

# IMPACT OF GOODS AND SERVICE TAX ON MSMEs

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## **Abstract:**

Goods and Services Tax (GST) is expected to revolutionize the Indian tax system and is the biggest tax reform since Independence. It will integrate and simplify the process of indirect taxation and will replace the complicated taxes such as State Value-Added Tax(VAT),Central Excise, Service Tax, Entry Tax or Octroi and other indirect taxes.. GST involves a marked shift from state-wise taxation to a one nation, one tax structure, affecting the various facts of business such as portability, cashflow, and sourcing, pricing, supply chain. The principle expectation from this system is to abolish all indirect taxes and only GST would be levied. Because the name indicates, the GST could be levied each on items and offerings. GST is a tax that needs to pay on supply of products & offerings. Any person, who is presenting or offering goods and services, is liable to fee GST. The paper highlights the impact of GST on MSME's. MSMEs in India are an important contributor to the Indian economy and are drivers of growth. By its less capital intensive and high labour absorption nature, MSME sector has made significant contributions to the manufacturing output, employment generation, rural industrialization and exports of the country. The sector creates largest employment opportunities next only to agriculture. The sector is estimated to employ about 120 million people and contribute to around 46% of the overall exports from India.

**KEY WORDS: GST, ITC, MSMEs AND SGST.**

## **INTRODUCTION:**

The GST will take an important role in changing Indian Tax system and also make Indian products competitive in the domestic and international markets. This Study will show that this would instantly spur economic growth. The Goods and Services Tax (GST) would be a very significant step in the field of indirect tax reforms in India. By amalgamating a large number of Central and State taxes into a single tax, it would mitigate cascading or double taxation in a major way and pave the way for a common national market. From the consumer point of view, the biggest advantage would be in terms of a reduction in the overall tax burden on goods. Medium Small and Minor enterprises contribute approximately 37% of our Nations GDP. Implication of GST, substantially affecting this segment, in an adverse manner, may directly knock off the player from the competitive business market. It is found that a simplified tax structure and unified market will improve operational efficiencies, especially of MSMEs with a wider reach. India's paradigm shift to the Goods and Services Tax (GST) regime in July 2017 will increase their compliance costs and snare a majority of them into the indirect tax net for the first time.Last but not the least, this tax, because of its transparent character, would be easier to administer.

**OBJECTIVES OF GST:**

- To understand the concept of Goods and Service Tax.
- To study the impact of GST on MSMEs.
- To examine opportunities for MSMEs on the implementation of GST

**GOODS AND SERVICES TAX BACKGROUND:**

The Goods and Services Tax bill, touted to be India's biggest tax reform, will simplify the current system of taxation. The bill will convert the country into a unified market by replacing all indirect taxes with one tax. Brining all tax under single umbrella, Various Taxes like Excise Duty, Value Added Tax (VAT), Central Sales Tax, Luxury Tax and Entry Tax, etc. will all be included under a single roof by GST. The very important Feature of GST bill is that instead of collection of Taxes at every step, it will be collected in one step. Goods and Services will be treated equally and will be taxed similarly.

GST is imposed on supply of goods and services and it will replace all other taxes such as state/local tax, entertainment tax, excise duty, surcharges, octroi, etc. It will be applicable on transaction value which includes packaging, commission and other expenses incurred during sales. It will bring uniform taxation across country and will allow full tax credit from inputs and capital goods on procurement which can later be set against GST output liability. The reform gives equal footing to the big enterprises and SME alike and removes the tax differentiation on stock transfer. On the other hand, under the current system, VAT is levied partially at state and central level and at multiple points. Due to which the manufacturer has to shell out towards huge tax aggregates that is not sustainable in the long run. GST is aimed to simplify such tax hurdles and will be ultimately carried by the customer.

As per the current GST law, the tax slabs range from 5%, 12%, and 18% to 28%. Besides these slabs, some goods and services are exempt from GST. Essential commodities such as grains, cereals and vegetables are exempt from GST. The basic formula used for levying different rates of goods and services has been to fit them into their nearby slab of tax in the composite tax incidence in excise, service tax and VAT regime.

**TAXES ARE MERGED WITH GST**

The new GST will subsume or merge within itself the following Central (7) and State taxes (11):

Central taxes: Central Excise Duty (CENVAT), Service Tax, Additional Excise Duties, Additional Customs Duty or Countervailing Duty (CVD), Special Additional Duty (SAD) on Customs, all Surcharges and Cess, Central Sales Tax (CST).

