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## An Evaluation on the Influence of Goods and Service Tax (GST) on Micro Small and Medium Enterprises (MSMEs)

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### **Abstract**

*Goods and Service Tax (GST) launched by the Government of India on 1<sup>st</sup> July 2017 is aptly regarded as the biggest reform ever since the independence of India. GST is a globally accepted tax system and as the name indicates, it is a tax on both goods and services. Within a short period of three years of its implementation, GST has effected revolutionary changes in the business domain. The implementation has incurred many teething problems in the industrial sector because of the demographic, and socio economic characteristics of the sector. The major cause of concern is the MSME sector, as they lack compliance infrastructure. Implementation of GST provided opportunities for MSMEs and poses certain challenges. The study explores the experiences of MSMEs under GST scenario.*

**Key words :** 1.Goods and Service Tax, 2.Goods and Service Tax Network, 3.X Gross Domestic Product, 4.Micro Small and Medium Enterprises, 5.Goods and Service Tax Network, 6.Value Added Tax, 7.Gross Domestic Product.

### **Introduction**

There is a saying in Kautilaya's Arthashastra, the first book on economics in the world, that the best taxation regime is the one which is "liberal in assessment and ruthless in collection" (Olivelle, 2013). The Goods and Service Tax (GST) seems to be based on this principle. GST can be defined as a tax on goods and services, which is leviable at each point of sale or provision of service, in which, at the time of sale of goods or providing services the seller or service provider may claim the input tax credit of tax which he has paid while purchasing the goods or procuring the service (ICAI, 2018). Replacing almost 17 indirect taxes (Kumari, 2017), GST is truly a revolutionary move. GST in India is already 2 year old and in its journey till date businesses and registered taxpayers have learnt a lot of lessons in terms of law, its mandates, amendments and how it needs to be adopted and implemented.

GST has been implemented across 160 countries (Debnath, 2016) in the world (number of countries based on region is represented in table 1) and the businesses in these countries had undergone several challenges under it. Its adoption and implementation in India was not an easy task. There has been lot of resistance from various industries and sectors towards adoption of GST (Nayyar & Singh, 2018). With the implementation of GST, businesses were required to change their accounting system, institute proper accounting record keeping, modify business processes, train their personnel, and have proper software to ensure successful documentation and recording for GST compliance (Loo & Taib, 2017).

**Table 1.**  
**Number of countries with GST**

Region	No. of countries with GST
ASEAN	7
Asia	19
Europe	53
Oceania	7
Africa	44
Caribbean, Central & North America	19

**Source:** www.treasury.gov.my

The transition to GST is affected Micro Small and Medium Enterprises (MSMEs) to the most as it have a far-reaching impact on almost all the aspects of the business operations including pricing of products and services, supply chain, IT, accounting, and tax compliance systems (Kotnal, 2016). Thus, it is important that the MSMEs must understand the concept for their effective compliance under GST regime.

### **MSMEs in India**

Micro Small and Medium Enterprise is one in which the investments in fixed assets does not exceed Rs10 crore in manufacturing enterprises. For service enterprises, to be considered as Micro Small and Medium, the investment in plant and machinery should not exceed Rs5 crore (MSME Act, 2006).

**Table 2.**  
**Classification of MSMEs**

Types of enterprises	Engaged in manufacture/production of goods	Engaged in providing/rendering services
	Investment in plant and machinery	Investment in equipment
Micro	Under ₹25 lakh	Under ₹10 lakh
Small	₹25 lakh to ₹5 crore	₹10lak to ₹2crore
Medium	₹5 crore to ₹10 crore	₹2 crore to ₹5 crore

