Inspira-Journal of Commerce, Economics & Computer Science (JCECS)
ISSN : 2395-7069 (Print), General Impact Factor : 2.0546, Volume 03, No. 03, July-Sept., 2017, pp. 208-214

GST: OPPORTUNITIES AND CHALLENGES FOR INDIAN MSMEs

Seema Pandit*

ABSTRACT

India's decade long wait for its landmark tax reform ended on 1st July, 2017 with the implementation of Goods and Services Tax (GST).This paper examines the possible impacts of the introduction of the Goods and Services Tax (GST) on MSMEs in India The paper discusses the opportunities and challenges faced by the Indian MSMEs with the introduction of the GST. The paper also focuses on the experience of the implementation of GST faced by various countries across the world. The common observation from the review of literature is that the compliance cost has increased post adoption of GST. There was resistance from the various stakeholders in the beginning but with the passage of time the adoption was a smooth process. In certain countries the government after the introduction of GST also invited feedback and suggestions from the industry. It has also been observed that the smooth implementation of GST necessitates a robust IT infrastructure and an educating the businesses about the various aspects of GST like the computation of tax liability, availing the input tax credit etc. The Indian MSMEs will have to make a behavioural change in managing their business instead of taking GST only as a tax reform.

***KEYWORDS**: Goods and Services Tax (GST), MSMEs, IT Infrastructure, Stakeholders, Tax Credit.*

Introduction

India's decade long wait for its landmark tax reform ended on 1st July with the implementation of GST- 'Goods and Services Tax. The GST will mark revolutionary change in the taxation system with the "One Nation, One Tax" motto. It will integrate and simplify the process of indirect taxation and will bring in many benefits compared to the present tax systems such as easy process of availing input credit, single point tax, elimination of cascading tax system and simpler taxation. If the implementation of GST is smooth, it has the potential to accelerate economic growth by 2%. It will especially give impetus to the manufacturing sector and make it more competitive. It will also boost up the exports and create more employment opportunities.

Structure of Indirect Tax in India

Type of Tax	Levied on
Excise Duty	Manufacture of Goods in India
Service Tax	Provision of Service
Sales Tax/ VAT	Sale within State
Custom Duty	Import & Export
Central Sales Tax	Inter State Sales
Local Body tax – Entry tax, Octroi	Entry of goods to a State from a place outside the State

In addition to the above taxes, certain other taxes like Entertainment tax, Luxury tax, Lottery taxes, Taxes on betting and gambling, Electricity duty, State surcharges relation to supply of goods and services are also levied by the state government.

* Assistant Professor, Faculty of Business Administration, GLS University, Ahmedabad, Gujarat, India.

However the present tax structure suffers from following limitations:

- Cascading/ Double taxation
- Exemptions & Concessions
- Lack of transparency
- Lack of uniformity in provisions and rates
- Multiple points of taxation
- Complexity in determining the nature of transaction – Goods vs. Service
- Narrow base
- Multiple administrations

GST–Solution to Overcome Present Tax Structure's Limitations

The introduction of the Goods and Services Tax is significant step towards the indirect tax reforms in India. It is beneficial to the various stakeholders like the industry, consumers and government:

- By combining a large number of Central and State tax into a single tax, GST is expected to eliminate double taxation and make taxation overall easy for the industries.
- Implementation of GST will ensure the development of Common National Market or Common Economic Market
- Reduced cost of compliance
- Reduction of manufacturing costs due to lower burden of taxes on the manufacturing sector. Hence prices of consumer goods will be likely to come down.
- Introduction of GST will also make Indian products competitive in the domestic and international markets.
- The GST, because of its transparent character, will be easier to administer.
- Beneficial to government as it would broaden the tax base and improve revenue collections

Once implemented, the proposed taxation system holds great promise in terms of sustaining growth for the Indian economy. Hence, this revolutionary

Statement of Problem

The Goods and Services Tax (GST), a radical step towards India's transformation into a common market was launched on 1st July 2017. The Prime Minister Mr. Narendra Modi at the launch of the event said "GST was not just about taxation reform that would help business persons by putting an end to tax terrorism but is a measure that will help in the fight against corruption and black money". This is one of the important national agenda and has received a considerable attention from academicians, tax experts, consultants, business community, politicians, consumer bodies as well as the wider public. One of the major concerns of GST implementation is its implementation impact on MSMEs. The implementation of GST will provide opportunities to the MSMEs to develop but will also pose certain challenges. GST compliance will require MSMEs to make sure that they have a good accounting system to ensure correct calculations of tax liability, input tax credit etc. This compliance job is seen as a major challenge for MMSMEs on top of coping with their day-to-day business survival. Therefore the present research is targeted to study the impact of GST on the MSMEs in India.

