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# Examining the Impact of the Goods and Services Tax (GST) on Micro Small and Medium Enterprises (MSMEs) in India: Challenges, Opportunities, and Policy Implications

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**Abstract**

This study examines the transformative effects of the Goods and Services Tax (GST) regime, particularly emphasizing its implications for MSMEs, and provides new insights into its practical consequences for businesses and the wider economy. The Goods and Services Tax represents the most significant indirect tax reform in India since independence, replacing a multitude of cascading taxes imposed by both central and state governments. GST is a tax that must be paid on the supply of goods and services. The implementation of GST has influenced various sectors of the economy, including MSMEs. It serves as a single tax on the supply of goods and services, extending from the manufacturer to the consumer. The two primary promises of GST are a simplified tax structure and a unified market. GST streamlines the entire process of tax filing and payment. Additionally, it is expected to enhance competition among MSMEs by creating a unified Indian market, enabling them to compete with multinational and multi-state enterprises. This study aims to understand the overall effects of GST on MSMEs by examining its advantages and challenges. Nevertheless, the impact of GST on micro, small, and medium enterprises (MSMEs) has raised concerns. This critical assessment study concentrates on the effects of GST on MSMEs.

**Key words:** GST, Indirect tax, MSMEs, implications

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## Introduction

The Goods and Services Tax (GST) represents one of the most significant tax reforms in the history of India, having been introduced in July 2017. This tax replaced numerous indirect taxes imposed by both central and state governments, with the objective of establishing a uniform tax framework and enhancing the ease of conducting business. Nevertheless, the implementation of this tax has had a substantial effect on the Micro, Small, and Medium Enterprises (MSMEs) sector in India (Dhillon et al., 2022). GST serves as a singular indirect tax applicable across the entire nation. It is a unified tax on the supply of goods and services, extending from the manufacturer to the end consumer. Goods and services are categorized into five tax slabs: 0%, 5%, 12%, 18%, and 28%. The MSME sector, which encompasses Micro, Small, and Medium Enterprises, functions as a support mechanism for industry, trade, agriculture, and everyday consumers, providing advantages to both central and state governments, thus facilitating the advancement of the Indian economy (Leemput & Wiencek, 2017). Numerous economists and scholars regard this initiative as a commendable move towards enhancing transformation and transparency within businesses. It has been recognized as a remedy for the persistent issue of integrating the national market, with the aim of streamlining business processes, strengthening financial resources, and addressing the fiscal deficit. Ultimately, this strategy promotes economic growth (Jayalakshmi & Venkateswarlu, 2018). In a report titled "Public Finance System Overview: Indian States," S&P Global Ratings credit analyst YeeFarn Phua emphasized that the enactment of the GST bill in 2017 marks a pivotal change in the tax structure. The MSME sector is a vital component of the Indian economy, playing a crucial role in generating employment and fostering economic growth in India. It serves as the backbone of the Indian economy, accounting for 25% of employment, 45% of industrial output, and 40% of the country's exports, while also making a significant contribution to the gross value added of the nation. The MSME sector is the second largest contributor to employment generation in India, following agriculture.

The introduction of this tax allows the government to maintain a stronger grip on taxpayers, which subsequently enhances the overall tax structure and offers numerous additional benefits. The MSME sector has been recognized as a primary growth engine of the Indian economy for many years. However, despite its potential, the effective implementation of the GST framework has encountered several obstacles. Businesses have faced difficulties with compliance complexities, necessitating a thorough comprehension of tax laws and procedures (Pandey 2017). Additionally, the transition to

a digital GST system has introduced technological challenges, compelling organizations to adapt to new systems and workflows (Gupta 2017). The effects of GST on MSMEs have resulted in significant transformations. This research will assist MSME entrepreneurs in mitigating the adverse effects associated with GST implementation.

II. Objectives of the study

1.To Study the conceptual background and the evolution of Goods and Services Tax on MSMEs in Indian Scenario.

2.To ssess the GST opportunities and challenges of MSMEs on Indian Economy and its

III. **Data sources**

An attempt to have been made on the basis of secondary data sourced from various Journals, Magazines, Articles and Media reports. Available secondary data was extensively used for the study.

1. Fourth All India Census Report of MSME (2024 - 2025)
2. Annual Report of MSME (2011-12 to 2017-18)
3. Websites of Ministry of Micro, Small and Medium Enterprises.

