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Impact of GST on MSMEs in India

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Abstract:

The Goods and Services Tax (GST) has brought significant changes to the functioning of Micro, Small and Medium Enterprises (MSMEs) in India by replacing multiple indirect taxes with a unified tax structure. MSMEs play a vital role in the Indian economy through employment generation, contribution to GDP, manufacturing output, and exports. The implementation of GST aimed to simplify the taxation system, reduce cascading taxes, improve transparency, and create a "One Nation, One Tax" regime. The study highlights both positive and negative impacts of GST on MSMEs. On the positive side, GST has streamlined tax compliance, enhanced interstate trade, improved input tax credit mechanisms, and encouraged digitalization and formalization of businesses. However, MSMEs also faced challenges such as increased compliance burden, technological difficulties, higher operational costs, and initial disruptions in business activities. Despite these challenges, GST is considered a long-term reform that can strengthen MSMEs by promoting competitiveness, transparency, and economic growth. Overall, the study concludes that GST has transformed the MSME sector and its success largely depends on effective implementation, awareness, and supportive government policies.

Keywords: GST, MSMEs, Indirect Taxation, Economic Growth, Tax Reform, Input Tax Credit, Digitalization, Indian Economy, Small Enterprises, One Nation One Tax.

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Introduction

Micro, Small and Medium Enterprises (MSME) is considered as the economic and social growth engine all over the world. And for country like India having abundant manpower but scarce capital should identify its significant and actively promote enterprise and most importantly MSMEs because it requires small investments but their contribution to the economy is very big and significant because it generates a large scale of employment, it sustains economic growth and increases exports and also help in industrialization of rural & backward areas, thereby reducing regional imbalances and assuring more equitable distribution of national income and wealth. MSME are broadly classified into two categories viz. manufacturing and service enterprises that are engaged in the manufacturing of goods and rendering of services respectively.

GST or Goods and Services Tax is a comprehensive indirect tax (or consumption tax) levied on manufacture, sale on consumption of goods and services in India. The tax was launched at midnight on 1st July 2017 through the implementation of One Hundred and First Amendment of the Constitution of India by the President of India and the Government of India at the Central Hall of the Parliament. GST is considered as the biggest and most important economic reform since Independence because it has subsumed almost all indirect taxes levied both by the Central and state government on goods and services. It was implemented with an objective to make India "one nation one tax" economy and aims to provide a simplified and single tax regime in the nation. GST is a single indirect tax levied on all goods and services and since MSME are enterprises engaged in manufacturing of goods and rendering of services so the implementation of GST has directly impacted or affected the MSME sector. Implementation of GST has entirely changed the taxation system and some of the sectors have been benefited whereas few of them have received a negative impact.

MSMEs are the backbone of India's economy, contributing around 30% of GDP, 48% of exports, and providing employment to over 120 million people. These enterprises are located across various sectors including manufacturing as well as services, and contributes to the promotion of entrepreneurship and regional development.

GST reform has replaced various indirect taxes such as service tax, VAT and excise duty into single tax structure. The primary objective was to get rid of tax inefficiencies and set up a state of goods and services taxes. This transition fundamentally changed MSMEs compliance requirements, cost structures, and opportunities for growth.

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Goods and services tax

The word tax has been derived from the Latin word, "Taxo" which means touch sharply or change. Definition of tax according to Wikipedia: A tax is a compulsory financial charge or some other type of levy imposed upon a taxpayer (an individual or legal entity) by a governmental organization in order to fund various public expenditures. A failure to pay, along with evasion of or resistance to taxation, is punishable by law.

A tax is a compulsory payment levied by the government through its legislative authority to the individuals and corporates to finance the public welfare activities of the government. Therefore, the tax collected by government entity through various sources is used for the welfare of the general public not specific public such as construction of roads, hospitals, schools, colleges etc. as well as to maintain the existing infrastructures prevailing in the country. The taxes collected are also used to pay salaries to the government employees such as Doctors, Nurses, Armies, Navy Officers, Police Officers, who provide services to the general public. It is also used to provide financial help to the needy people such as farmers, martyr's families, natural calamities victims (such as people who have incurred losses due to earthquakes, floods. Cyclones, etc.)or to build bridges, dam's, etc. To put it in a general way, Tax is used for the wellbeing of the people whether it is fulfilling basic needs of the people such as building houses for poor people or providing rice, sugar, kerosene at cheaper rates or providing better educational and health facilities or to protect the country from enemy countries or to invest in research and development in various fields such as Space Research, Health research and so on.

