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Tax Policy and Entrepreneurship: How Incentives Shape the and MSMEs in India Growth of Start-ups

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ABSTRACT: Tax policy is a vital tool in forming the entrepreneurial landscape because it impacts investment decisions, capital formation, and business expansion. In India, where Micro, Small, and Medium Enterprises (MSMEs) and startups contribute immensely to economic growth and employment, taxation policies both fuel and restrict the entrepreneurial journey. This study analyses how tax incentives, including corporate tax cuts, startup exemptions under Section 80-IAC of the Income Tax Act, and Goods and Services Tax (GST) reforms, affect entrepreneurship in India.

This research will examine direct tax incentives, including a reduced corporate tax rate for new manufacturing companies (15%), as well as indirect tax policies such as GST simplifications for MSMEs, for example, Composition Scheme. The empirical evidence so far presents that beneficial tax policies promote formalization, improve access to credit, and promote innovation. However, regulatory complexities and compliance burdens often offset these benefits, creating entry and growth barriers (Ayyagari et al., 2011). Another example is Angel Tax or Section 56(2)(viib), which was implemented to check money laundering. However, it hampers the chances of venture capital investments (Nasscom, 2021).

By fostering a predictable and supportive tax environment, India can enhance its startup ecosystem and drive sustainable economic growth.

KEYWORDS: Tax Policy, Entrepreneurship, MSME, Tax Incentives, Startup Growth, Regulatory Compliance

I. INTRODUCTION

Recent years have been very dynamic for entrepreneurship in India and more so for the startup and MSME sector. These are being identified as very important growth drivers of economic growth, job creation and innovation relevant to the developmental aspirations of the nation; however, most startups and MSMEs face a lot of challenges despite having the potential. But perhaps the most dominant factor that will determine the course of businesses in any country will be the prevalent tax policy. Some very important factors that influence nurturing or stifling of the entrepreneurial spirit, hence in determining ease in doing business and shaping decisions related to investment, expansion and innovation are tax incentives, exemptions and compliance requirements. This paper reviews the current tax frameworks and their direct effects on entrepreneurial activities as a way of finding upto what extent policies promote or hamper business creation, growth and scalability in the country. Analyzing and drawing salient lessons that can be applied in India to make tax reforms more effective and incentives more efficacious in spurring entrepreneurship and fostering a vibrant startup ecosystem.



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As India climbs the ranks and becomes one of the world's leading innovation hubs it is essential to comprehend how tax policy intersects with entrepreneurship—a key component in creating an enabling environment for businesses to flourish and establishing economic resilience.