**Source:** Micro Small and Medium Enterprises Development Act 2006

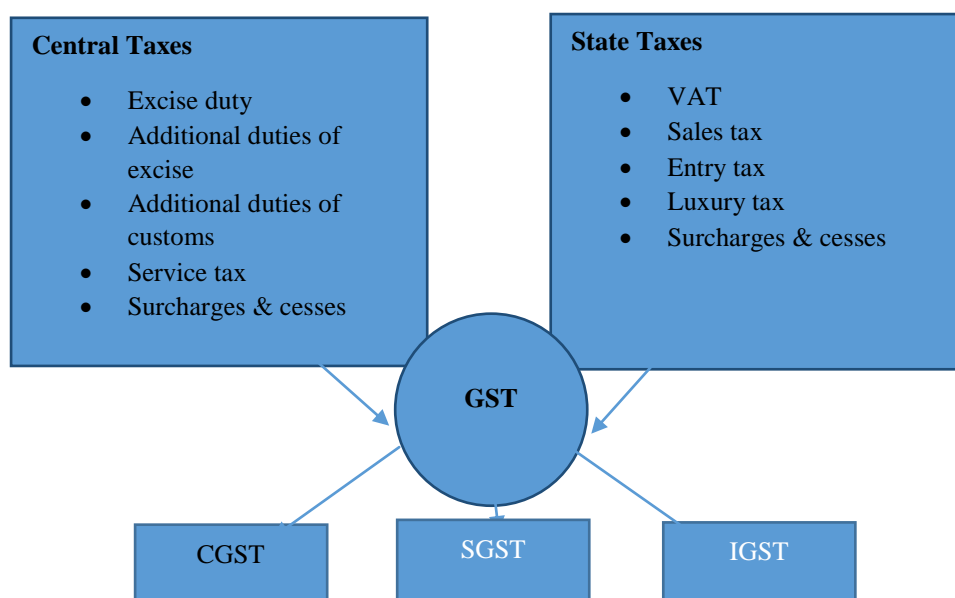
MSMEs play a significant role in the development of a nation (Nanda, 2016) as they provide large employment opportunities and need only a shorter gestation period and relatively lower investments. As on 2018, about 80 million employment opportunities are being generated by 36 million MSMEs, contributing to about 8% of the Gross Domestic Product (GDP) and 33% of total manufacturing output in India (Ministry of Micro Small and Medium Enterprises, 2018). India's MSME sector, in general is known to face several problems which inter alia include inadequate access to financial resources, little or no access to technology, availability of trained staff, difficulty in marketing output etc. (ISID, 2018).

Several measures have been taken by the government to revive the sector but the lackluster response has been a real cause of worry for the nation. On top of that, sudden introduction of new tax reform has blocked the growth of the sector in the short run (Chakraborty, 2018). The major hurdle faced by these enterprises under GST is that GST expands the base of taxpayers which include more MSMEs and increase the burden of compliance cost. On the other hand, GST makes the MSMEs more competitive (Singh et al, 2012) in the national and international market.

Therefore, this paper aims to study the influence of GST on MSMEs in order to understand how well they coped up with the new Indian indirect taxation system.

The previous taxation system in India was not user friendly for MSMEs as they need to keep track of various indirect taxes like Octroi, Central Sales Tax[CST], tax on transportation of goods and services, state wise Value Added Tax (VAT), stamp duty charges and many others as given in the diagram below.

#### Pre - GST & GST indirect tax structure in India



**Source:** Compiled from report of the task force on Goods and Service Tax (Thirteenth Finance Commission, 2009)

As shown above GST is an indirect tax which subsumes almost all the indirect taxes of central government and state governments into a unified tax. It has dual model including Central Goods and Service Tax (CGST) and State Goods and Service Tax (SGST). Integrated Goods and Service Tax (IGST) also called Interstate Goods and Service Tax is also a component of GST (Bhattacharya, 2017).

#### Important Features of GST Act

- The base is extended to all goods and services except some specified items
- Tax is destination based
- There is seamless flow of tax credit in the value chain and across state borders
- The exports are zero rated
- Computerized compliance and administrative systems
- Simultaneous power for central government and state government to make law governing GST
- All transactions and processes only through electronic mode
- The e-way bill system has been introduced nation-wide for all inter-State movement of goods
- System of GST compliance rating for businesses
- Registration mandatory for suppliers of services only if the turnover exceeds Rs.20 lakhs

- Registration mandatory for suppliers of goods only if the turnover exceeds Rs.40 lakhs

### Applicability of GST on small businesses

There are three categories in which businesses can opt for GST registration

- Those below threshold need not to register for GST
- Those between the threshold and composition turnover have the option to pay turnover based tax or to opt GST
- Those above threshold limit have to be within the framework of GST (CBIC, 2016)

### Benefits of GST to MSMEs

GST brings benefits to all the stakeholders especially MSMEs in numerous ways. GST might not be the panacea for all the ills of indirect tax system but it is an inevitable transformation for our country. The following table explains how GST benefits MSMEs in their operations.

