD should enforce the law to buy those goods which are undervalued to evade taxes, increasing tax thresholds will help to reform VAT.

¹³ Cited from Country Study Report – Nepal compiled by Institute of Integrated Development Studies (IIDS), Kathmandu

- The study further recommended following policies: scientific valuation methods to be developed to replace discretionary valuation based on manual developed by local government, area based valuation will be optimal as it was suggested in MOLD/udle & GTZ (2008); sometimes this could create the problem to the low income brackets people who are residing in these areas. Thus, market oriented area based valuation is preferred. Likewise, staffs should be fully trained with well equipped software packages to keep records of the property and minimum and maximum rates of the property tax should be defined to avoid tax distortions as it was recommended by Mahat(2007) in his study conducted in Nepal. The FGD participants told that some norms should be followed to demarcate municipal land parcels on the basis of those property tax payments. For instance rating the improved and non improved land, rating of business, agriculture and commercial land, rating of vacant land etc.
- Tax payers' education is quite essential to raise awareness among general taxpayers.
- There should be synchronizations in numerous government policies and acts so that ambiguity in policies and act can be corrected and modified in time.

India¹⁴

Following from the survey and the discussions with experts in the field, some suggestions for improving the performance of the MSM enterprises in India have been made in the Country Study Report - India:

1. Given that firms are looking for reduction in compliance costs, a prime driver of which is the existence of a large number of taxes and related tax administrations, the GST reform initiative can be used to streamline both the tax design and the tax administration to reduce the compliance costs with being in the regime.
2. Since firms seem to perceive that there are too many audits, from the perspective of the firms, it would be very useful if there can be more coordination among the tax departments so that joint audits can be done or the audits done by one department can be shared by others. Alongside this, it would be useful to explore if it is possible to develop transparent indicators of tax compliance for tax payers, like the CIBIL for credit scores in India. These measures can then be monitored both by the tax authorities and the tax payers and measures to improve these scores can be discussed so that the tax payer can identify steps by which his score can increase and the interface with the tax department can thereby be reduced. While this appears to be a far-fetched idea, within tax departments, they do use risk assessment scores.
3. Development of clusters or industrial estates where plots or factory sheds can be provided for lease with adequate infrastructure seems to be the need of the day for encouraging SME and to prevent the brain drain from manufacturing to trading.
 - a. While Indian experiments with industrial estates in the past have not been very successful, the time may be ripe for another such experiment maybe with short term leases. Some such experiments are being done in some states and compilation of the experiences may be useful in developing a perspective in the matter.

Since access to credit continues to be dominant concern, two issues need to be addressed. First, simplifying the process and documentation for getting credit would be important to bring more SME within the fold of the formal sector. Here 'aadhar' based credit histories or CIBIL based credit histories can be used to expand the access to credit. Improving the tax regime so that compliance cost is reduced too could bring in more people to the formal institutions for credit.

¹⁴ Cited from Country Study Report – India compiled by National Institute of Public Finance and Policy (NIPFP), New Delhi

Pakistan¹⁵

An analysis of the impact of current policy and its implementation on all three themes, tax concessions and exemptions, RGST and Property tax, on the SMEs shows that Pakistan needs to do a lot more to promote the sector. The informal sector lacks willingness to join the formal sector and sees no benefit in changing its status. At the same time public policy is also not conducive. In this environment, it is important that some effort is made by the public sector to strengthen the SMEs, particularly given their role in employment generation, export promotion and contributing to inclusive growth.

The government has adopted some policy measures that were included in the initial theoretical and recommended policy framework, however, many remain. The Country Study Report - Pakistan suggests that the government may consider the following:

- Rationalizing tax expenditures and enhancing greater public investment, especially in power generation and distribution, gas supply, roads, etc. for small enterprises. As compared to tax expenditures it will be improve the competitive position of the SMEs relative to the large scale sector and enhance their growth and profitability.
- Provide fiscal incentives for conversion from AOP to small company according to the Companies Ordinance. This will improve their competitive position and growth and profitability prospects

Besides that, the government may consider reducing competitive advantage from tax expenditures to large companies by the following policy measures;

- Limiting the duration of tax holidays to a maximum of five years. The government has in fact extended it from 5 to 10 years for Special Economic Zones (SEZ), with its negative revenue consequences
- Reduction in the accelerated depreciation allowance on the acquisition of non-productive physical assets (like buildings) is likely to improve the competitive position of SMEs also. The Finance Bill 2013 has reduced the initial allowance from 50 % to 25%.
- Higher accelerated depreciation allowances on acquisition of locally manufactured machinery (50%) versus 25% on imported machinery
- Elimination of the presumptive tax differential between commercial importers (who mostly supply small companies) and industrial importers. This has, in fact, been increased in the Finance Bill 2013. This is likely to adversely affect the SMEs.

