

Comparison of Tax Laws for Micro, Small, and Medium Enterprises in Developing Countries

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) are the backbone of economies in many developing countries. They played a vital role in job creation and income distribution. Given the importance of SMEs in increasing economic inclusion and reducing poverty, governments in developing countries often implement tax policies designed to support SMEs' growth and sustainability. Moreover, education and tax support are important efforts in improving MSMEs' understanding of their tax obligations, with tax ownership often associated with access to broader benefits, including financing. Despite variations in implementation, the study stresses the importance of continuous dialogue between governments and MSME owners, as well as the need for a flexible and responsive approach to MSME needs in developing countries. In conclusion, this research contributes to a better understanding of how developing countries can design effective tax policies to support the development of MSMEs, ultimately contributing to more inclusive economic growth.

Keywords: *Tax Law, Micro, Small and Medium Enterprises (Msmes), Developing Countries.*

Introduction

For developing countries, the activities of micro, small, and medium enterprises (MSMEs) are the backbone of their economies. They play an important role by significantly contributing to job creation and income distribution and as a source of innovation and entrepreneurship. (Juminawati et al., 2021). MSMEs provide an inclusive economic dynamic, enabling communities from all walks of life to engage in the formal economy and enhancing wider opportunities for overall economic growth. (RAMLI et al., 2022).

The contribution of MSMEs (micro, small, and medium-sized enterprises) covers the capacity to absorb up to 97% of the total existing labor force and can raise to 60.4% of total investment. (Sedyastuti et al., 2021). It shows how vital the role of MSMEs is in the national economic structure, not only as a major driver of job creation but also as a producer of products that support the needs of the wider society. (Endris, E., & Kassegn, A. 2022). The MSME sector in Indonesia in 2021 recorded the number of business sectors reaching 64.19 million with a share of gross domestic product (GDP) of 61.97 percent or Rs 8.6 trillion. These figures indicate how much MSMEs contribute to the national economy and its potential for economic recovery, especially after the COVID-19 pandemic (Tambunan, T. 2021).

Given MSMEs' vital role, inclusive financing is one key to supporting their growth. Accessible financing by MSMEs can stimulate further growth, ultimately contributing to national economic recovery. Although it cannot be denied that MSMEs provide many opportunities, the challenges faced by these entrepreneurs are not few. One of them is the taxation aspect (Sulistyono et al., 2022). Taxation, as a means of collecting state income, has a complex structure and is often a burden for MSME owners who have to struggle to understand and fulfill their tax obligations. How tax laws are designed and implemented directly impacts the survival and competitiveness of MSMEs. (Bhalla et al., 2023).

In many developing countries, efforts to establish a fair and efficient tax system for MSMEs have become integral to national economic development strategies (Khan et al., 2020). Each country's approaches and strategies vary depending on its economic, political, social, and cultural conditions. Some countries may adopt simpler tax schemes and tax incentives that drive MSMEs' growth, while others may have more complex and demanding systems. (Deyganto, K. O. 2022).

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MSMEs, or Micro, Small, and Medium Enterprises, play a crucial role in the economies of developing countries because it is regarded as a creation of jobs, a driver of economic growth, poverty reduction, rural and remote development, a source of innovation, and economic resilience. (Utthavi et al., 2023). Therefore, supporting MSME growth and development is an important strategy for developing-country governments to boost their economies, reduce poverty, and promote more inclusive and sustainable development. Policies that support MSMEs, such as access to finance, business training, and tax incentives, are vital to boosting economic growth and creating more prosperous societies. (Mapuasari et al., 2023).

The diversity of tax laws for micro, small, and medium-sized enterprises (MSMEs) in developing countries is an interesting and complex phenomenon. (ADEWARA et al., 2023). Across the world, developing countries face the same yet unique challenges in stimulating economic growth and creating jobs, with MSMEs often at the heart of these economic strategies (Kuo et al., 2022). Tax policy differences for MSMEs reflect a variety of factors, including economic conditions, policy objectives, and administrative capacity (Augusti, R. R., & Rahman, A. F. 2023). Tax policy determinants for the MSMEs are caused by;

- Tax Administration Capacity. Countries with lower administrative capabilities tend to simplify tax laws for the MSMEs to minimize the administrative burden for both the government and the MSMEs.
- Economic Policy Objectives. Some countries prioritize MSME growth as an economic motor and create tax incentives to stimulate growth and investment in this sector.
- Economic development level. (Geeta et al., 2023; Bhalla et al., 2022).