II. LITERATURE REVIEW

1. **The Influence of Tax Policies on Investment Decisions and Business Development of Micro, Small, and Medium-Sized Enterprises (MSMEs) and its Implications for Economic Growth in Indonesia.** Anna Sofia Atichasari, Asep Marfu-*Journal of Economics, Finance and Management Studies*. This article analyzes how tax policies affect investment choices, business expansion and economic growth in MSMEs. Based on a quantitative survey that was done, the research concludes that good tax policies have a positive effect on MSME investments with a reasonable growth. Policy makers need to design tax policies to support investment and growth, whereas MSMEs need to capitalize on such policies to make them competitive. The primary disadvantage of the study is that it was regionally focused and based on self-reported information. Future studies would need to examine longitudinal studies and contextual factors. Generally, the results indicate that positive tax policies can stimulate sustainable growth and development in the MSME sector.
2. **The Impact of Tax Policy on The Growth of Micro, Small, And Medium En-terprises (MSMEs) In Indonesia(2024)- Goei Elvian Kertojoyo.** MSMEs are a significant component of the Indonesian economy, accounting for 60% of GDP and 97% of employment. MSMEs, however, have issues with taxation, especially in tax burden and administration. The government responded by implementing a 0.5% final income tax policy for MSMEs. This study encompasses a mix of normative juridical and qualitative empirical approaches, such as literature reviews, interviews with 30 MSME players, surveys of 200 respondents, and focus group discussions. The findings indicate that although policies have streamlined the tax regime, their enforcement continues to impede tax awareness and compliance. The MSME sector demands policy reforms responsive to their needs and mass-scale education and mentoring programs to encourage growth.
3. **Impact of MSME tax initiatives affected by covid-19 on tax compliance (2022)** Rudianti, W., & Ningrum, S- In this study, the influence of tax incentives for MSMEs by the government during the COVID-19 era on tax compliance was examined and analyzed. A descriptive qualitative case study method was used for the process, collecting data via interviews and observations among MSME stakeholders and the tax authorities in Purbalingga Regency. The results indicate that tax incentives implication which took place due to COVID-19 crisis had a positive effect on MSME tax compliance in Banjarnegara Regency. The government's tax relief income under PMK-44/PMK.03/2020 exceeded taxpayers' expectations and facilitated business recovery which enabled MSMEs to convert tax savings into capital for sustainability. This motivated MSMEs to comply with tax laws.
4. **Lannai, D., Syahban, F. A., Nurfadila, N., Haeruddin, S. H., & Subhan, S. (2023). How Tax Policies and Business Strategies Affect MSME Actors During the Covid-19 Pandemic.** *Advances in Taxation Research, 1(1), 13–24.*- This research as a whole investigated the effects of tax policies and business plans on MSMEs in Kolaka City during the pandemic. By employing a quantitative descriptive method, data was collected from 52 MSME respondents who were chosen using purposive sampling. The results indicate that tax incentives for MSMEs impacted by the COVID-19 pandemic had a positive and significant effect. Also, the utilization of online marketing as a company strategy greatly was in favor of MSMEs at this time. This paper discusses how tax incentives benefited MSMEs, enhancing tax consciousness, and how online marketing helped bring back business operations during the pandemic.
5. **Nuryanah, S., Mahabbatussalma, F., & Satrio, A. A. (2021). Evaluation of Government Reform in Tax Administration: Evidence from Micro, Small and Medium Enterprises (MSMEs) in Indonesia.** *International Journal of Public Administration, 46(5), 313–325.* This study analyzes the efficacy of government reforms in MSME tax administration through evaluating players' attitudes towards new tax rules according to the four canons of taxation: equity, certainty, convenience, and economy. Data was gathered from a survey of 518 MSME respondents. The findings indicate that the majority of respondents perceive that the new rules of income tax for MSMEs are in accordance with these four principles. This research is unique in addressing the effect of the new



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tax policy on Indonesian MSMEs, a developing nation with a lower tax/GDP ratio than those of developed countries.

6. **Sitompul, Monica Dwi Putri and Lubis, Satia Negara and Rahmanta, . (2023) *The Effect of Government Policies on the Success of Micro, Small, and Medium Enterprises (MSMEs) in Regional Development in North Tapanuli Regency*. *South Asian Journal of Social Studies and Economics*, 20 (4). pp. 225-236. ISSN 2581-821X.** This study explains the impact of government policies towards MSME success in Sumatra Utara, North Tapanuli. Based on field data consisting of 100 respondents (random samples of 39,856 units), it investigates Monetary Policy (X1), Fiscal Policy (X2), and MSME Success (Y1). People's Business Credit comes under monetary policy, while tax and funding come under fiscal policy. Success is reflected in terms of growth, access to market, and economic influence. Partial Least Square analysis confirms that monetary and fiscal policies positively affect MSME success. The study combines qualitative and quantitative methods to measure the contribution of MSMEs to the local GDP, offering insights into local policy support and sustainability.
7. **Hutagaol, L. (2025). *The Impact of the HPP Law on Changes in MSME Income Tax Rates and Modernization of the Tax System on MSME Taxpayer Compliance*. *International Journal of Business, Law, and Education*, 6(1), 124 - 133.** The Law of Harmonization of Tax Regulations (UU HPP) overhauled Indonesia's taxation system by lowering MSME income tax and streamlining tax procedures. Utilizing MSME surveys, this study concludes that decreased tax rates enhance compliance and that digital taxation increases transparency and efficiency. Adopting technology streamlines tax declaration, raising the participation of MSMEs. The results aim to inform policymakers to design better tax policies that facilitate MSME development and compliance in Indonesia.
8. **Klevantura, R. and Hama, A. . (2022) "THE EFFECT OF MSME TAX REDUCTION AND TAX SANCTIONS ON TAXPAYER COMPLIANCE FOR MSMEs IN SHOES CAMPOENG IN SIDOARJO ", *Jurnal Mantik*, 6(2), pp. 1269-1277.** The government reduced MSME tax rates from 1% to 0.5% as part of tax incentives in Regulation 46/2013. This paper investigates the effects of tax cut and penalties on MSME tax compliance in Kampoeng Shoes, Sidoarjo. Through multiple linear regression on 133 registered MSMEs, results indicate that reduced taxes and penalties significantly enhance compliance
9. **Pertiwi, A. R., Iqbal, S., & Baridwan, Z. (2020). *Effect of fairness and knowledge on tax compliance for Micro, Small, and Medium Enterprises (MSMEs)*. *International Journal of Research in Business and Social Science* (2147- 4478), 9(1), 143–150.** This research investigates the effect of tax fairness and awareness on MSME tax compliance in Malang. Based on 107 MSME surveys and SPSS 24 analysis, the results indicate that general fairness, tax rates, and self-interest affect compliance. Tax awareness also has a positive effect on compliance
10. **Djuminah, D., & Andreas Catur Restu Kurniadi. (2024). *Effectiveness of final income tax imposition on MSME performance*. *Jurnal Ekonomi*, 13(01), 933–948.** This research investigates MSME tax incentives and their effects on corporate value and tax revenue. With the Mann-Whitney U Test in SPSS 27 for taxpayers in DJP Central Java II (2015–2022), results indicate no short-term effect (2015–2017) but long-term fluctuations in favor of non-MSMEs. MSME tax incentives in PP 46/2013, PP 23/2018, and PP 55/2022 failed to improve MSME performance. Limited information and extraneous influences, such as COVID-19, were not taken into account. Results can benefit policy evaluation and tax planning.

