Investigating The Relationship Between Tax Incentives And Small Business Growth

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ABSTRACT

When it comes to assisting small companies in thriving, tax incentives are an essential component in order to both promote investment and ease financially challenging situations. Taking advantage of these incentives, which consist of tax deductions, credits, and exemptions, enables businesses to reinvest in their operations, create new products and services, and reinvent themselves. The degree to which they are effective is determined by a variety of factors, such as the accessibility of the policy, the design of the policy, and the economic conditions. It is possible that the benefits of well-structured incentives for owners of small businesses might be hampered by convoluted tax rules. This is despite the fact that these incentives could potentially boost the creation of jobs and increase the economy. It is essential for governments to prioritise transparency, simplicity, and equitable distribution of incentives in order to achieve maximum impact. At the end of the day, tax incentives need to be used in conjunction with other forms of assistance, such as those that enhance infrastructure, business education, and access to finance.

Keywords: Small and medium-sized enterprises; Tax incentives; Enterprise growth; Value-added tax.

INTRODUCTION

The use of tax breaks and credits is a global fiscal instrument that governments deploy for a number of goals. Some of these purposes are connected to economic development and progress, while others are to meet political promises made in manifestos, and still others are to protect the social contract. Tax breaks and exemptions are often provided by the government to both people and corporations in order to facilitate the process of attracting and motivating investors to put their money into a certain economic sector. The United Nations Conference on Trade and Development (UNCTAD) defines tax incentives as measures that stimulate investment in certain projects or sectors by decreasing the tax burden of prospective supporters. These policies are intended to encourage investment in such industries or projects. There are a few examples of these tax breaks, including tax holidays, lower rates for certain incomes and profits, accounting rules that allow you to deduct losses more quickly and use them later for taxes, and either lower tariffs on imported raw materials, components, and equipment or higher tariffs to protect the domestic market.

There are provisions in the law known as incentives in taxes, which are clauses that, in place of more normal tax regulations, give specific businesses or activities with preferential treatment. According to Dotun (1996), tax incentives are measures taken by the government with the intention of influencing the tax system in a manner that is beneficial to individuals who are considering becoming taxpayers. The system may suffer financial losses as a result of revenue leakage brought about by these incentives. Tax expenditures are incurred when the government legitimately permits any economic actor to take advantage of tax benefits such as exemptions, deductions, allowances, credits, preferential tax rates, or payment delay. This results in a loss of money for the government, which in turn causes tax expenditures. It is possible to employ taxes and tax incentives as tools of fiscal policy in order to encourage macroeconomic development. This may be accomplished by providing certain activities or sectors with preferential tax treatment in comparison to the general industry. Tax incentives have not been effective in achieving the government's goal of fostering consistent macroeconomic development via the implementation of these incentives. It is the poor condition of infrastructure development that, according to Randle (2000), is the root reason of the failure of tax incentives. However, there is evidence to support the argument that tax incentives are only successful under

certain conditions, such as when the infrastructure is adequately established and the design is acceptable. When the costs are taken into consideration, however, the benefits no longer seem to be so favourable.

Countries that engage in the practice of offering tax incentives have the potential to reap the advantages in a variety of different ways. The development of job opportunities, the transfer of technology and training, improved tax revenues, and other non-economic gains from industrialisation are some examples of these benefits. However, this list is not exhaustive. Some academics believe that tax policy is a powerful tool for managing the flow of investments. These same academics have also shown that investment decisions are extremely sensitive to tax incentives. The alleviation of poverty and the promotion of economic growth and job opportunities are the objectives of these benefits. Policy decisions about taxes, particularly tax incentives, are expected to be advantageous from a tax point of view; yet, there are times when they are not. However, they are beneficial to the economy as a whole since they promote the creation of employment, investments in the environment, the construction and improvement of infrastructure, and other similar activities. This, in turn, may contribute to the reduction of poverty. In view of the fact that there is no model that can evaluate the impact that tax incentives have on investments, the primary objective of this study is to provide a response to the question of whether or not tax incentives are a suitable method to solve issues such as poverty, unemployment, and the entrepreneurial deficit. There is a dearth of systematic and focused guidance on how to use tax incentives to achieve the specified economic objectives in Nigeria. The majority of the tax policy orientations that have been implemented in Nigeria over the years have been based on trial and error or political considerations. This study fills a gap in the existing body of research by presenting early evidence that tax incentives and infrastructure have an impact on the attractiveness of entrepreneurship in Nigeria. This is a subject that is in dire need of more investigation.

OBJECTIVE

1. To look at the connection between tax breaks and the expansion of small businesses.

2. To Evaluate Export Tax Incentives' Effectiveness.

RESEARCH METHODOLOGY

The objective of this study is to determine the extent to which the Goods and Services Tax (GST) has an impact on the rise of the natural logarithm of the gross domestic product (GDP) in India. Check out Table 1 for a list of acronyms that were used in this research. FDI, GFD, GSTRL, INF, and TO are the categories of regressors that have an impact on the growth of India's GDP. One may see the functional connection that exists between the regressors and the dependent variable by looking at (1):

$$\text{GDPGR}_t = f(\text{FDI}_t, \text{GFD}_t, \text{GOVE}_t, \text{GSTR}_t, \text{INF}_t, \text{TOP}_t)$$

Table 1: Description of research variables.