India has implemented a "Presumptive Tax Scheme" for SMEs that allows small to pay taxes based on a certain percentage of their income, simplified to reduce the administrative burden. 2) Kenya. In Kenya, micro and small contribute largely to the economy. The government has implemented a progressive tax rate and introduced a "Turnover Tax" for MSMEs with annual income below a certain threshold. 3) Brazil. Brazil has a "Simples Nacional", a tax system that simplifies the collection of various federal, state, and local taxes for small, with tax rates varying according to turnover. (Bhalla et al., 2023).

This diverse tax policy reflects the efforts of developing countries to create an enabling business environment for MSMEs, recognizing their central role in economic and social development. This understanding is important for global stakeholders, investors, and entrepreneurs to navigate the fiscal landscape and take advantage of the opportunities available in various jurisdictions. (Abdellaif, M., & Tran-Nam, B. 2022).

Promoting access to finance, technology, and markets and creating a supportive regulatory environment are essential in economic development strategies. In this increasingly interconnected global context, the diversity of MSMEs' tax laws offers valuable lessons on how policies can be adjusted to stimulate economic growth while ensuring fiscal justice. (Deyganto, K. O. 2022).

Therefore, comparing how developing countries design tax laws for MSMEs becomes a highly relevant and insight-rich research topic. This research can reveal differences in the policies and strategies implemented, as well as their effectiveness in supporting the development of MSMEs. By understanding the variations and results of these different approaches, we can assess which policies are most successful and recommend best practices for implementing tax policies that benefit MSMEs in developing countries.

Research Method

The research method of this study is literature research. The method of literature research is to gather references from various reliable sources on the subject being studied. (Bungin, 2001; Moleong, 2007; Adi, 2021). Several methods can be used to study literature, including keyword search, which is the first and very important method. Find relevant keywords in catalogs, indexes, and search engines to find literature relevant to the research topic. (Soekanto, 2007; Muhdlor, 2012).

The research uses descriptive analytical methods, in which researchers collect, identify, compile, and analyze the various data found. The data used are secondary data, which are available to the public and can be accessed by the public. The course of research on the literature study encompasses systematic phases and is presented as flow charts to facilitate understanding. (Arikunto, 2013; Reay, 2014; Graue, 2015).

Result and Discussion

MSMEs Definition

MSMEs is an abbreviation for Micro, Small, and Medium Enterprises that covers various types of small enterprises and has the potential to advance the national economy. (Juminawati et al., 2021). MSMEs in Indonesia are defined on the basis of certain criteria, such as turnover and the amount of net wealth that does not include land and buildings at the place of business (RAMLI et al., 2022). This classification is important to determine the appropriate policies and facilitations from the government to the entrepreneurs to support its growth. (Sedyastuti et al., 2021).

The Republic of Indonesia Law No. 20 of 2008 on MSMEs also defines MSMEs according to the type of business, i.e., micro, small, and medium-sized enterprises (Endris, E., & Kassegn, A. 2022). (Tambunan, T. 2021).

Understanding and Basic Principles of Tax Law

Tax law is the set of rules governing the tax system in a country, including the imposition, collection, and use of taxes by the government. The tax law authorizes the government to withdraw a portion of the property of a society or legal entity through taxation for use in the public interest (Chumaidi, I., & Noor, A. 2022). (Pistone, P., & Szudoczky, R. 2018).

The basic principles of tax law are concepts that form the foundation of the tax system of a country, including Indonesia. Governments use these principles as guidelines in the tax collection of taxpayers to ensure that the process is fair, effective, and efficient. (Kartiko et al., 2023).

