The Impact of Goods and Service Tax on the Micro, Small and Medium Enterprises

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Abstract: A comprehensive dual Goods and Services Tax (GST) has replaced the complex multiple indirect tax structure from 1 July 2017. It is the biggest tax reform ever happened in India. Now we are witnessing how this tax reform reshapes our economy and business dynamics for Micro, Small and Medium Enterprises. The Micro Small and Medium Enterprises sector is a major constituent of our economy and contributes significantly to manufacturing output, employment and exports of our country. This paper look into how GST impact and what are its implications on the Micro, Small and Medium enterprises of the country.

1. Introduction

India has witnessed substantial reforms in indirect taxes over the past two decades. Even after these reforms indirect tax was a highly fragmented and distortionary tax structure characterized by multiple tax rates, barriers to interstate trade and cascading of taxes. However VAT reforms have succeeded in preparing the ground for the introduction of a comprehensive Goods and Service Tax [GST]. 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 new GST appears to be based on this principle. Goods and Services Tax [GST] is a system of indirect taxation in India merging most of the taxes into single system of taxation.

2. Meaning of Goods and Service Tax

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 (The Institute of Chartered Accountants of India, 2013). Implementation of GST is accepted among the direct stakeholders as it removes several blockades in the former VAT system such as tax cascading, double taxation, complexity, composite contracts…etc.

3. Origin of GST

GST is framed based on the Value Added Tax (VAT) principles. Value Added Tax was first devised by a German economist named Dr. Wilhelm Von Siemens during 18th century. France was the first country to introduce VAT system in 1954. At present VAT based tax regime has been introduced in more than 150 countries. Most of the countries have a unified GST system. Brazil and Canada follow a dual system where GST is levied by both the Union and the State Governments.

4. GST Scenario in India

The Micro, Small and Medium Enterprises [MSMEs] have been the solid backbone of our country’s economic development. It is estimated that in terms of value, the MSME sector accounts for about 45 percent of the manufacturing output and 40 percent of the total exports of the country. The sector is estimated to employ about 69 million employees in over 26 million units throughout the country (MSME Development Institute, 2015).

5. MSMEs and the Tax System

The former taxation system in India was not very 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 VAT, service tax, stamp duty charges and many others. With the introduction of the GST there is an end to all such indirect taxes. The GST will benefit MSMEs and large corporates by simplifying procedures, thus saving time and improving productivity.

6. Impact of GST on MSME’s

In the earlier taxation system, any manufacturer with a turnover of Rs 1.5 crore or less was not required to comply with the rules of excise duty. Under the GST realm, any manufacturer with a turnover of Rs 20 lakh (others) /10Lakh (Special
category states) or more will have to comply with GST, and that results in the increase of taxpayer base. Accordingly majority of MSME’s working now in the unorganized sector fall under GST regime and will put a burden of compliance and associated costs to them.

7. Positive impact of GST

7.1. Easier to Start Business

GST proclaimed as “One nation, One Tax”, and carries the flagship of ease of doing business in India. With GST there are uniform procedures, uniform payment of fees, and a smooth and uniform tax structure in all states, thus easing out the process to start a business in multiple states.

7.2 Facilitates Expansion of Business

Earlier, MSME’s was not much engaged in inter-state trade as it attracted more taxes and increased cost to customers, thereby reducing their customer base. With the introduction of GST, inter-state trade becomes cheaper as the tax credit can be transferred irrespective of location of buyer and seller. As a result SME’s will be able to expand their business across borders.

7.3 Lesser Tax Burden

GST eliminates the cascading effect of taxes by subsuming various state and central taxes. Businesses are able to take input tax credit too with GST. This reduces tax burden on businesses, making goods cheaper and increasing profit margins for MSMEs.

7.4 Online Compliance Procedures

Under GST all compliance procedures such as registration, payments, refunds and returns will be carried out through online portals. The burden on MSME’s to interact with department officers carrying out compliances will be eliminated. In this way GST will save time and effort of MSME’s.

7.5 Encourage Manufacturing Sector

With the implementation of GST, burden of tax is expected to reduce both for the manufacturer and the end user. Manufacturer can get the benefit of input tax credits and the end user has to pay only the tax charged by the last dealer or the retailer in the supply chain.

7.6 Purchase of capital goods

In the former taxation system, only 50 per cent of the input tax credit against purchase of capital goods is available in the year of purchase and the balance amount in subsequent years. Under GST regime, entire amount of input tax credit can be availed in the year of purchase.

8. Negative impact of GST

8.1. Lower Threshold

Under the previous excise tax regime, no duty is paid by a manufacturer with a gross turnover of less than Rs 1.50 crores. However, after GST implementation, this exemption limit gets considerably lowered to Rs 20 lakhs. As a result, a large number of MSME’s and start-ups come under the network of the GST.

8.2 Selective Tax Levying

GST is not applicable to Alcoholic liquor for human consumption and petroleum products, which creates further gap and does not support the ‘unified market’ ideology of GST.

8.3 Compliance Cost

GST regime operates on a self-assessment model, requiring MSMEs to file several returns and execute other compliances with monthly frequency. Increase in compliances would lead to increase in costs.

8.4 Technological Preparedness

Upgrading IT systems by MSMEs require a sizeable investment. In addition, expenses incurring for training employees for the new GST regime is also lead to increased overhead costs for the MSMEs.

8.5 Financial Preparedness

Since outward and inward supplies would be electronically matched every month, availing of input tax credit by the buyer would be based on the compliances of the supplier. Any failure by the supplier to declare his outward supplies correctly would lead to mismatch of returns leading to reversal of credits availed by the MSMEs.
9. Conclusion

There was a dire need to integrate India into one economy and get rid of the multiple taxes and its cascading effect. Introduction of GST resulted in simplification of indirect tax system in the country and thereby ensures seamless business transactions across our nation and world over. On the arrival of GST, the MSME sector has forced to revamp their strategies, systems, supply chains and costing apart from meeting the quality standards as per international norms. So far, unorganised MSMEs have grown faster than organised peers because of lower cost structures stemming from tax benefits, (if turnover is less than ₹1.5 crore). India’s paradigm shift to the Goods and Services Tax (GST) regime brought majority of MSME’s into the indirect tax net for the first time and thereby increased compliance costs for MSME’s. Complying with GST is bit complex for MSME’s at present. However in the long run it will benefit small and medium businesses as well as consumers. The overall impact of GST on MSME sector has to be reviewed by the Centre and the States periodically, and any adverse impacts observed should be addressed at appropriate times for the success of new tax regime.

10. Bibliography


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Online Resources

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