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Impact of GST on MSME

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Abstract

India's tax structure relies heavily on indirect taxes revenues from indirect taxes are major source of tax revenue till tax reforms were undertaken during nineties. The major argument for heavy reliance on indirect taxes is that widening the base of direct taxes has inherent limitations. The basic characteristic of indirect taxation is that it is cascading, distorting tax on production of goods and services leads to low productivity and slower economic growth. There are many indirect taxes in the Indian tax system that is levied by Centre and State. Goods and Services Tax (GST), is an indirect tax, was introduced in India on 1 July 2017 applicable throughout India. GST has replaced multiple cascading taxes levied by the Central and State governments. As the name indicates, the GST will be levied on each and every items and services.

In this paper we will analyse, how this tax reform will affect the business dynamics of Micro, Small and Medium Enterprises, flourishing amidst a challenging environment. The Indian economy is aimed to become a $5 trillion economy by 2025; major impetus is being given to strengthen the back bone of our economy i.e. MSME sector. This paper highlights the Impact of GST on MSMEs.

Keywords: - Indirect Tax, GST, MSMEs

INTRODUCTION

Constitution 122nd Amendment Bill i.e. Goods and Services Tax (GST) was introduced as **'The Constitution (One Hundred and First Amendment) Act 2017'**. The governing body of GST is; GST Council and its Chairman will be the Finance Minister of India. Under GST, goods and services are taxed at the following rates, 0%, 5%, 12%, 18% and 28%. There is special rate of 0.25% on rough precious and semi-precious stones and 3% on gold. In addition a **'GST Compensation Cess'** of 22% on top of 28% GST applies on 'Discredited Goods' or "Sin Goods" like aerated drinks, luxury cars, tobacco products etc. etc.. GST subsumed a slew of indirect taxes with a unified tax and is therefore set to reshape the country's 2 trillion dollar economy.

The single GST (goods and service taxes) subsumed several former taxes and levies it includes; central excise duty, services tax, additional customs duty, surcharges, state-level value added tax and Octroi. Other levies that were applicable on inter-state transportation of goods have also been merged into GST. India adopted a dual GST model; it implies that taxes are administered by both the Union and State Governments. Transactions made within a single State are levied with Central GST (CGST) by the Central Government and State GST (SGST) by the State governments. For inter-state transactions and imported goods or services, an Integrated GST (IGST) is levied by the Central Government. GST is a consumption-based tax or destination-based tax, therefore, taxes are paid to the state where the goods or services are consumed not the state in which they were produced.

As per the government website on GST, **"Goods and Services Tax Network" (GSTN)** is a nonprofit organization proposed to be formed for creating a website / platform for all the concerned parties related to the GST, namely stakeholders, government and taxpayers to collaborate on a single portal. The efficacy and efficiency of GSTN is yet to be tested. The known authorized capital of GSTN is Rs. 10 crore (US$1.6 million) in which Central Government holds 24.5 percent of shares while the state government holds 24.5 percent and rest with private banking firms for smooth running of the transactions.

The **Micro, Small and Medium Enterprises Development (MSMED) Act** was notified in 2006 to address policy issues affecting MSMEs as well as the coverage and investment ceiling of the sector. The Act seeks to facilitate the development of these enterprises as also enhance their competitiveness. It provides the first-ever legal framework for recognition of the **'Concept of Enterprise'** that comprises both manufacturing and service entities. It defines medium enterprises for the first time and seeks to integrate the three tiers of these enterprises, namely, micro, small and medium.

Definitions of Micro, Small & Medium Enterprises is given in the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified in two Classes:

1. **Manufacturing Enterprises:** Those enterprises that are engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the industries Development and regulation Act, 1951 or employing plant and machinery in the process of value addition to the final product having a distinct name or character or use. The Manufacturing Enterprises are defined in terms of **investment** in Plant & Machinery.
2. **Service Enterprises:** The enterprises engaged in providing or rendering of services they are also defined in terms of **investment** in equipment.