Union Budget 2025: MSMEs' investment and turnover criteria enhanced

| **Type** | **Investment (Current)** | **Investment (Revised)** | **Turnover (Current)** | **Turnover (Revised)** |
|---|---|---|---|---|
| Micro Enterprise | Rs 1 crore | Rs 2.5 crore | Rs 5 crore | Rs 10 crore |
| Small Enterprise | Rs 10 crore | Rs 25 crore | Rs 50 crore | Rs 100 crore |
| Medium Enterprise | Rs 50 crore | Rs 125 crore | Rs 250 crore | Rs 500 crore |

***Source:*** *Budget 2025–2026, Speech of Nirmala Sitharaman, Union Minister of Finance (February 1, 2025)*

In 2025, the Micro, Small, and Medium Enterprises (MSME) sector continues to be a cornerstone of the Indian economy, contributing approximately 30% to 31.1% of India's total GDP.

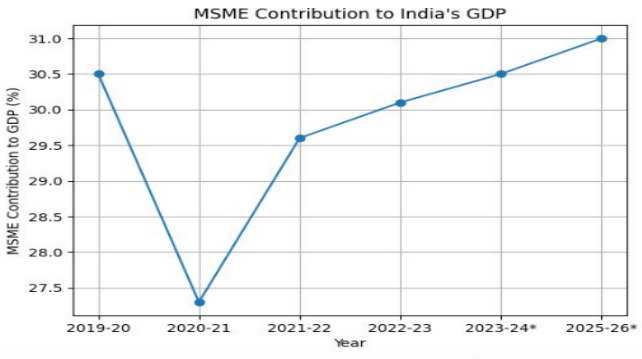
Key highlights of the MSME sector's contribution in 2025 include:

1. **Manufacturing Output:** MSMEs account for around 35.4% of India's manufacturing sector.
2. **Exports:** The sector is a vital component of foreign trade, accounting for over 45% to 48.58% of total exports.
3. **Employment Generation:** The sector employs over 32.82 million people, making it the second- largest employer after agriculture.
4. **Scale and Registration:** As of mid-2025, there are over 7.47 crore MSME enterprises registered across the country

MSMEs Contribution to GDP in India

| Year | MSME Contribution to GDP (%) |
|---|---|
| 2019–20 | 30.5% |
| 2020–21 | 27.3% *(COVID impact)* |
| 2021–22 | 29.6% |
| 2022–23 | 30.1% |
| 2023–24* | ~30.5% (estimated) |
| 2025–26* | ~31.0% (projected) |

*Source: Press Information Bureau* – "Contribution of SMEs to the GDP" (July 2024)




Pre-COVID Stability (2019–20)

Before the pandemic, MSMEs in India showed a stable and strong contribution to

the economy, accounting for around 30.5% of GDP. This reflects the sector's vital role as the backbone of economic activity, supporting production, employment, and income generation across both rural and urban areas.

Impact of COVID-19 (2020–21)

During the COVID-19 period, the MSME sector experienced a significant decline, with its contribution falling to about 27.3%. This drop was mainly due to lockdowns, supply chain disruptions, labor shortages, and reduced consumer demand. The trend highlights the vulnerability of MSMEs to external shocks and economic uncertainties.

Recovery Phase (2021–22 to 2022–23)

Following the pandemic, the MSME sector demonstrated strong resilience by recovering quickly. Its contribution increased to around 29.6% in 2021–22 and further to 30.1% in 2022–23. This recovery was supported by government initiatives, financial assistance, and increased adoption of digital technologies, enabling businesses to adapt to changing market conditions.

Growth and Future Trend (2023–24 onwards)

In the recent and projected years, MSMEs continue to show a positive growth trend, with their contribution expected to reach around 31% of GDP. This indicates sustained expansion, improved productivity, and a stronger integration into national and global markets, positioning MSMEs as key drivers of future economic growth.

Overall, the MSME sector consistently contributes nearly one-third of India's GDP. Despite temporary setbacks during crises, it has shown remarkable recovery and long-term growth potential, reaffirming its importance in economic development, employment generation, and export performance.

State-wise Distribution of MSMEs in India

| Rank | State / UT | Share of MSMEs (%) |
|---|---|---|
| 1 | Uttar Pradesh | 14.2% |
| 2 | West Bengal | 14.0% |
| 3 | Tamil Nadu | 8.0% |
| 4 | Maharashtra | 7.5% |
| 5 | Karnataka | 6.0% |

| | | |
|---|---|---|
| 6 | Bihar | 5.0% |
| 7 | Andhra Pradesh | 4.5% |
| 8 | Gujarat | 4.0% |
| 9 | Rajasthan | 3.5% |
| 10 | Madhya Pradesh | 3.0% |
| 11 | Other States/UTs | 30.3% |

*Source : Ministry of MSME Annual Report*

The distribution of MSMEs in India is uneven, with Uttar Pradesh and West Bengal having the highest share due to large populations and strong presence of small businesses. Industrial states like Tamil Nadu, Maharashtra, and Karnataka also contribute significantly because of better infrastructure and industrial development. Overall, MSMEs are both concentrated in key states and widely spread across the country, supporting employment and balanced regional growth.