**Table.3 Benefits of GST**

➤ Reduction in cascading of taxes	Decrease in inflation
➤ Overall reduction in prices	
➤ Common national market	Ease of doing business
➤ Benefits to small tax payers	
➤ Self-regulating tax system	Decrease in black transactions
➤ Non- Intrusive electronic tax system	
➤ Simplified tax regime	More informed consumer
➤ Reduction in multiplicity of taxes	
➤ Exports to be zero rated	Make in India
➤ Protection of domestic industry-IGST	

**Source:** [www.cbic-gst.gov.in](http://www.cbic-gst.gov.in)

### Favorable Influence of GST on MSMEs

#### Easy to start business

Unlike Value Added Tax (VAT) system GST requires a centralized registration. A business with multi-state operation in this case has not to follow varied tax rules applicable to different states (Siddique & Sathyaprasad, 2017). MSME's can expand their business as they don't want to worry about complex taxes applicable in different states.

**Easy compliance**

All the compliance procedures under GST — registration, payments, refunds and returns are now to be carried out through online portals only. Thus MSMEs need not worry about interacting with department officers for carrying out these compliances, which were considered as a headache in the earlier tax regime (Hassan, 2017).

**Expanded market**

The tax credit under GST is transferred, regardless of the location of the buyer and the seller. This allows the MSME segment to extend its operations beyond the limits of geographical area (Subramania et al, 2019).

**Removal of distinction between goods and services**

Under Goods and Services Tax the distinction between goods and services is removed and therefore it will simplify various legal proceedings related to the packaged products. As a result, there will no longer be a distinction between the material and the service component, which will greatly reduce tax evasion (Pandit, 2017). Apart that there is no additional tax burden for MSMEs that operate on sales and service model of business.

**Increased competitiveness**

Tax reform offers equal footing to large and small companies and ensure that equities are transferred evenly. GST improves the competitiveness of manufacturing sector by mitigating the cascading effects of taxes (Chaturvedi, 2018).

**Lower logistical overheads**

As GST is tax neutral, it eliminates time consuming border tax procedures and toll check posts and encourage supply of goods across borders. Accordingly the logistical cost in time and money for companies manufacturing bulk good will be reduced. Such costs can be crucial for the survival of MSMEs.

**Reduce tax burden on new business**

Earlier, business which have turnover more than 5 lakh rupees need VAT registration (Vasanthagopal, 2011), (Sharma S, 2017). The government introduced exemption limit of 40 lakh (Business Line, 2019); (CBEC, 2019) under Goods and Services tax which helps to reduce tax burden on small dealer and MSME's.

**Unfavorable Influence of GST on MSMEs****Working capital requirement**

Business houses has to be punctual to ensure that tax dues are timely paid and a valid return cannot be filed until tax payments are made. This is having greater impact on working capital requirement of business.

**Taxation under reverse charge scheme**

Under GST, if any goods or services are supplied by an unregistered person to a registered person, then GST needs to be paid by the registered person under reverse charge as a recipient. This provision shall have negative impact, as businesses would not prefer to deal with unregistered persons and to take the additional burden of compliance under reverse charge. Therefore, this provision directly impacts the business of small sector negatively and virtually forces them to either register or to shut the business (Satbhai, 2018).

### **Restrictive composite levy mechanism**

This is nothing but an alternative method to levy tax designed for small taxpayers who are having turnover not greater than 1.5 crore (Clear Tax, 2019). Entrepreneurs opting for such a mechanism cannot take input tax credit and cannot sell through e-marketplace.

### **Compliance rating provisions**

Extra care is required from the part of MSMEs in order to maintain good performance in 'Compliance Rating', which assign ratings based on timely filing of returns and timely payment of taxes.

### **Compliance cost**

Not all the MSMEs have technical expertise in dealing with online system for compliance and most of them are in need of intermediaries and digital resources which will add to the compliance cost.