The limit for investment in plant and machinery / equipment for manufacturing/service enterprises, as notified, vide S.O. 1642(E) dtd.29-09-2006 are as under

Enterprise	Manufacturing Sector (Investment in Plant and Machinery)	Service Sector (Investment in equipments)
Micro Unit	Not to exceed Rs. 25 lakh	Not to Exceed Rs. 10 lakh
Small Scale	More than Rs.25 lakh not to exceed Rs. 5 Crore	More than 10 not to exceed Rs. 2 Crore
Medium	More than Rs. 5 crore not to exceed Rs. 10 Crores	More than Rs. 2 Crore not to exceed Rs. 5Crore

Objectives

The main objective of writing this paper is to study the impact of GST on MSME sector as this sector is not only in organised sector but it is very much present in unorganised sectors. MSME sector is backbone of Indian Economy hence it is necessary to study the impact of GST on this sector.

Research Methodology

The study has been carried out using secondary data collected from several journals, articles, magazines and newspapers this study has used data from Government of India Ministry of Micro, small and Medium Enterprises and also search edited books and websites. Descriptive study has been undertaken to understand GST and its impact on MSME sector.

Review of Literature

A number of research papers and articles provide a detailed insight on GST. The findings from the literature are presented below:-

Agogo Mawuli (2014), “Goods and Service Tax-An Appraisal” and found that GST is not good for low-income countries and does not provide broad based growth to poor countries. If still these countries want to implement GST then the rate of GST should be less than 10% for growth.

Dr. R. Vasanthagopal (2011), “GST in India: A Big Leap in the Indirect Taxation System” and concluded that switching to seamless GST from current complicated indirect tax system in India will be a positive step in booming Indian economy. Success of GST will lead to its acceptance by more than 130 countries in world and a new preferred form of indirect tax system in Asia also.

Ehtisham Ahmed and Satya Poddar (2009), "Goods and Service Tax Reforms and Intergovernmental Consideration in India" and found that GST introduction will provide simple and transparent tax system with increase in output and productivity of economy in India. But the benefits of GST are critically dependent on rational design of GST.

Jaiprakash (2014) , the GST at the Central and the State level are expected to give more relief to industry, trade, agriculture and consumers through a more comprehensive and wider coverage of input tax set-off and service tax setoff, subsuming of several taxes in the GST and phasing out of CST. Responses of industry and also of trade have been indeed encouraging. Thus GST offers us the best option to broaden our tax base and we should not miss this opportunities to introduce it when the circumstances are quite favorable and economy is enjoying steady growth with only mild inflation.

Jana V. M., Sarma & V Bhaskar (2012) , "The Road Map for implementation of Goods and Service Tax". He found that the steps to be undertaken to implement the comprehensive tax system i.e., GST. The authors have thrown light on the constitutional amendment required for the implementation of GST in India.

Nitin Kumar (2014), "Goods and Service Tax-A Way Forward" and concluded that implementation of GST in India help in removing economic distortion by current indirect tax system and expected to encourage unbiased tax structure which is indifferent to geographical locations.

Saravanan Venkadasalam (2014) , seven out of 10 ASEAN countries are implementing GST and studied the correlation of GST implementation to nation's development, a positive impact of GST depends on a neutral and rational design of the GST model.

Syed Mohd Ali Taqvi (2013) 'The challenges and opportunities of Goods and Service Tax in India' GST is only indirect tax that directly affects all sectors and sections of our country. It is aiming at creating a single, unified market that will benefit both corporate and economy. The proposed GST model will be implemented parallel by the central and state governments as Central GST and State GST respectively.