Some of the main principles include:

- the principle of legal certainty: emphasizing that tax collection must be based on clear legal regulations so that the taxpayer knows their obligations without any doubt.
- the Principle of Justice: Taxes must be levied fairly in accordance with the individual's financial capabilities. In other words, those with higher incomes are expected to pay more tax than those with lower incomes.
- the principle Benefits: The tax levied on a good or service must be proportionate to the benefits the taxable person obtains from such goods or services.
- the principles of Economic Efficiency: Tax collection should be carried out in a way that interferes with economic activity as little as possible, so as not to impede economic growth. (Saptono, P. B., & Ayudia, C. 2021; Pramudya, A. H. P. 2022).

These principles are universal and serve as a benchmark in tax collection for achieving social justice and efficiency in tax administration and its use in development.

MSMEs Economic Growth Theory

MSME's economic growth theory focuses on how micro, small, and medium-sized enterprises (SMEs) contribute to the economy as a whole and how these sectors can be enhanced to promote inclusive and

sustainable economic growth. (Sulistiyono et al., 2022). One of the approaches used is Keynes' theoretical approach, which suggests government intervention in the economy, mainly through spending and fiscal stimulus, to maintain aggregate spending levels that can maintain healthy economic activity. MSMEs are considered an important pillar in building a nation's economy because of their ability to create jobs and promote economic growth. (Rosul, R. D. 2024).

MSMEs Tax Laws in Developing Countries

Tax laws for micro, small, and medium-sized enterprises (MSMEs) in developing countries play a significant role in boosting local economic growth and development. MSMEs' tax policy is designed to stimulate business growth, advance innovation, and increase economic competitiveness. (Bhalla et al., 2023).

Here are some important aspects related to MSMEs tax laws in developing countries:

- Tax exemption or reduction. Some developing nations offer tax exemptions or reduced tax rates for MSMEs to ease the tax burden and help them grow. This is meant to increase their income and encourage reinvestment in business.
- Simplified tax systems. Developing countries often simplify the tax system for MSMEs by providing a simpler tax reporting scheme or by implementing a single tax system with a fixed rate. This aims to reduce the administrative burden and encourage tax compliance.
- To promote investment in certain sectors that are considered essential for economic development, such as technology or renewable energy, developing countries can offer tax incentives, such as tax credits or accelerated deflation, to MSMEs investing in those areas.
- Support for Exports. MSMEs that export their goods and services often get tax incentives or tax relief to increase foreign trade and strengthen the country's trade balance.
- Training and support. In addition to tax policy, some developing countries provide training and support programs for MSMEs to help them understand tax obligations and manage their finances better, which in turn can improve tax compliance.
- Digital compliance. Governments in developing countries are also encouraging the digitization of tax processes to facilitate MSMEs in online tax reporting and payment, which helps reduce the time and costs associated with tax compliance (Roy, P., & Khan, M. H. 2021; Yerima et al., 2023).

The overall approach is expected to help MSMEs grow and generate stable tax receipts for the country without compromising sectors that are critical to the local economy. It is important to remember that an effective tax policy for MSMEs must balance promoting economic growth with ensuring fairness and adequate tax compliance. (Atichasari, A. S., & Marfu, A. 2023).

MSMEs Tax Policy and Regulations

The tax policy for micro, small and medium-sized enterprises (MSMEs) is an important instrument used by the government to support the growth of this sector that plays a major role in the economy. In addition to securing a source of national income, a well-designed tax policy can help MSMEs grow and thrive. (Luthra, R. K. 2024). The following are some of the tax policies generally adopted by governments to support MSMEs:

- Lower Tax Rates. To boost MSME growth, some countries set lower tax rates for this sector compared to large corporations. This is aimed at reducing the tax burden and improving the competitiveness of MSMEs.

- Simplified Taxation System. Governments often simplify the taxation process for MSMEs by implementing a simpler tax reporting system or cash-based taxation system, which allows MSMEs to report and pay taxes easily.
- Tax exemption. For MSMEs that are new to starting or operating in a particular sector that is considered important, the government sometimes offers a tax exemption for a certain period. It aims to encourage entrepreneurship and investment in priority sectors.
- Tax incentive. Tax incentives such as tax credits, tax cuts, or degradation facilities are given to MSMEs for specific activities such as research and development, investment in new technologies, or exports.
- Tax deferral. Tax deductions can be applied to MSMEs to enable them to delay tax payments during difficult periods or when making large investments.
- Tax digitization. The government supports using technology to facilitate tax administrative procedures, such as online registration for tax numbers, e-filing for tax reporting, and e-payment for tax payments. This reduces the administrative burden for the UCM. 7

7. Additional Tax and Education Program. To ensure that the UCM understands their tax obligations and is able to manage their finances well, the government provides an accompanying and educational taxation program. In situations of economic crisis or natural disasters, governments often provide temporary tax relief to MSMEs, such as tariff reductions or exemptions from certain tax payments. (Sherpa, D. 2022; Chandak, M. P., & Argade, N. U. 2024).