### **MSME's experience under GST**

India's paradigm shift to the GST regime brought majority of MSME into the indirect tax net for the first time and there by increased compliance cost for MSMEs (Ashtekar, 2019). So far the unorganized MSMEs were growing faster than the organized ones because of the tax avoidance. Under GST, it has made the taxation system transparent thus making the entities liable for tax payment (Subramanian et al 2019). There has been fifty percent increase in the number of indirect tax payers and a large increase in voluntary registrations, especially by small enterprises and want to avail themselves of input tax credits (Ministry of Finance, 2018).

GST encouraged MSMEs to register themselves and take them to formal economy. As per (Kutty, 2019) 48lakh MSMEs are registered with Udyog Adhaar Memorandum as of July 2018. A year after GST small businesses report huge drop in sales, struggle with high cost of compliance (Sachdev, 2018). It is also evidenced by another study (Sharma & Singh, 2018) which says, more than half of the respondents revealed that their sales post-GST implementation has declined and had a substantial effect on their profitability margin (Mohan & Ali, 2018). The demand for workforce had increased mainly due to the extensive return filing process, reconciliation of inputs in the GST portal, e way bill generation etc (FICCI, 2018).

### **Problems faced by MSME under GST**

A change as comprehensive as GST is bound to pose certain challenges not only for the government but also for business community. Some of these challenges relate to the unfamiliarity with the new regime. Many of the processes in the GST are new for small and medium enterprises in particular, who were not used to regular and online filing of returns and other formalities. Major problems faced by the MSMEs are given below.

1. GST compliance, return filing and payments all have to be done online. Many small businesses are not tech-savvy and do not have the resources for fully computerized compliance. There were so many problems associated with GSTN portal.
2. Difficulty in understanding complex provisions in the law. Extra care is required to avoid the burden of unnecessary action on MSMEs.
3. Multiple rate structures made it more complex for taxpayers to understand and implement GST in their existing business systems. Further, lower threshold for composition dealers and classification of commonly used goods under higher rate slabs caused dissatisfaction amongst the business community.

4. In GST law one would require to file not less than 37 returns (Praharaj, 2017) in a fiscal year. This includes several files such as monthly outward supplies return, monthly inward supplies return, monthly summary return and one annual return.
5. Funds are required to be maintained in the form of electronic ledger for the GST compliance purpose. Thus MSMEs face liquidity crunch in their operations.
6. MSMEs can avail refunds only after filing relevant returns and it depends on supplier's compliance and his rating.

### **Suggestions to simplify GST for MSMEs**

GST was pain for MSMEs when it is introduced but it can be a gain in the near future. GST will enormously benefit the Indian MSMEs in the long run if the complexities faced by them are alleviated by considering the following suggestions.

1. Proper GSTN functionality should be ensured and rigorous procedures on compliance should be eased out for the better compliance of MSMEs under GST.
2. Delays in payment of input tax credit and getting refund should be minimized, so that MSMEs can get rid of the problems of working capital to a great extent.
3. The composition scheme is available for manufacturers, traders and restaurant service providers only. It must be extended to other service providers too with certain percentage of inter-state outward supplies, which is not allowable in the present GST scenario.
4. E- Way Bill compliance must be made little easy for small taxpayers by prescribing simple form with lesser details.
5. Payment and return filing process should be interlinked and it can be made quarterly for MSMEs to reduce their compliance burden.
6. The government should take active step in educating the complex provisions of the Act and make circulars on important information are easily available for them.

### **Conclusion**

It is critical for MSMEs to remain competitive in the market under GST scenario. GST compliance is a big issue for MSMEs in coping with their day to day activities. This paper made an attempt to understand how MSMEs are affected by the introduction of GST, what are their areas of concern and the potential benefits accruing to their business. Regardless of some problems in managing compliance requirements, implementation of GST is seen as being positive for MSMEs and they are in pace with the changes in the new scenario. Success of GST on MSMEs depends to a great extent on how quickly businesses adapt to the digital format of taxation. MSMEs should be motivated to maintain GST discipline and financial soundness, so that they do not default in compliances. If the complexities in the return filing process are eased, it could trigger more regular filings from many of the small traders.



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