Impact of GST on MSME

Micro, Small and Medium Enterprises (MSMEs) have shown an exceptional growth in the past 70 years; this has been a salient features in the economic development of the country. It has been a major contributor to the overall growth of the Indian economy be it GDP, employment generation or export. In India, the SME sector has played a pivotal role in the socio-economic development of the country since Independence even before. The factors that hindered the development of the SMEs have been; low capital base, difficulties in accessing technology, credit constraint, low access to business services, constraint of quality of human resources, low market awareness, low lobbying capacity and poor infrastructure. SMEs are recognised as engine of growth all over the world in the changing economic scenario. As per the National Sample Survey (NSS) 73rd round, conducted by National Sample Survey Office, Ministry of Statistics & Programme Implementation during the period 2015-16, there were 633.88 lakh unincorporated non-agriculture MSMEs in the country engaged in different economic activities (196.64 lakh in Manufacturing, 230.35 lakh in Trade and 206.84 lakh in Other Services and 0.03 lakh in Non-captive Electricity Generation and Transmission,) this number is excluding the MSMEs registered under different other Acts and provisions (Report on Key Indicators of the Survey is available at www.mospi.gov.in.). The SMEs account for about 95% of the industrial units, 40% of the industrial production, and 36% of the total exports and provides direct employment to 18 million persons in about 3.2 million registered SME units in the country. The significant contribution of SMEs in GDP growth makes it important to study the role of GST on MSME sector.

Goods and Service Tax (GST) combines both the current Central and State Taxes in the country into a solitary tax, thereby eliminating the multiple taxation system and enabling a 'one nation one tax' system. The implementation of this tax allows the government to have a better control on the taxpayers that, in turn, improves the complete tax system with many other benefits.

For Micro, Small, and Medium Enterprises (MSME), the business proprietors and producers are required to pay many taxes as per the then prevalent tax laws, fulfilling all the tax-related documentations has them running to different departments. These entrepreneurs faced harassment from the various departments they had to report to file their taxes. India‘s paradigm shift to the Goods and Services Tax (GST) regime in July will increase the compliance costs due to digitisation of tax returns filing, majority of MSME producers will come into the indirect tax net for the first time; this is a big concern of the MSME sector.

Unorganised MSMEs have outnumbered the organised sector because of lower cost structures due to the tax avoidance, not having to pay social security benefits to employees (such as provident fund and gratuity), and excise duty (if turnover is less than Rs.1.5 crore). Unorganised MSMEs use different practices to keep their input cost law, they understate employee base or set up multiple ventures to avoid breaching tax thresholds. These practices helped them price products and services at competitive rate over the past few decades and also maintain operating margins at organised player levels.

There are many dimensions of GST on one hand manufacturers will be adversely affected due to reduction in the minimum turnover for GST exemption it is brought down to 20 lakh from 1.5 crore it implies that tens of thousands of unorganised MSMEs will soon be in the tax net. On the other hand tax compliance will strengthen due to digital transaction trails created by dual authentication of invoices under GST. This tax regime will benefit the MSME producer as GST will reduce the cost of raw materials and logistics.

The **tax burden on service sector will increase;** this will have a negative impact on unorganised service sector. Organised players with the ability to hold their price-lines, or pass on any increase in cost to customers, will be able to maintain their profit margins. The simplified tax structure and a unified market will improve operational efficiencies, especially of MSMEs with a wider reach. However, the impact of demonetisation has been severe in the second quarter of last fiscal; they could close the year with a growth of just 6 to 8 per cent, while MSMEs were expected to record growth of 14 to 16 per cent. It is expected that growth will pick up in the current fiscal year and the affects of demonetisation will fade away.

Impact on electrical equipments: Growth in electric equipments grew at about 23 per cent in fiscal year 2016 compared with 16 per cent in FY 2015. The sector will benefit from lower freight costs and tax rates. Growth is expected to be strong this fiscal year, cheaper imports, especially from China, will pose a big challenge.

Impact on light engineering products: Light engineering MSMEs saw 15 per cent compound annual growth rate between fiscal years 2014 and 2016. Demonetisation caused just a blip; GST is expected to provide a boost to this segment because of lower tax rate. The Government's thrust on 'Make in India' will also help the sector to maintain growth.