MSMEs in India

Micro Small and Medium-scale Enterprises (MSMEs) play a significant and vital role in the economic growth and development in all countries. MSMEs contribute towards the growth of the economy by bringing in new innovations, creating new investment and employment opportunities in the economy. Their contribution towards the growth and development of a nation cannot be underestimated.

The Micro Small and Medium Enterprises have been defined under MSME Act, 2006. According to the Act, MSME have been broadly classified in two categories:

- Enterprises engaged in the manufacturing and production of goods pertaining to any industry;
- Enterprises engaged in providing or rendering services

The manufacturing enterprises have been further defined in terms of investment in plants and machinery wherein the service enterprises have been defined in terms of their investment in equipment.

The Further Classification of Manufacturing and Service Enterprises can be seen below:

Classification of SMEs (According to Micro, Small and Medium Enterprises Development Act)

Types of Enterprises	Engaged in manufacture or production of goods. Investment in plant and machinery	Engaged in providing or rendering of services Investment in equipment
Micro	Under INR 25 Lakhs	Under INR 10 lakhs
Small	INR 25 Lakhs to INR 5 Crores INR	10 lakh to INR 2 Crores
Medium	INR 5 Crores to INR 10 Crores	INR 2 Crores to INR 5 Crores

The Micro Small and Medium Enterprises (MSMEs) of India experienced several highs and lows in the past few years. With the Indian economy expected to emerge as one of the leading economies in the world and likely to become a $5 trillion economy by 2025, major impetus is being given to strengthen the backbone of our economy-the MSME sector. MSMEs contribute around 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities as well as 33.4% of India's manufacturing output. They have provided employment to around 120 million persons and contribute around 45% of the overall exports from India.

Overview of Goods and Services Tax

Goods and Services Tax (GST) is a value added tax levied on manufacture, sale and consumption of goods and services. GST offers a continuous chain of tax credits from the producer's point/ service provider's point up to the retailer level/ consumer's level thereby taxing only the value added at each stage of supply chain. The supplier at each stage is permitted to avail credit of GST paid on the purchase of goods and/or services and can set off this credit against the GST payable on the supply of goods and services to be made by him. Thus only the final consumer bears the GST charged by the last supplier in the supply chain, with set off benefits at all the previous stages. Since only the value added at each stage is taxed under GST, there is no tax on tax or cascading of taxes under GST system. GST does not differentiate between goods and services and thus, the two are taxed at a single rate:

- Goods and Services Tax will be on the 'supply' of goods or services or both, in India except Jammu and Kashmir.
- For supplies within the State or Union Territory Central GST(CGST) will be payable to the Central Government and State GST(SGST) or Union Territory GST(UTGST) will be payable to the State Government or Union Territory
- For inter-state supplies (supply from one State or Union Territory to another State or Union Territory), Integrated GST (IGST) will be payable to Central Government
- The rates of GST-(CGST+SGST/UTGST) - Nil, 5%, 12%, 18% an d 28%. These rates will apply to IGST also.

Literature Review

France is the first country to adopt GST way back in 1954. At Present around 160 countries across the globe have adopted GST.

Region	No of Countries
ASEAN-(Thailand& Philippines)	7
ASIA(Iran &Tajikstan)	19
Europe (Jersey & Hungary)	53
Oceania (Niue & New Zealand)	7
Africa (Nigeria & Gambia)	44
South America (Brazil & Uruguay	11
Caribbean, Central & North America, Canada & Barbados	19
Total	160

(Source: Tax Research Department, The Institute of Cost Accountants of India (Statutory Body under an Act of Parliament)

GST Experiences in Selected Countries

Majority of the countries across the globe have a unified GST system. Brazil and Canada follow a dual system where GST is levied by both the Union and the State governments. India is also following the Dual system. France was the first country to introduce GST system in 1954. The standard GST rate in most countries ranges between 15-20%.

Australia

Goods and Services Tax (GST) was adopted in Australia in the year 2000.It replaced the wholesale sales tax system which was prevalent in Australia since 1930s. The GST is levied at a flat rate of 10% on most goods and services, apart from GST exempt items, and input taxed goods and services. A number of studies were undertaken in Australia to study the impact of GST on MSMEs.. According to studies conducted by Ernst & Young (1999) Pope (1999), it was difficult to estimate the startup costs and also the measurement of cost for the GST compliance as well as the costs incurred for managerial purposes. Further, it was pointed out that it was difficult to differentiate between the cost of startup and the ongoing costs. A survey carried out by CPA, Australia pointed out that the MSMEs made a sea change in their procedures to meet the requirements of GST. They upgraded their record keeping systems and also upgraded their computer software. Overall it was accepted positively by the MSMEs. The only limitation they felt was the increase in the work load of their staff.