Implementation of these policies not only supports the sustainability and growth of MSMEs but also encourages innovation and job creation, which ultimately contribute to a stronger and more inclusive economy.

The tax regulation for MSMEs (micro, small, and medium enterprises) has undergone some important changes in recent times, including the adjustment of the final income tax rate (PPh). The final PPh rate for the MSMEs is now set at 0.5% of gross turnover. In Indonesia, these changes are regulated in Government Regulation No. 55 Year 2022 on Adjustment of Regulations in the Field of Income Tax, which is part of the government's efforts to provide wider tax facilities for MSMEs in support of economic growth and empowerment of the MSMEs itself. (Djuminah, D., & Kurniadi, A. C. R. 2024).

Meanwhile, in relation to broader regulation, in Indonesia for example, there is Government Regulation No. 7 of 2021, which also supports simplifying processes for MSMEs. This PP is a derivative of Law No. 11 of 2020 on Creating Work, which aims to provide facilities, protection, and empowerment for cooperatives and MSMEs. It covers various aspects, including, but not limited to, taxes (Chalim et al., 2022). The Law No.11 of 2020 itself has undergone changes. The current law is Law No.6 of 2023 on the Determination of Government Regulation in Lieu of Law No.2 of 2022 concerning Job Creation into Law. Based on Article 185 of the Government Regulation in Lieu of Law No.2 of 2022, as of the enactment of the Government Regulation in Lieu of Law No.2 of 2022, Law No.11 of 2020 was revoked and declared not applicable anymore.

It is also important to note that MSMEs' tax liability is not limited only to the final payment of PPh. They need to pay attention to other aspects, such as the tax reporting of SPTs that are part of their tax commitments. Compliance with these regulations is essential so that MSMEs can take advantage of the various tax facilities and incentives offered by the government. (Prasetiasari et al., 2023).

Impact of Tax Regulation on MSMEs' Growth

The tax regulation of micro, small, and medium-sized enterprises (MSMEs) has a significant impact on the growth and development of this sector. Well-designed tax policies can provide a strong impetus for MSMEs to grow, innovate, and compete in both local and international markets (Luthra, R. K. 2024).

Here are some positive and potential negative impacts of tax regulation on MSMEs growth:

- Strengthening financial structures. Low tax rates can boost UMKK's net profits, strengthen its financial structure, and improve its ability to re-invest in business.
- Tax regulations that simplify the process of reporting and paying taxes encourage MSMEs to formalize their businesses. This helps them gain access to banking facilities, credit, and other incentives.
- Promote Innovation and Development. Tax incentives for research and development can drive innovation among MSMEs.
- Workplace creation. Growing MSMEs means requiring more workforce, so it can significantly contribute to creating jobs. (SHERPA, D. 2022; Triyono, D., & Kusumawardhani, A. 2022).

The cost of understanding and ensuring compliance with tax regulations can be significant for MSMEs, especially for those who are new and do not have sufficient resources. Without adequate supervision, a simplified tax system can trigger tax evasion behavior, whether intentional or not, which ultimately undermines fiscal justice and sustainability. It is also important to understand that there is always a dependency on tax incentives. (Saputri, R. D. A., & Nugraha, F. K. 2024).

Governments have an important role to play in mitigating the potential negative impact of education and training on MSMEs regarding tax compliance, as well as reviewing tax policies on a regular basis to ensure that they continue to support MSMEs' growth. Strengthening the digital taxation system, improving access to tax information and training, and adjusting tax incentives dynamically to the economic conditions and needs of MSMEs, can enhance the positive impact of tax regulation on the MSMEs. (Chalim et al., 2022; Djuminah, D., & Kurniadi, A. C. R. 2024).