III. RESEARCH OBJECTIVES

1. To examine the efficacy of tax incentives in encouraging startup development.
2. To determine if tax incentives result in long-term business operations.
3. To analyze the effect of taxation on MSME survival rate.



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IV. METHODOLOGY

1. Research Design

The research has a descriptive and analytical study design to assess the effectiveness of tax incentives to stimulate MSMEs and startups in India. The research heavily relies on secondary data to assess the effectiveness of the tax advantages in stimulating entrepreneurial development and business viability.

2. Data Collection Methods

The research relies on secondary data sources such as:

Government Reports and Policy Documents: Ministry of Finance, Startup India, GST Council, NITI Aayog, and Budget Reports data would be used to monitor the development of policy. Academic Literature and Research Papers: Recent research after 2021 on the impact of tax on entrepreneurship and MSMEs would be examined. Industry Reports and Case Studies: In addition, FICCI, CII, World Bank, and RBI reports are to be considered in sectoral impact studies.

3. Research Approach

The research method is comparative analysis and simulation-based with emphasis on:
A. Comparative Analysis: Pre & Post Policy Reforms: A longitudinal study of the MSMEs and startups pre- and post-tax incentive announcements like lower corporate tax rates, GST exemptions, and initiatives like Section 80-IAC for startups.

Sectoral Breakup: The study would categorize the firms into core sectors, i.e., IT, Manufacturing, and Services, to study the impact of tax incentives on their growth pattern.

Survival Rate Analysis: Survival rate of the companies would be compared with some important parameters like revenue growth, profitability, and employment generation capability.

4. Study Limitations

Reliance on Secondary Data: The study relies on secondary data and, to a lesser degree, the authenticity of government and industry reports.

Variation Across Sectors: Tax incentive impacts may be different across sectors, hence generalizability may be affected.

Ongoing Policy Revisions: Tax law changes may make some data obsolete or, at best, less relevant with the passage of time.

5. Ethical Aspects

Making sure the information is credible by only using authoritative sources like government websites and reputable journals. Being objective in analysis by taking into account several viewpoints of thinking of both recipients and non-recipients of tax incentives.

V. DATA FINDINGS AND ANALYSIS

1. Government of India, Ministry of Commerce and Industry, Department for Promotion of Industry & Internal Trade

Tax Exemption for Startups (Section 80-IAC):