New Zealand

Goods and Services Tax (GST) was introduced in New Zealand on October 1, 1986. According to various researches undertaken, it has been pointed out that the experience of GST in New Zealand has been positive. The report of Ernst &Young, 1999) observed that there was a lack of clear legislation because the legislation focused more on provisions but the processes were not well defined. Inland Revenue Department, New Zealand reviewed the implementation and administration of GST and invited feedback and suggestions from the public and businesses. A strong feedback received suggested that the compliance costs were high and these were proportionately higher for businesses with lower turnover or MSMEs. MSMEs which had less stringent accounting and reporting standards had higher compliance costs. It was also found that MSMEs who registered late had compliance costs above the average for their size. As a result of the feedback received the New Zealand government focused on reduction of changes in the GST structure, simplify the structure and educate the businesses.

Singapore

Goods and Services Tax (GST) was introduced in Singapore on April 1, 1**994.**In the first fiscal year after its implementation, GST contributed $1.5 billion to the tax revenue, which accounted for about 11 per cent of government tax revenue. The Singapore government invited the feedback and suggestions on the implementation of GST from industry. The government took the industry feedback in a positive manner and introduced certain concessions and reliefs for manufacturers, retailers and exporters to boost up the businesses.

Canada

The Goods and Services Tax (GST) was introduced in the form of a multi-level VAT in 1994 replacing manufacturers' sales tax. GST was levied on supplies of goods or services purchased in Canada and included most products, except certain essentials such as groceries, residential rent, medical services, financial services and exports. Inland Revenue Authority of Singapore had to face resistance form general public, business community and politicians during the initial stage. In spite of this resistance IRAS has been successful in the implementation of GST through its continuing efforts towards educating the tax payers about the legislation and implementation of GST.

Malaysia

Malaysia is the most recent country to implement GST in 2015. Malaysia's journey of implementing has not been a smooth sailing. There was strong protest by small business MSMEs and traders who were not well informed about the GST tax calculations as well as the procedural aspects of getting the tax credits. The Malaysian government was not ready to take up the challenges in the implementation and administration of GST.

Impact of GST on MSMEs

With the implementation of Goods and Services Tax (GST), MSMEs and startups will be affected the most. It will offer opportunities for growth and development of MSMEs as also pose challenges for the MSMEs. The opportunities for the growth would be in the form of various benefits that will be available to the MSMEs. Some of the ways GST will benefit MSMEs and startups are:

- **Ease of starting business:** A business which has operations in various states needs to do the VAT registration under the state laws and regulations. Different states have different provisions and rules with respect to VAT registration and therefore it creates complications and confusion for the businesses. It increases the time and cost in the procedural formalities as the business needs to apply for VAT registration separately in each state. Under GST, the businesses have to do a centralized registration. Hence it will result into simpler procedures and also eliminate the time and cost of procedural aspects. Hence starting a business would become easier and simpler.

- **Reduction of tax burden on new business:** Under the current tax structure, businesses with a turnover of more than rupees 5 lakhs need to pay a VAT registration fee. The government has increased this exemption limit under GST to twenty five lakhs. This will be beneficial to around 60% of the small traders.
- **Better logistics and quick delivery of services:** Under the current tax system, entry tax is to be paid on interstate manufacture and sale of goods. Under GST, no entry tax will be charged for goods manufactured or sold in any part of India. This will result into quick delivery of goods as the time at interstate points and toll check posts would be eliminated. According to an estimate by CRISIL, the logistics cost for manufacturers of bulk goods will get reduced significantly—by about 20%. This will give an impetus to ecommerce across the nation.
- **Removal of distinction between goods and services:** Under Goods and Services Tax (GST) 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.
- **Will boost up the 'Make in India' campaign:** Goods and Services Tax (GST) would improve demand and competitiveness of 'Make in India' products. The GST tax structure will reduce the burden of indirect tax both for the producer of goods and the ultimate end user except in some cases, as the producer or manufacturer of goods will get the advantage of input tax credits (ITC) and the consumer will have to bear only the indirect tax charged by the last retailer or dealer in the supply chain. This will lead to expansion of the market for the MSMEs.
- **Unified mar*ket:*** Goods and Services Tax (GST) will facilitate free transfer of goods across states and reduce the cost of doing business, as it will cut down multiple taxes imposed by state and central government.