Tax is a part of a person's earning or a part of a company's profit paid to the government. Or in other words some portion of an individual's earnings or company's profit is given to the government which is used by the government for the welfare of the general public. So, the government is a body that collects funds from the public in the form of tax and utilizes those funds for the best interest of the public or collects and channels the funds of the public in a way that benefits everyone. Individual or corporate who pays tax to the government are called Tax payer.

Definition: Good and Services Tax

Article 366(12A) defines "Goods and Services tax" means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption.

1 Goods 366(12) Includes all materials, commodities, and articles. 2 Services 366(26A) Anything other than goods [Introduced vide 101st Constitutional Amendment Act] 3 State

366(26B) With reference to article 246A, 268, 269, 269A, and article 279A includes a Union territory with Legislature. [Introduced vide 101st Constitutional Amendment Act] "Goods and Services tax" law of India Is a unique indirect taxation system but while having unique principle, it has taken significant elements of prior Central and State laws and is also inspired by VAT/GST legislation of EU, Australia, Malaysia, etc. who have already implemented GST before India along with International VAT/GST guidelines of OECD.

Constitutional Powers

Constitution of India (COI) is the supreme law and all the laws are formed as per the constitution and so all the laws and actions of the government are subordinate to it which means no one go against the constitution and make and law and levy any amount of tax to the public so Article 265of the Indian Constitution states that "No tax shall be levied or collected except by the authority of law". As per Article 246 of the Constitution, Parliament has the powers to make new laws or to amend existing laws in respect to matters of the Central Government given in Union List(List I of the Seventh Schedule) and matters given of the State in the State List(List II of the Seventh Schedule). In case of matters of both the Central and the State Government, the matter is contained in Concurrent List (List III of the Seventh Schedule), where both the state and central government have concurrent powers to legislature.

Taxation Provision of Constitution

The power to levy and collect taxes are given in the constitution of India and no citizen of India can make tax laws as per their wish. All tax should be made for the welfare of the general public and made as per the provision stated in the constitution which are given as follows:

• **Article 265:** As stated earlier no one can impose tax as per their wish even governments or MukeshAmbani who is the richest person of India cannot impose tax as per their wish. Tax should be levied and collected except by the authority of law. The constitution of India prohibits arbitrary collection of tax. In India the tax imposement and collection powers are given to Union government, State government and Local authorities such Panchayats and Municipalities.

• **ARTICLE 246**: It states that the parliament has exclusive powers to make laws with respect to any matters of the state or central government individually or in case of matters of both the central and the state government collectively. The parliament can make laws

for the entire nation or any part of the nation and the State legislature can make laws for the entire state or part of the state.

Schedule VII (in Article 246):

The seventh schedule contains three lists which contains the matters under which the union and state governments have the authority to make laws as per the needs. a) UNION LIST (LIST I): The Central government are given exclusive powers by the Constitution of India to make laws with the help of parliament in respect of matters of the union government stated in entries between 82-92C of Union List i.e. List I. b) STATE LIST (LIST II): The constitution of India has given powers to respective state governments or respective authority to make laws on behalf of matters stated in List II (State List), entries between 45-63.

Pre-GST Scenario: Complexity and Fragmentation in Taxation

Prior to the introduction of GST, India's taxation system was characterized by a multitude of indirect taxes levied at both state and central levels. MSMEs, in particular, were heavily burdened by the need to comply with various taxes, which included:

Value Added Tax (VAT):

Imposed by state governments, VAT rates varied across states, leading to a lack of uniformity and increasing the complexity of tax compliance. For example, a product could be taxed at 5% in one state and 12% in another, complicating interstate business operations.

Excise Duty:

Levied by the central government on the manufacture of goods, excise duty increased the production cost for MSMEs, especially those engaged in manufacturing activities.