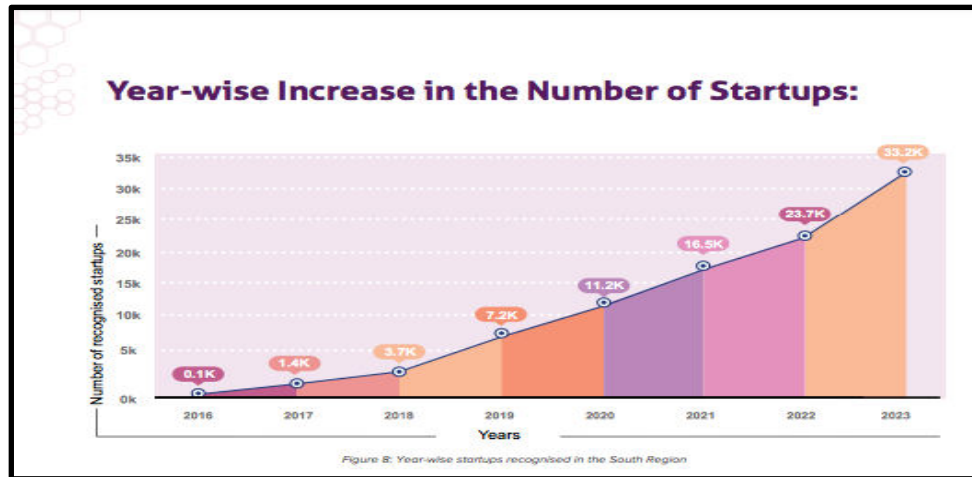
- Long-duration startups can claim profit tax exemption at 100% for 3 assessment years within 10 years from the year of incorporation.
- The startup will be given a Certificate of Eligibility by the Inter-Ministerial Board (IMB) in order to be eligible for this relief.
Tax Exemption on Investment in excess of Fair Market Value (Section 56(2)(viib)):
- Startups being exempted from tax on investment in excess of Fair Market Value (FMV) while giving shares are DPIIT-approved startups.
- It removes the tax on premium investments received by startups in excess of their FMV.



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2. Start-up India Factbook (Region Wise Data)



Key Observations & Interpretation:

Exponential Growth Post-2016:

- The number of startups in the North has risen from 100 in 2016 to 37,500 in 2023; in the South, from 100 in 2016 to 33,200 in 2023; and in the Northeast, from 8 in 2016 to 1,400 in 2023.
- The launch of Startup India in 2016, coupled with tax incentives by way of Sections 80-IAC and 56(2)(viib), provided the much-needed impetus to early-stage startups.
- The North and South regions had more numbers of registered startups, which are in line with better access to investors, markets, and policies that help business growth.
- The NorthEast region, though growing, is still considerably low, meaning there is a problem in access to funding and market penetration.

MSME & Startup Synergy:

Many startups in India operate in sectors that overlap with those of MSMEs. The extension of MSME tax incentives to these, with reduced corporate tax rates, subsidies for credits, ease in compliances, resulted in a spurt in startup registrations since 2019.

Impact of the Pandemic (2020-2021).

Startups further grew by 2020 and 2021, mainly in the technology sector, fintech, and healthcare, aided by government relief measures and COVID-19-related flexible compliances.

Resilience in the number of startups post-2020 reflects the success of the financial and tax relief measures.

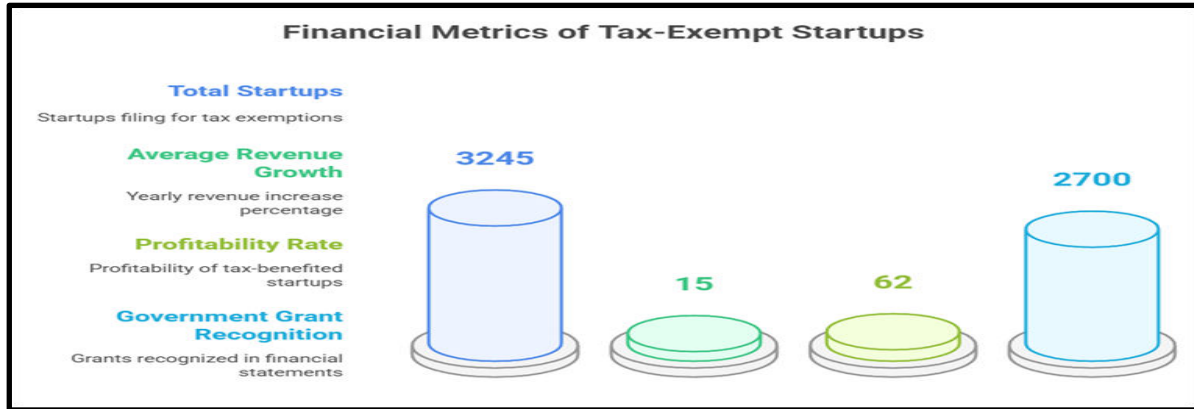
Growth in Number of Startups & Job Creation

The number of recognized startups directly corresponds with job creation. The number of jobs grew from a mere 3,000 jobs in the year 2016 to more than 1 lakh jobs in the year 2023. The said increase in jobs was on account of: Lower tax rates for MSMEs (from 25% to 22%), letting firms invest returns in hiring. Startup-friendly tax policies, thus making it easier for businesses to scale. Access to credit schemes—CGTMSE, MUDRA loans, SIDBI—that enabled the MSME sector to expand operations and workforce.