Positive Impact of Goods and Services Tax (GST)on MSMEs

**Enhancing the competitiveness of MSMEs:-**The GST is poised to improve the competitiveness of MSMEs by integrating them into organized commerce and providing them with a level playing field.

**No additional tax burden: -** GST treats sales and services as equivalent, thereby eliminating any extra tax burden for MSMEs that operate under a sales and services business model.

**Centralized registration process: -** The registration for GST will be straightforward, as a centralized registration process has replaced the various tax and registration regulations across different states.

**Flexibility: -** GST will facilitate the transfer of goods between states and lower the cost of doing business for MSMEs, as the reform will reduce the multiple taxes imposed by both state and central governments.

**Easier business launch: -** Initiating a new business and subsequently expanding it will be simpler under the GST framework. There is no requirement to register for VAT with each state's sales tax department to conduct business there. All that is needed is to complete and submit an online GSTIN (GST Identification Number).

**Attracting foreign investment: -** A streamlined regulatory framework will

benefit not only modern businesses but also help attract increased foreign investment from the global market.

**Increased threshold limits for new businesses: -** The exemption limit for new businesses has been raised to 25 lakhs, which will alleviate the tax burden on newly established enterprises.

**Transparent transactions: -** Electronic compliance will enhance transparency within the system and also reduce compliance costs.

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:** Manufacturers with a turnover under Rs.

1.50 crores were previously exempt from excise tax, but with GST, this threshold is now Rs. 20 lakhs nationwide and Rs. 10 lakhs in North East states. Consequently, many businesses that were previously exempt will now be taxed, increasing their tax obligations. The government aims to broaden the tax base by including more traders and businesses.

**No distinction on taxes levied on luxury items and services:** Before GST, the government had different tax rates for luxury and regular goods, with luxury items taxed at a higher rate. Now, under GST, this distinction is eliminated, resulting in a uniform tax rate for all goods and services. This poses a major challenge for MSMEs competing against larger, 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 levy of 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**: GST compliance is stringent, requiring MSMEs to file monthly returns, and separate filings for each state of operation, increasing compliance costs. Unlike the earlier quarterly system, proprietors must now

spend more time on taxation instead of business development. Additionally, GST mandates online registration, return filing, and input tax credit claims, forcing MSMEs to upgrade IT infrastructure and hire skilled personnel, further raising costs.

**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:** Current tax regulations do not specify a return period for goods sent on a sale or return basis. However, GST has set this period to six months. If goods are not approved within this timeframe, they are deemed supplied, incurring tax liability. Many small businesses, especially in textiles, commonly send goods on this basis, with returns often occurring after the season. The six-month GST limit may negatively affect these small enterprises.

**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.

## Implications of GST Compliance on MSMEs in India

### 1. Increased Compliance Cost

Frequent return filing, multi-state registrations, and professional support increase the overall operational costs for MSMEs.

### 2. Time Burden on Entrepreneurs

Proprietors must spend more time on taxation and compliance activities, reducing

focus on core business growth and innovation.

**3. Need for Digital Transformation**

Mandatory online processes push MSMEs to adopt digital systems, improving transparency but requiring investment in IT infrastructure.

**4. Demand for Skilled Workforce**

MSMEs may need to hire accountants or trained personnel to manage GST filings, increasing labor costs.

**5. Improved Transparency and Formalization**

GST promotes proper record-keeping and brings MSMEs into the formal economy, enhancing credibility and access to finance.

**6. Short-term Challenges, Long-term Benefits**

While initial compliance is difficult, GST can benefit MSMEs in the long run through input tax credit, reduced tax cascading, and better market integration.

Conclusion

The Goods and Services Tax (GST) is undoubtedly a long-term strategy. It is expected to result in increased output, ob opportunities, and the economic advancement and progress of the country. Nevertheless, during the initial phase of its implementation, it is anticipated to heighten administrative challenges and compliance costs.

Micro, Small, and Medium Enterprises (MSMEs) will be able to benefit from GST if they can overhaul their business processes and systems to align with the compliance requirements stipulated by this legislation, as it would not be operationally viable for MSMEs to function outside the credit chain. With the aid of technology and a robust IT infrastructure, compliance can be simplified. MSMEs must possess the determination to adhere to tax regulations and ultimately contribute to the nation's growth. The transition from the traditional tax system to GST is viewed as a 'behavioral change' rather than merely a tax alteration, as its successful execution largely hinges on how swiftly businesses adjust to the digital taxation format.

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