State Taxes: State VAT or Sales Tax, Central Sales Tax (CST), Luxury Tax, Entry Tax (all forms), Entertainment and Amusement Tax (except when levied by the local bodies), Taxes on advertisements, Purchase Tax, Taxes on lottery, betting and gambling, State Surcharges and Cess so far as they are relate to supply of goods and services.

**BENEFITS OF GST**

- Subsume all indirect taxes at the centre and the state level.
- One-Country-One-Tax. Reduce the cascading effect of taxes on taxes.
- Increase productivity and transparency, increase tax-GDP ratio.
- Reduce/Eliminate tax evasion and corruption
- The tax structure is made of lean and simple.
- Improved SME market expansion
- Aids SMEs dealing in sales and services

**STATUS OF MSMES**

- Unorganized MSMEs have grown faster than organized peers because of lower cost structures stemming from tax avoidance, and not having to pay social security benefits to employees and excise duty (if turnover is less than Rs 1.5crore).
- GST is expected to provide a boost to this segment because of lower tax incidence.
- Last fiscal, MSMEs were expected to record on-year top line growth of 14 to 16%.
- The impact of demonetization has been severe in the second half and they would have closed the year with an increase of just 6 to 8%.
- As the effects of demonetization fade, growth will pick up in the current fiscal and “Make in India” is promising in leading this sector.
- Though growth is expected to be strong this fiscal, cheaper imports, especially from China, remain a challenge.

**IMPACT OF GST ON MSMES**

**Negative Impact:** While the MSMEs will enjoy the tax neutrality, reduction in duty threshold is one of their main concerns in warming up to the GST bill.

- **The burden of lower threshold:** The GST bill proposes a reduction in threshold to be Rs. 9 lakh to increase the tax net, Rs. 41akh for North Eastern states. (However, GST council has increased the threshold limit from 10 lakh to 20 lakh and from 41akh to 10 lakh for North eastern states) Under the reform, any service provider or retailer will be subject to tax levy. In the current central excise law threshold is Rs.1.5 crore. This reduction will significantly impact the MSMEs' working capital. For example, a manufacturer who trades today at Rs. 25 lakhs without any tax levy will be expected to pay GST post implementation. As the threshold is low, most MSMEs are now exempted and will have to pay a chunk of their capital towards tax in future.
- **No tax differentiation for luxury items and services:** The tax neutrality will not differentiate luxury goods and normal goods. Currently the state and central government levy higher taxes on luxury goods and services. Under GST implementation, all goods and services will have to pay the same tax which will lead to rich becoming richer and poor becoming poorer. It is not an ideal situation for MSMEs competing against large businesses.

- **Selective tax levying:** GST will not be applicable to Alcoholic liquor for human consumption and Petroleum based businesses, which creates further gap and does not support the 'unified market' ideology of GST.
- **The burden of higher tax rate for Service Provider:** Presently Service Tax rate is 15%. GST rate will be around 18%. The scenario in the service sector will further be impacted as the concept of Centralized Registration has been done away with and each unit in different states will have to take separate registration. Thus even if services are supplied by company's one Unit in State A to another Unit in State B , then also taxes will be payable.
- **Excess Working Capital Requirement** - Taxation of stock transfer will primarily impact the working capital requirements. The quantum of impact will vary depending on stock turnaround time at warehouse, credit cycle to customer, quantum of stock transfer, etc. Higher amount of Capital Requirement will increase interest cost which ultimately will increase the price of Finished Goods.
- **Realignment of Purchase and Supply Chain** - Under GST credit will not be available to a compliant company if the vendor from whom MSME is purchasing goods does not show the same in his return. Thus sourcing strategies will change on account of GST credit mechanism. Also there will be re-consideration of Supply Chain on account of taxation of Stock Transfers.
- **Dual Control** - In recent GST Council Meeting it was decided by the Ministry that those assesses having turnover of less than 1.5 Crores will be assessed by State Government and existing Service Tax assesses, irrespective of turnover will be assessed by Central Government as there is lack of expertise with the State Government in relation to Service Tax matters. As a result of this, small traders dealing in both goods and services will have dual administrative control both by Centre and State. **Positive Impact:** GST boosts competitiveness of MSMEs. They will benefit as follows
- **Starting business becomes easier:** Currently, the Sales Tax department has various turnover slabs which require VAT registration. A business with multi-state operation in this case has to follow varied tax rules applicable to different states. This not only creates excess complication but also adds to procedural fees, due to which the price sensitive MSMEs will be burdened. Uniform GST will standardize the process.
- **Improved MSME market expansion:** In the current system, big corporations procured goods based on MSME's locality in order to reduce overheads. Thus MSMEs limit their customers within state as they will bear the ultimate burden of tax on interstate sales, reducing their customer base. With implementation of GST, this will be nullified as tax credit will transfer irrespective of location of buyer and seller. This allows MSME segment to expand their reach across borders.
- **Lower logistical overheads:** As GST is tax neutral it will eliminate time consuming border tax procedures and toll checks posts and encourage supply of goods across borders. Accordingly the logistical cost for companies manufacturing bulk good will be reduced. Such costs can be crucial for the survival of MSMEs.