Service Tax: Applicable to service providers, this tax created confusion for MSMEs engaged in both goods and services, as they had to comply with different tax rules.

Central Sales Tax (CST):

Levied on inter-state sales, CST contributed to the cascading effect of taxation, where taxes were applied on top of other taxes, increasing the overall cost of goods.

Need for Goods and Services Tax in India:

A. **Multiplicity of Indirect Taxes**:

As discussed above there was existence of many indirect taxes in India such as custom duty, service tax, etc. which was imposed by Union government and VAT, luxury

tax, entertainment tax, etc. imposed by State Government. So, there was a need to replace multiple taxation system with a single tax system.

B. **Less Coordination Between Union and State Government**:

As in a single good/service the Union government was charging say excise duty and State government was charging VAT separately so there was no or less coordination between Union government and State Government. So, a new tax system was required to increase coordination between the Union and State Government.

C. High Tax Rates:

In many goods and services more than one tax was levied which result in increase in price of goods and services and prior to GST the tax rate was high as 50% and normally between 30-35% so a single tax system was required to decrease the cost of goods and services.

D. **Complicated Tax System**:

Pre GST government used to impose Custom duty on import on raw materials of goods and services and from manufacturing phase till the goods are sold the person has to different taxes such as excise duty on manufacturing, central sales tax if the goods are delivered and sold to various states within India, and if to sold within the state it is manufactured than VAT was charged, if any services is used during the manufacturing of the product then service tax was charged, etc. So, the taxation system before GST was complicated and difficult both for the government and the person selling goods and services as they have to understand and follow different tax laws to run a single business so as a result there was a need to replace or convert complex indirect tax structure to a simple tax system in India.

E. **Difficulty Paying Taxes**:

Prior to GST the person has to pay different taxes and there were difficulties filing return and paying taxes as some CA' s practiced only Central Government taxes or State Government taxes as a result they had to visit different tax practitioners to pay taxes.

F. **Time Consuming And Costly For Tax Payers:**

Due to existence of multiple taxes, the tax payer had to register to different tax departments, file returns on different dates and pay multiple taxes on goods and services which discouraged many traders, sellers, whole-sellers and so on, so a better tax system was required to make the taxation system easier so that business can flow easily in the economy and encourage many people to start and run their own businesses.

G. **Rise in Inflation Rate**:

Indirect taxes were the main source for continuous inflation rate in India as a result the government has to come up with some solutions to decrease the continuous inflation rate.

BENEFITS OF GST

➢ Before GST both the central and state government levied various taxes on different goods and services mentioned above but due to implementation of GST a single type of tax is levied on various different goods and services.

➢ Before GST the public had to pay high taxes on various goods and services, generally 30-35% and in some cases it was as high as 50% but due to implementation of GST the maximum tax rate is only 28%.

➢ Before GST the public had to pay almost 17 different taxes on goods and services but after the implementation of GST the public have to pay only one tax i.e. GST making India "one nation one tax" economy. Implementation of GST eliminated various existing tax such custom duty, additional duty of customs, VAT, Sales tax, Central Sales tax, State sales tax, entertainment tax, luxury tax and many more.

➢ Before GST, tax was imposed on place where goods were manufactured of produced but after the implementation of GST tax is imposed on the place where it is sold and not where it is manufactured. For instance, if a good is manufactured in Mumbai and sold in Sikkim than before GST tax was imposed on the place where it was manufactured i.e. Mumbai but after the implementation of GST tax will be imposed on the place where it is sold i.e. Sikkim. By doing so the direct tax imposed on that particular good will be eliminated and the public will have to pay only one tax i.e. GST. For example, if a refrigerator is manufactured in Mumbai, after the production of refrigerator in the factory excise duty is levied, then to reach Sikkim the product has to pass through various states and entering each state entry tax is imposed on that particular product, then VAT is charged in Sikkim. So, we can see that in a single product 3 different tax is charged.