Impact on Textile Industry: GST will have a marginally negative impact on textile sector because of higher GST rates. Some of the Economists have raised concerns that a unified market would create more competition in an already crowded and price-sensitive market with a large number of unorganised players, the input cost of unorganised sector will escalate due to provisions of GST Act as discussed earlier. Many experts have gone to the extent that more than 50% unorganised sector manufacturers will have to put their shutters down. This will lead to escalation of prices in garment sector; GST will hurt the unorganised sector of garment industry on one hand and on other it will affect the purchasers as they will have to pay higher prices. Organised players dealing in branded apparel are expected to be benefitted by GST and its provisions one due to shortage in supply two they are producing for high end users then can afford to pay high prices. The textile sector as a unit is expected to record below-par growth of 5 per cent or may be lower. Growth in the textiles-related MSME segment had already declined from 15 per cent in fiscal year 2015 to 8 per cent in FY 2016.

Impact on pharmaceutical industry: Growth in pharmaceutical industries was 11 per cent in fiscal years 2016 compared with 15 per cent in 2015. Demonetisation had a limited impact as the Government had allowed using the banned Rs.500 and Rs.1, 000 currency notes for the purchase of medicines and medical equipments.

Impact on automobile industry: Growth in automobile industries in the fiscal years 2014 and 2016, by unorganised auto component makers grew at 14 per cent annually compared with 7 per cent for their organised counterparts. However, demonetisation led to a short-term drop in sales to original equipment manufacturers (OEMs), or vehicle makers. This fiscal year, OEM sales are expected to normalise. Organised players will benefit and record moderate growth given the thrust on digitisation and lower tax rates under GST.

Impact on leather and footwear sectors: Leather and footwear industry is facing a tough competition from global players especially from China. Leather and footwear industries growth is showing downwards trend and has fallen to as low as 6 per cent for organised players. We do not expect GST rates to vary much from the current indirect tax rates. There is no overall growth in this sector and expected to remain subdued this fiscal year.

In the fiscal year 2015-16, the total tax collection in India (Centre Government) is around 14.5 Lakh Crore, of which 34% is indirect tax. Indirect taxes include service tax, stump duty, customs duty, VAT, etc. It refers to the collection of tax indirectly by the Government of India. In most of the developing countries, the share of indirect tax is higher than the direct tax. However, in the developed countries the share of indirect tax is much lower. Therefore, the new GST implementation will allow the government to have a better grip on the taxpayers. This should be capable of evolving the entire tax system.

Conclusion

GST will help and ease the process of starting a business in India. In the pre-GST regime, every business in India was required to obtain many tax registration numbers; the procedure was different in every state. However, under GST, the businesses have to only register for GST which will have a centralized process, similar to service tax. Currently, for any business, it is mandatory to make a VAT payment on the annual turnover that ranges between Rs. 5 lakh and Rs.10 lakh depending on states. In GST regime a unit involved in intra – State taxable supply of goods or services or both, if its aggregate turnover in a financial year does not exceed prescribed amount of threshold exemption limit i.e. Rs. 20 lakhs (Rs. 10 lakhs in case of the special category states of Nagaland, Manipur, Mizoram and Tripura), than there is no need to get registered under GST. GST allows small and medium business to do business with ease in India, due to the less complexity. The distinction between the services and goods will be gone, and this will make compliance easier.

Several policy interventions along with technology and innovation will continue to play vital role in creating a business-friendly atmosphere for the SMEs. No doubt that GST is aimed to increase the taxpayer base, majorly SMEs into its scope and will put a burden of compliance and associated costs to them. But in the long run, GST will turn these SMEs more competitive with a level playing field between large enterprises and them. In fact, recently government has also formed a special committee to look after the issues faced by MSME sector in GST. It is urged to the industry that they proactively highlight the above issues and obtain the relief prior to advent of GST as once GST is implemented; the chances of respite would be very minimal for the sector. Furthermore, these Indian SMEs would be able to compete with foreign competition coming from cheap cost centers such as China, Philippines and Bangladesh.

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