- **Aids MSMEs dealing in sales and services:** GST will not distinguish between sales and services. This is good news for the MSMEs that deal with sales and services model of business, for them the taxation is simplified and will be calculated on total.
- **Unified market:** GST will allow flexibility in transfer of goods across states and reduce the cost of doing business, as the reform will cut down multiple taxes imposed by state and central government.
- **Purchase of Capital Goods:** In the current system, only 50% 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 itself. This will support "Make in India" campaign.

#### **IMPACT ANALYSIS OF GST ON SMALL & MEDIUM ENTERPRISES**

Small and Medium Enterprises (SMEs) have been considered as the primary growth driver of the Indian economy for decades. It is further evident from the fact that today we have around 3 million SMEs in India contributing almost 50% of the industrial output and 42% of India's total export. For developing country like India and its demographic diversity, SMEs have emerged the leading employment- generation sector and has provided balanced development across sectors. Let's examine what would be the impact of GST on Small and Medium Enterprises.

After passing of the Goods and Services Tax (GST) Bill, the Industry is hailing the government for bringing up this reform which has been pending because of political deadlocks. But before we analyze the impact of GST on Small and Medium Enterprise ,we should understand how GST is going to wider the taxpayer base. Earlier, any manufacture with a turnover of Rs 1.5 crore or less was not required to comply to the rules of excise duty. However, with the merging of all State and Central level taxes into the ambit of GST, any manufacture with a turnover of Rs 20 lakh (others) / 10 lakh (Special category states) or more will have to comply with GST and its procedures.

All the compliance procedures under GST Registration, Payments, Refunds and Returns will now be carried out through online portals only and thus SMEs need not worry about interacting with department officers for carrying out these compliances, which are considered as a headache in the current tax regime.

Compliance Procedure	Positives	Negatives
Registration	Online registration will ensure timely receipt of certificate of registration and minimal bureaucracy interface	Not all the SMEs have technical expertise to deal with online systems, thus most of them will need intermediaries to obtain registration for them. This will add to their

		registration cost
Payment	Electronic compliance will bring transparency and will also reduce the compliance cost.	Since funds are required to be maintained in the form of electronic credit ledger with the tax department, it may result in liquidity crunch.
Refund	Electronic refund procedures will fast track the process and enhance liquidity for SMEs	Refunds can be claimed only after filing of relevant returns. Also it depends on the compliances done by the supplier and his rating.
Returns	All returns are required to be filed electronically and input tax credit and tax liability adjustment will happen automatically on the basis of these returns	Minimum of thirty-seven returns are required to be filed by every registered taxpayer during a financial year. Thus SMEs will have to deploy additional resources and eventual cost of compliance will increase

No doubt that GST is aimed to growth the taxpayer base, majorly SMEs into its scope and will positioned a burden of compliance and associated costs to them. But ultimately, GST will flip these SMEs extra competitive with a stage gambling field among massive firms and them. Furthermore, those Indian SMEs might be able to compete with foreign competition coming from cheap cost centers together with China, Philippines and Bangladesh.

## CONCLUSION

Every major reform is faced with certain hurdles, and arguments from various stakeholders. However, from an SME perspective, GST will bring in many positives compared to the current systems such as easy process of availing input credit, single point tax, elimination of cascading tax system, and simpler taxation. These pros offset the negatives.

While hopes rests with GST to boost the GDP growth and reduce the fiscal deficit. The extent of such impact will depend on a favorable consensus on GST rates for all business segments and integrated implementation of the same. Foreseeing the challenges the MSMEs may face in the GST regime, SIDBI, supported Federation of Indian Micro and Small & Medium Enterprises (FISME) to conduct a country wide programme to disseminate information on GST for benefit of MSMEs. Under the programme, brainstorming sessions have been conducted all over India where MSMEs interacted with experts on taxation.



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