Main Features of GST Act

a) All transactions and processes only through electronic mode – Non-intrusive administration

b) PAN Based Registration

c) Registration only if turnover more than Rs. 20 lakhs

d) Option of Voluntary Registration

e) Deemed Registration in three working days
f) Input Tax Credit available on taxes paid on all procurements (except few specified items)
g) Credit available to recipient only if invoice is matched – Helps fight huge evasion of taxes
h) Set of auto-populated Monthly returns and Annual Return
i) Composition taxpayers to file Quarterly returns
j) Automatic generation of returns
k) GST Practitioners for assisting filing of returns
l) GSTN and GST Suvidha Providers (GSPs) to provide technology-based assistance
m) Tax can be deposited by internet banking, NEFT / RTGS, Debit/ credit card and over the counter
n) Concept of TDS for certain specified categories
o)Concept of TCS for E-Commerce Companies

Micro-Small and Medium Enterprises *(MSMEs*)

Micro-Small and Medium Enterprises *(MSMEs*) are small sized enterprises defined in terms of their size of investment. According to Micro, Small and Medium Enterprises Development (*MSMED*) Act, 2006, MSMEs are manufacturing and service enterprises. Manufacturing Enterprises: Manufacturing enterprises are those enterprises engaged in production or manufacturing 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 Enterprise are defined in terms of investment in Plant & Machinery.

Service Enterprises:

The enterprises engaged in providing or rendering of services and are defined in terms of investment in equipment. These two categories of MSME are further categorizes into Micro, Small and Medium Enterprises in terms of investment made in plant and machineries (in case of manufacturing sector) and investment in equipment for service sector companies.

Governing Body of MSME:

The Ministry of Micro, Small and Medium Enterprises (*branch of Indian Government*) is the governing body of the MSMEs around that nation. It is the executive

body for the formulation and administration of rules, regulations and laws relating to MSMEs in India.

The governing body of MSME is headquartered in New Delhi and is headed by Nitin Gadkari since 31st May 2019. In 2018, a cabinet meeting was by the Ministry of Micro, Small and Medium Enterprises which proposed to change the definition of MSMEs. It was decided that MSMEs (***both manufacturing and service enterprises***) will be defined and categorized or classified on the basis of annual sales turnover of the enterprises instead of the investment criterion and there will be no distinction between manufacturing and service enterprises.

Classification of MSMESs

(*On the basis of Annual Sales Turnover*)

Manufacturing/Service Sector Enterprises Annual Sales Turnover :

Micro Enterprises Annual sales turnover is up to Rs 5 crores. Small Enterprises Annual sales turnover exceeds Rs 5 crores but does not exceed Rs. 75 crores. Medium Enterprises Annual sales turnover exceeds Rs 75 crores but does not exceed Rs 250 crores.

significance of MSMES:

Although MSMEs are small but their contribution to the Indian economy is enormous and significant which can't be neglected. However, because of its smaller size it is under estimated but being India a knowledge-based, entrepreneurship driven economy of which MSMEs are the major part and the contribution towards its economic and social growth by the MSMEs are enormous. That's why it's said that MSMEs are the silent performers who are carrying India's 5 trillion goal on their shoulders. As of October, 2019 there are almost 63.4 million MSMEs in India which contributes to about 1/4th of the India's GDP, output (***about 45% of the manufacturing output***), exports(***about 40% of the total exports***) and employment(about 69 million persons in over 29 million units throughout the country).MSMEs also helps in industrialization of rural areas by providing huge employment opportunities at comparatively lower capital cost than large industries**.**

Importance of MSMEs

Contribute to GDP:

As already stated MSMEs contribute about 27% to the India's GDP and has set a target to increase its contribution to GDP to 50% and more by 2025 as Prime Minister NarendraModi has started a mission to make India a $ 5 trillion economy.

Nation Development:

SMEs also play a prominent role in Nation development through high contribution to Domestic Production, Significant Export Earnings, Low Investment Requirements, Operational Flexibility, Location Wise Mobility, Low Intensive Imports, Capacities to Develop Appropriate domestic Technology, Import Substitution, Contribution towards Defense Production, Technology – Oriented Industries, Competitiveness in Domestic and Export Markets thereby generating new entrepreneurs by providing knowledge and training.