Determining Factors in an Effective Tax Policy for MSMEs

An effective tax policy for micro, small, and medium-sized enterprises (MSMEs) requires a thorough understanding of this sector, including its challenges and needs.

In order to create a tax environment that supports MSMEs growth, several factors must be considered:

- Simple and Transparent. Simplicity and transparency in the tax system are crucial to MSMEs. It includes the process of reporting and payments and easy-to-understand tax calculation. Complex tax systems are often a barrier for MSMEs to grow and thrive because of the resources and time it takes to ensure compliance with tax regulations.
- Establishing a competitive and reasonable tax rate is key to supporting MSMEs. Excessively high tax rates can reduce the profits generated and impede MSMEs' ability to compete in the market. Low tax rates for MSMEs, such as the final PPh rate of 0.5%, help ease the tax burden.
- Tax incentives. Tax incentives can boost the growth and construction of MSMEs. These can be tax credits for investments, tax exemptions, or deferrals for new startups to tax facilities for research and development. They are intended to boost innovation, increase production capacity, and open up new jobs.

- Tax education is an important factor in building tax compliance among MSMEs. Many MSMEs have difficulty fulfilling their tax obligations due to a lack of knowledge. Educational programs and technical assistance in tax matters can improve tax understanding and compliance.
- Access Digitalization. Implementing a digital-based tax system could make it easier for MSMEs to fulfill their obligations. Integrating technology into taxation processes, from reporting to tax payments, can reduce administrative burdens and increase efficiency.
- Policy flexibility. Tax policy flexibility allows adaptation to changing economic conditions or specific challenges facing MSMEs. This includes quickly adjusting tax incentives or providing temporary tax reductions to support MSMEs in difficult times.
- Feedback and Dialogue. Create feedback mechanisms between MSME entrepreneurs and tax regulators, enabling sustained improvements in tax policy. Open dialogue can help governments understand the challenges faced by MSMEs and adjust policies as needed. (Purba, M. A. 2024; Sumiok, C. 2023; Michael, M., & Widjaja, W. 2024).

Implementing these factors in tax policy will create an enabling environment for MSME's growth and sustainability and will ultimately contribute to more inclusive and sustainable economic growth.

Conclusions

A comparison of tax laws for micro, small, and medium-sized enterprises (MSMEs) in developing countries shows variations in approaches and practices. However, some important points tend to be common among tax legal systems designed to support MSMEs in developing countries:

- Tax incentives. Most developing nations provide tax incentives to MSMEs to boost their growth and construction. These incentives can include tax cuts, tax exemptions for startups, and special facilities for investment in research and development.
- A simple and flexible tax system. Most developing countries seek to simplify their tax systems for MSMEs, aiming to reduce administrative burdens and promote tax compliance. These include simpler tax forms, the use of technology for efficiency, and lower tax rates or a single tax that is easier to manage.
- Focus on digitalization. Digitalization of tax processes is a common trend, and developing countries are encouraging MSMEs to use online tax systems. It improves efficiency, transparency, and accessibility, making it easier for MSMEs to meet their tax obligations.
- There is a recognition of the importance of education and taxation for MSMEs in developing countries. Tax education and technical assistance programs are part of an effort to improve tax understanding and compliance among MSMEs.
- Tax compliance as access to greater benefits. Developing countries use tax policies as a tool to push for the formalization of UNMIK, which in turn supports overall economic growth.
- Different approaches to tax rates. Although there are generally attempts to reduce the tax burden, the approach to the tax rate varies. Some countries apply a mildly progressive tax rate for UMKK, while others may offer a fixed tax rate or even tax exemption for the initial period of operation. 7) Sustainable Dialogue between Government and MSMEs. Tax policy success often depends on a sustained dialogue between the government and the MSMEs stakeholders. Inputs from MSMEs help governments identify challenges and adjust tax policies to support better the development of micro, small, and medium-sized enterprises.

In conclusion, an approach that supports MSMEs' growth through tax policies in developing countries emphasizes the need for a simple, transparent, and growth-supporting tax system. Tax incentives, tax education, and digitization are key to creating an enabling environment for the development of MSMEs and, ultimately, for more inclusive and sustainable economic growth.

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