¹⁵ Cited from Country Study Report – Pakistan compiled by Beaconhouse National University, Lahore

- Making the withholding tax rate on electricity bills proportionate to the size of the bill, in the Finance Bill 2013. There has been introduced an additional sales tax at the rate of 5 per cent on non-registered commercial and industrial users of electricity and gas having monthly bill in excess of Rs 15000
- Introduction of incentives for higher compliance by small enterprises. The proposed scheme is described in Box 2.

RGST

- Allowing voluntary registration by small enterprises, which are below the exemption limit will have positive implications on their growth and competitiveness
- Simplifying the tax system with more tax payer friendly returns, less frequency in filing of returns for small enterprises and availability of forms in local languages. This will both improve revenues and improve tax compliance.

Property Tax

- Simplification of the method of assessment of tax liability and making a transition to a self-assessment system. This will increase compliance and revenues
- Computerization of property records, following a comprehensive survey to improve revenue collection, and compliance.
- Reducing tax differential between different types of properties to generate more revenues
- Rationalization of the overall tax incidence on property transactions to improve compliance
- Reduce the documentation requirements for small land transactions.

Transfer collection of property tax to large municipal governments to improve compliance by establishing a stronger link between taxation and benefits.

Sri Lanka¹⁶

The Country Study Report – Sri Lanka suggests that the prevailing tax incentives structure favor large enterprises. So more needs to be done to explore how the tax incentives regime can be reoriented to suit the growth needs of SMEs and also streamline them and enhance awareness about them.

Tax compliance appears to be low, mainly due to the fact that SMEs are not making enough money to be caught into the taxable threshold. This calls for a review of the taxable threshold on one hand, and supporting SME growth so that they become taxpayers on the other hand.

Low awareness on tax matters came across as an overall theme in this study and more needs to be done. While good initiatives have been undertaken by the IRD to improve awareness through workshops, etc., a more regular and continual approach may need to be adopted. An SME friendly tax collection approach would also need to be inculcated among the IRD regions officials.

A review of huge tax compliance and overall regulatory burden may be warranted, as the study revealed that many SMEs found tax compliance to be cumbersome and burdensome. While it is acknowledged that any enterprise would find tax payment burdensome and would rather not pay, a more user-friendly and streamlined compliance structure may boost compliance.

With regard to land and property taxes, the study does not find any significant influence of this on SMEs, however exploring this area revealed that the critical issue is the availability and access to land for SMEs. Earlier moves to establish a government land bank for commercial undertakings may need to be revisited in huge context of SME growth, and also a review of the existing procedures with regard to land purchase/sale.

An overarching issue that emerged in this research was the lack of a coherent understanding of 'what constitutes an SME?' stemming particularly from the lack of a common definition agreed to by all stakeholders. This has been a perennial issue in Sri Lanka's SME sector. It must be tackled as a priority matter, as it not only has implications on government support to SMEs, SMEs' access to finance, etc., but also has implications for widening the SME tax base and improving tax compliance.

The study will be incomplete if it does not place on record that tax policies, tax rates/structures, tax administration and compliance, and all related tax issues faced by

¹⁶ Cited from Country Study Report – Sri Lanka compiled by Institute of Policy Studies (IPS), Colombo

SMEs are but one aspect influencing the growth and success of the SME sector. Other factors like the overall regulatory and business climate, availability of finance, business development services, management and technology upgrading, etc., need to be simultaneously addressed in order to improve the competitiveness of the sector.

In conclusion, the study asserts that while the SME sector is an important sector for tax collection purposes, given the current policy focus on SMEs and the desire to growth the SME sector, tax authorities should be sensitive to the needs of SMEs when introducing or changing taxes. Overall, Sri Lankan authorities must bear in mind that in a context where over 90% of industrial establishments in the country are of small and medium-size, and the vast majority of private sector enterprises outside the Western Province are SMEs, any tax policies that affect the private sector as a whole should necessarily consider the impact on the SME sector in particular. While Sri Lanka pushes forward to improve its tax-to-GDP ratio and gears its tax structure and tax policies to achieve that end, the start up, growth, and job creation potential of SMEs should not suffer. With tax policies that strike a clever balance of tax compliance improvement and growth-promotion, the Sri Lankan SME sector can continue to play a key role in the country's socio-economic development.



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