To Sustain Economic Growth and Increase Exports:

More than 90% of the MSMEs are engaged in manufacture and export of non-traditional products (such as readymade garments, plastic products, etc sports goods,.). These products are manufactured and handcrafted by unskilled or semi-skilled employees and are eco-friendly as a result there exist an enormous potential or opportunity to expand the quantum of MSME led exports. It also helps in raising manufacturing sector production and extending support to large industries by supplying raw material, basic goods and other vital components, etc.

Exports:

MSMEs contribute 40% of the total outputs.

Manufacturing Output:

It contributes about 45% to the manufacturing output.

Government Schemes to Promote MSMEs

A) **Credit Linked Capital Subsidy Scheme**:

Credit Linked Capital Subsidy Scheme (CLCSS) is operational for upgradation of technology for MSMEs.

B) Udyog Aadhaar Memorandum:

Aadhaar is a 12-digit individual identification number issued by the Unique Identification Authority of India on behalf of the Government of India. The number serves as a proof of identity and address, anywhere in India. In this, the Aadhaar card is a mandatory requirement. The benefit of registering in this scheme is ease in availing credit, loans, and subsidies from the government. Registration can be done both ways in the online mode or the offline mode.

Udyamimitra Portal:

launched by SIDBI to improve accessibility of credit and handholding services to MSMEs.

B) **Digital MSME Scheme:**

It involves usage of Cloud Computing where MSMEs use the internet to access common as well as tailor-made IT infrastructure

D) **A Scheme for Promoting Innovation, Rural Industry & Entrepreneurship (ASPIRE):**Creates new jobs & reduce unemployment, promotes entrepreneurship culture, facilitates innovative business solution etc.

E) Prime Minister Employment Generation Programme*:*

It is a credit linked subsidy program under Ministry of MSME.

Zero Defect Zero Effect:

Any goods that are manufactured for export have to adhere to certain standard so that they are not rejected or sent back to India. So, to make sure that
the goods exported are not sent back to India the government has launched this scheme to check the quality of the goods and to be sure that those particular goods are eligible for some rebates and concessions.

F) Revamped Scheme of Fund for Regeneration of Traditional Industries (SFURTI):

Organizes traditional industries and artisans into clusters and make them competitive by enhancing their marketability & equipping them with improved skills.

G) **National Manufacturing Competitiveness Programme (NMCP):**

To develop global competitiveness among Indian MSMEs by improving their processes, designs, technology and market access.

H) Micro & Small Enterprises Cluster Development Programme (MSE-CDP)

Adopts cluster development approach for enhancing the productivity and competitiveness as well as capacity building of MSMEs.

I) **MSME Sambandh:**

To monitor the implementation of the public procurement from MSMEs by Central Public Sector Enterprises.

J) **MSME Samadhaan**

MSME Delayed Payment Portal — will empower Micro and Small entrepreneurs across the country to directly register their cases relating to delayed payments by Central Ministries/Departments/CPSEs/State Governments.

Conclusion

Micro, Small and Medium Enterprises (MSMEs) are life blood of the Indian economy. As stated, earlier MSMEs are enterprises that requires less capital and more manpower and India is country with abundant manpower and scarce capital hence MSMEs perfectly fits the Indian economy. MSMEs are playing a crucial role in the socio-

economic growth of the nation as it contributes about 27% to the Gross Domestic Product (GDP), 45% of manufacturing output, about 40% of the total exports and provide employment to around 63.4 million people around the nation. It provides employment to rural peoples so hence MSMEs are also playing in the urbanization of rural areas. MSMEs are also playing a significant role in promoting domestic products and making the public skillful and self-reliant as 95% of the goods manufactured are non- traditional handcrafted products such readymade garments, plastic products, etc. MSMEs are also eco-friendly as they are handcrafted. As our Prime Minister Modi has set a vision to make India a $5 trillion economy by 2024 and to fulfill this vision the MSME has set an objective to increase their contribution to the nation GDP from 27% to more than 50% in coming days. As we all know that tax is an important part of any business whether Micro, Small or Medium Enterprises so this study was undertaken to ascertain the impact on GST on MSME sector as we all know that new taxation system is in effect from July 1, 2017.

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