Challenges Before the MSMEs

While the MSMEs will enjoy the tax neutrality, there are number of challenges that the MSMEs will have to face with implementation of Goods and Services Tax (GST).

- **Reduction in the basic exemption (threshold) limit:** Under the existing excise tax laws, a manufacturer whose turnover is less than Rs. 1.50 crores is not required to pay the duty. But, with implementation of GST, the exemption limit is significantly lowered to Rs. 20 lakhs in all states except North East states where the exemption limit is Rs. 10 lakhs. Due to this, many of the businesses which are at present outside the tax bracket will be covered under the tax bracket and will have to pay a sizeable amount of their earnings towards tax. The objective of the government is to widen the tax base and bring maximum traders/businesses under the tax bracket.
- **No distinction on taxes levied on luxury items and services:** Before the implementation of GST, the government distinguished between the tax rates levied on the luxury goods and the normal goods. Higher rate of taxes were applicable to luxury goods and services. However under GST, there is no distinction between luxury goods and normal goods. And therefore the rate However with the implementation of GST, all of tax will be same for all goods and services. This will be a real challenge for the MMSMEs competing against large established businesses.
- **Increase in cost of product for businesses that supply directly to end users:** The businesses that supply directly to the end users will not be eligible to claim the input tax credit as GST is levied on supply of goods or services. This in turn will lead to an increase in the cost of the products for businesses that supply directly to end users.
- **Selective levyof tax:** Goods and Services Tax (GST) will not be applicable to alcohol and petroleum based businesses. This defeats the unified market ideology of GST.
- **High compliance cost:** The standards for compliance under Goods and Services Tax (GST) are very stringent. There are number of returns that businesses are required to file on monthly basis. Moreover, if the business is operating in more than one state, separate return is to be filed in each

state. This would increase the compliance cost for the MSMEs. In many MSMEs, the proprietor himself manages the task of accounting. Under the present system, the tax returns are to be filed on quarterly basis. Hence the proprietor can concentrate on the development of his business instead of taxation matters. But with implementation of GST, he will have to devote his time and funds also for maintaining his accounting and taxation affairs, filing of monthly returns, computation of liability and availing the input tax credit. Moreover under GST, all the procedures - registration, filing returns and availing tax credit has to be compulsorily done online. This will add to the cost of compliance for MSMEs as they will have to update their IT infrastructure and will also have to appoint informed persons to operate their GST software.

- **Higher Interest/Finance Cost:** IGST will be applicable on interstate branch transfers and stock transfers. This will increase the working capital requirements of the businesses which have interstate transactions due to blockage of funds. This in turn will increase the interest burden which would ultimately will have impact on the pricing policies.
- **Reverse charge mechanism:** Under the provisions of the Goods and Services Tax (GST) bill, it has been laid down that if a registered person buys goods from an unregistered trader/dealer then as per the provisions of reverse charge, the tax is to be paid by the registered person. This will increase the working capital requirements of the registered persons. Therefore, registered businesses will prefer to deal only with the registered businesses. This will have a negative impact on the unregistered traders/dealers and will hamper their growth and development. They will be compelled to register themselves or shut down their businesses.
- **Goods sent on sale or return basis:** As per the provisions of the present tax laws, there is no time limit for the return of goods sent on sale or return basis. But with implementation of GST, this time limit is limited only for a period of six months. If within six months the goods are not approved then they are deemed to have been supplied since the liability for payment of tax will arise. In many small scale businesses (e.g. textiles), the practice is to send goods to customers on sale or return basis. The customers usually return the goods after the season is over. But the time limit of six months put under GST will adversely affect such small businesses.
- **Availability of Input Tax credit:** Before the implementation of GST, the Input Tax credit was available on the basis of invoice. However, under the provisions of GST it will be available only if the vendor pays taxes to the government and if the details uploaded on the government's IT server matches with the details uploaded by the vendors.

Conclusion

Goods and Services Tax (GST) is clearly a long term blueprint. It would lead to increase in output, employment opportunities and economic development and progress of the nation. However, in the initial phase of its implementation it is likely to increase the administrative difficulties and the compliance cost. MSME's would be able to reap the benefits of GST, if they are able to revamp their business processes and systems in line with compliances as required under this law, as it would not be operationally feasible for an MSME's to operate out of credit chain. With technology &robust IT infrastructure, compliance can be made simple. MSMEs will need to have the courage to comply with the tax laws & ultimately contribute towards the growth of the nation. The shift from the traditional tax regime to GST is considered as a 'behavioral change' more than a tax changes because its successful implementation depends to a great extent on how quickly businesses adapt to the digital format of taxation.

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