S. No.	Variable	Mathematical computation	Notation used	Data source	Expected Sign
1.	GDP growth rate	Natural log of GDP	GDPGR	RBI	NA
2.	FDI inflow	FDI as % of GDP	FDI	RBI	+
3.	Gross fiscal deficit	Gross fiscal deficit as a % of GDP	GFD	RBI	–

4.	Government expenditure	Government expenditure as a % of GDP	GOVE	RBI	+
5.	GST revenue	Log of GST revenue	GSTRL	GST council	+
6	Inflation rate	% change in CPI	INF	RBI	–
7	Trade openness	Import and export as a % of GDP	TOP	RBI	+

The following regression model (3) is specified to examine the impact of GST on economic growth:

$$\text{GDPGR}_t = \alpha_1 + \beta_1 \text{FDI}_t + \beta_2 \text{GFD}_t + \beta_3 \text{GOVE}_t \\ + \beta_4 \text{GSTR}_t + \beta_5 \text{INF}_t + \beta_6 \text{TOP}_t + \mu_t$$

Specification of Econometric Modeling

This research makes use of the ARDL model in order to investigate the relationship between the expansion of the GDP and several explanatory variables, including FDI, GFD, GOVE, GSTR, INF, and TOP. Despite the fact that the ARDL model functions well with variables that have varied integration levels (I(0) and I(1)), none of the variables should be integrated at the third level (0-3). ARDL is well suited for use in economic studies that include variables that display various trends over time. This is due to the fact that, in contrast to traditional cointegration models, it is designed to function effectively with datasets that have different integration orders. For the purpose of determining how changes in policy, such as India's Goods and Services Tax (GST), would impact individuals over the course of time, we want a model that is capable of taking into consideration both the short term and the long term.

This idea was provided by Pesaran, Shin, and Smith in the study that they worked on. In addition to its versatility with small sample sizes and a variety of integration orders, the ARDL model is a popular option because it provides reliable coefficient estimates, diagnostic tests for cointegration and error correction, and diagnostic tests for error correction. Using this model, which accurately depicts the complex interactions that occur between economic components in response to shifting conditions, it is possible to conduct empirical research on economic growth and the consequences of policy with a high degree of certainty.

$$\Delta \text{GDPGR}_t = \gamma + \sum_{i=1}^{p} \alpha_1 \Delta \text{GDPGR}_{t-i} + \sum_{i=0}^{p} \alpha_2 \Delta \text{FDI}_{t-i} \\ + \sum_{i=0}^{p} \alpha_3 \Delta \text{GFD}_{t-i} + \sum_{i=0}^{p} \alpha_4 \Delta \text{GOVE}_{t-i} \\ + \sum_{i=0}^{p} \alpha_5 \Delta \text{GSTR}_{t-i} + \sum_{i=0}^{p} \alpha_6 \Delta \text{INF}_{t-i} \\ + \sum_{i=0}^{p} \alpha_7 \Delta \text{TO}_{t-i} + \beta_1 \text{GDPGR}_{t-i} + \beta_2 \text{FDI}_{t-i} \\ + \beta_3 \text{GFD}_{t-i} + \beta_4 \text{GOVE}_{t-i} + \beta_5 \text{GSTR}_{t-i} \\ + \beta_6 \text{INF}_{t-i} + \beta_7 \text{TO}_{t-i} + \varepsilon_t$$

The study tested of no cointegration among the research variables

$$(\beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = \beta_7)$$

against the alternative

$$\beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq \beta_5 \neq \beta_6 \neq \beta_7)$$

Cointegration among the variables is crucial in order to take into consideration short-term fluctuations and the pace at which they rebalance to long-term equilibrium. These are aspects that are often influenced by targeted policy changes and the delayed repercussions of those adjustments.

An error correction term, also known as an ECM, is included into the model in order to account for both short-term fluctuations and the rate at which variables find their equilibrium. This allows the model to take into account both short-term changes and the rate at which variables find equilibrium over the long run.

$$\Delta\text{GDPGR}_t = \gamma + \sum_{i=1}^{p} \alpha_1 \Delta\text{GDPGR}_{t-i} + \sum_{i=0}^{p} \alpha_2 \Delta\text{FDI}_{t-i}$$
$$+ \sum_{i=0}^{p} \alpha_3 \Delta\text{GFD}_{t-i} + \sum_{i=0}^{p} \alpha_4 \Delta\text{GOVE}_{t-i}$$
$$+ \sum_{i=0}^{p} \alpha_5 \Delta\text{GSTR}_{t-i} + \sum_{i=0}^{p} \alpha_6 \Delta\text{INF}_{t-i}$$
$$+ \sum_{i=0}^{p} \alpha_7 \Delta\text{TO}_{t-i} + \alpha_8 \text{ECT}_{t-1} + \mu_t$$