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Interpretation

- There is an encouraging trend for Indian startups taking advantage of tax exemptions. The huge turnover of startups taking advantage of these exemptions (3,245) and the year-on-year 15% average revenue growth indicates a booming industry..
- With 62% of these startups becoming profitable, the financial health of these companies appears robust, perhaps fueled by the tax benefits they are enjoying.
- Government contribution by grants (₹2,700 crore) reveals its intentions in favor of backing startups and inducing innovation to not only ease taxes but also contribute directly to expansion and development

Ministry of Corporate Affairs (MCA) – Financial Statements of Startups

INDICATOR	DATA (SAMPLE)	NOTES
Total Number of Start-ups Filing (Tax Exemptions)	3,245 start-ups	Number of start-ups availing Section 80-IAC tax exemptions in 2024.
Average Revenue Growth for Start-ups	15% YoY	Average revenue increase for tax-exempt start-ups over the past year.
Profitability Rate for Tax-Benefited Start-ups	62% of start-ups report profitability	Percentage of tax-exempt start-ups showing profits.
Government Grant Recognition (Ind AS 20)	₹2,700 crore	Value of grants recognized as part of financial statements under Ind AS 20.

TAX POLICY IMPACTS ON MSME'S SURVIVAL RATE IN INDIA

Tax policy impacts on the survival rate of Indian MSMEs are varied. The survival rates are both impacted negatively and positively, and the most significant reforms taken up are the rollout of GST in 2017 that has significantly reached the MSMEs.

Key Findings:

1. Reduction in Tax Exemption Threshold:

In the earlier system, MSMEs with turnover less than ₹1.5 crores were exempted from paying excise duty. In GST, the threshold was reduced to ₹20 lakhs, bringing a greater number of MSMEs under the tax net. This has imposed an increased tax burden on small businesses and may influence their profitability and survival rate.

2. Higher Compliance Burden:

GST imposed extra compliance costs like the requirement to file a series of returns in a year. While returns under the previous tax schemes were filed every quarter or bi-annually, even 37 returns would be filed in a fiscal year under GST, which raises their compliance expenses, especially for MSMEs who have limited administrative capacity.



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3. Increased Market Access and Competitiveness:

Although overall compliance has been enhanced, GST has facilitated the country to have a more integrated national market by removing state-level taxes and impediments. This integration has allowed MSMEs to operate their businesses more effectively outside the state boundaries, thereby enhancing their competitiveness and prospects for growth.

4. Input Tax Credit Benefits

GST enables businesses to claim input tax credits on purchases made, which would improve working capital flows and reduce the net tax burden. The scheme has been very helpful to MSMEs since it is cost-saving and keeps finances viable.

INTERPRETATION

The GST has created both adverse and beneficial effects on MSMEs in India. The lowering of the threshold for tax exemption and increased compliance costs have increased operating issues for MSMEs, yet simultaneously, the creation of a single market and input tax credits provided opportunities for growth and enhanced financial management. The net effect of GST on MSME survival rates is found to be mixed, depending on enterprise capabilities and flexibility.

VI. CONCLUSION

India's taxation policy has impacted its entrepreneurial environment considerably, with benefits like a concessional rate of corporate tax, GST changes, and exemptions under Section 80-IAC for the support of MSMEs and start-ups. While such incentives support business growth, the complexities of compliance and regulatory issues remain major hindrances, especially for small-scale enterprises.

It calls for an integrated approach, considering sectoral needs and taking international examples like the U.S. Small Business Jobs Act and SEIS of the UK. Simplifying taxation, declining regulations, and encouraging constant dialogue with entrepreneurs can make it more predictable, transparent, and stimulating. Tweaking policies will further strengthen India's startup environment, driving sustained innovation and economic development.

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