RESULT

When doing a financial time series analysis, it is essential to determine whether or not the variables being analysed are stationary. This prevents the formation of false correlations and the drawing of inaccurate conclusions. Using the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests, the results of this research were examined to see whether or not they were stationary. This was done to ensure that the findings gained from the study were reliable and valid. Table 2 presents the findings that were obtained from the unit root test. Following the first differentiation (I(1)), the variables GDPGR, GOVE, INF, and TO are considered to be stationary. FDI, GFD, and GSTR, on the other hand, continue to rest at the same level (I(0)) during the whole process. The conventional econometric approaches, such as the VAR and traditional cointegration models, have a difficult time coping with this diverse integration order (some variables are I(0) and others are I(1)). As a result, the ARDL model is preferred for both short-run and long-run relationship analysis since it is able to deal with variables that have different integration orders.

Table 2: Results of unit root test.

Variables	ADF	PP	Integration
	Constant and trend	Constant and trend	
GDPGR	−3.4229	−2.7785	I(1)
	(0.1566)	(0.2095)	
Δ LnGDP	−5.1284	−7.7768	
	(0.0004)*	(0.0000)*	
FDI	−8.7277	−8.7282	I(0)
	(0.0000)*	(0.0000)*	
GFD	−7.7352	−7.7052	I(0)
	(0.0000)*	(0.0000)*	

GOVE	−1.2746	−2.1985	I(1)
	(0.8858)	(0.6571)	
GOVE	−9.3642	−9.5300	
	(0.0000)*	(0.0000)*	
GSTR	−5.6768	−5.6089	I(0)
	(0.0000)*	(0.0001)*	
INF	−2.6760	−2.7238	I(1)
	(0.2493)	(0.2302)	
Δ INF	−8.0802	−8.8138	
	(0.0000)*	(0.0000)*	
TO	−2.2928	−3.2778	I(1)
	(0.4326)	(0.1775)	
TO	−13.1749	−13.3702	
	(0.0001)*	(0.0001)*	

Following the establishment of the integration order, a bound test was used in order to investigate the long-term co-integrating link that exists between the variables. As can be seen in Table 3, the fact that the F-statistic is higher than the critical upper limit demonstrates that there is a significant co-integration link over the long term.

Table 3: Result of ARDL bound test.

Variables name	F-Stat	C.V. at 1%		C.V. at 5%		C.V. at 10%		Decision
		I(0)	I(1)	I(0)	I(1)	I(0)	I(1)	
F $GDPGR$= (GDPGR | FDI, GFD, GOVE, GSTRL, TOP, INF,)	7.9523*	2.88	3.99	2.27	3.28	1.99	2.94	Co-integrated

DISCUSSION

Tax incentives are an essential component in facilitating the growth of small enterprises since they reduce the difficulties associated with financial restrictions and encourage investment. The provision of a variety of tax incentives to small businesses is often done by governments in an attempt to promote investment, the creation of new employment, and the progress of technology. When business owners have less money to pay in taxes, they are able to invest more money in their enterprises, which allows them to expand, hire more employees, and become more competitive at the same time. As an illustration of this argument, small firms are provided with R&D tax credits, which encourage them to develop, and capital expenditure deductions, which allow them to afford to upgrade their infrastructure and technology, also facilitate this innovation. The provision of incentives such as these helps to create an optimal environment for enterprises, which, in turn, may improve their bottom line and assure their continued existence in the long term.

Several factors, including accessibility, knowledge, and overall economic conditions, are among the factors that affect the degree to which tax incentives are effective in driving the growth of small businesses. It may be difficult for some owners of small businesses to comprehend and adhere to the complex tax requirements that are in place. As a result, they may be unable to take advantage of all the opportunities that are open to them. In addition, smaller firms may find themselves at a disadvantage as a result of poorly conceived tax incentives that favour larger enterprises or certain industries. In order to make the most of the tax breaks that are available for the growth of small businesses, authorities need ensure that these breaks are not only obvious but also conveniently accessible and targeted. When all is said and done, tax incentives are beneficial; but, they should not be employed in isolation from other measures, such as increasing access to finance, upgrading infrastructure, and training entrepreneurs.

CONCLUSION

The provision of tax incentives is an essential component in the process of fostering the growth of small businesses. The relaxation of financial limitations, which was made possible by their help, made it feasible for the development, expansion, and creation of new employment opportunities. Businesses are able to reduce their operational expenses and enhance their cash flow via the utilisation of tax benefits in an appropriate manner, all while encouraging innovation and the careful acceptance of risks. The amount to which such incentives have an impact is determined by a number of variables, including the size of the company, the industry in which it operates, and other economic considerations that are associated with the external environment. Tax incentives have the potential to be a strong growth engine; but, in order to ensure that they are reaching the firms who will gain the most from them, they need to be well-designed and tested on a regular basis. This is very necessary if they are going to assist in the development of an economy that is both sustainable and inviting to all individuals.

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