Impact of GST on Small and Medium Enterprises

Dr. Lakshmi S.

Assistant Prof. of Commerce, Govt. First Grade College, Malur.
Kolar District, Karnataka

Abstract

Goods and Services Tax (GST) had promised to revolutionize the Indian tax system. Earlier, the total tax collection in India was around 14.5 Lakh Crore, of which 34% was indirect tax. Indirect taxes include service tax, stump duty, customs duty, Value Added Tax (VAT), etc. In most of the developing countries, the share of indirect tax is higher than the direct tax. However, it is vice versa in the developed countries. The new GST was meant to bring every indirect form of tax under one roof. For example, before the total tax levied by the central and the state governments add up to 32%, but, with the implementation of GST, the business owners have to pay a much lower tax of around 18-22 percent. Besides, they do not have to pay different taxes to various departments. Consequently, it becomes convenient for the business owner. Against this backdrop, this paper presents an overview of GST concept, explains the implementation and impact GST on small and medium enterprises (SMEs).

Keywords: Goods and services tax, SMEs, Indirect tax, impact, Indian economy etc.

Introduction

Before introduction of Goods and Services Taxes (GST) in India, complicated indirect tax system was followed with multiplication of taxes imposed by union and states separately. With the implementation of GST in the country on 1 July 2017 has unified all the indirect taxes under an umbrella and has created a smooth national market. According to experts, GST will help the economy to grow in more efficient manner by improving the tax collection as it will remove all the tax barriers between states and integrate country via single tax rate. GST was first introduced by France in 1954 to reduce tax evasion. Since then more than 140 countries have GST with some countries follow single and while some other countries pursue with dual system of tax practices respectively. In India, also dual system of GST is proposed. GST will be an indirect tax at all the stages of production to bring about uniformity in the system. On bringing GST into practice, there would be amalgamation of Central and State taxes into a single tax payment. It would also enhance the position of India in both, domestic as well as international market. At the consumer level, GST would reduce the overall tax burden, which is currently estimated at 25-30%. Under this system, the consumer pays the final tax but an efficient input tax credit system ensures that there is no cascading of taxes on tax paid for inputs that go into manufacture of goods. In order to avoid the payment of multiple taxes such as excise duty and service tax at Central level and VAT at the State level, GST unified these taxes and created a uniform market throughout the country.

Integration of various taxes into a GST system has bought about an effective cross-utilization of credits. Because, the previous tax system was more focussed on production, whereas the GST will aim to tax consumption to broaden the tax base. How the GST has widened the taxpayer base?. Earlier, any manufacturer with a turnover of Rs. 1.5 crore or less was not required to comply with the rules of excise duty. However, with the merging of all State and Central level taxes into the ambit of GST, any manufacturer with a turnover of Rs. 20 lakh (others) /10Lakh (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 complication process in the previous tax regime.

Efficacy of the Study

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 a developing country like India and its demographic diversity, SMEs have emerged as the leading employment-generating sector and has provided balanced development across sectors. What would be the impact of GST on Small & Medium Enterprises?. To find out the possible reasons for this question an attempt has been in the present research paper to examine the impact of GST on small and medium enterprises.

Objectives of Study

1. To understand the concept of Goods and Service Tax.
2. To evaluate the advantages and challenges of GST.
3. To study the impact of implementation of GST on SMEs.
4. To examine the opportunities and challenges for SMEs due to implementation of GST.

Research Methodology

Being an explanatory research it is based on secondary data obtained from journals, articles, newspapers and magazines. Considering the objectives of study descriptive type research design is adopted to have more accuracy and rigorous analysis of research study.

A high level impact analysis of GST on small and medium businesses in India.

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 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. Furthermore, these Indian SMEs would be able to compete with foreign competition coming from cheap cost centers such as China, Philippines and Bangladesh.

Positive Impact of GST on SMES

Ease of starting business:

Today, a business with operations across different states needs VAT registration. Different tax rules in different states only add to the complications and lead to businesses incurring a high procedural fee. GST enables a centralised registration that will make starting a business easier and the consequent expansion an added advantage for SMEs.

Market expansion:

SMEs limit their customers within States as they will bear the ultimate burden of tax on interstate sales, which reduces their customer base. With implementation of GST, this will be nullified as tax credit will be transferred, irrespective of the location of the buyer and seller. This will allow start-ups, SMEs and MSMEs to expand their reach across borders.

Reduction of tax burden on new businesses:

As per the current tax structure, businesses with an annual turnover of over Rs 5 lakh need to pay a Value Added Tax (VAT) registration fee. The basic exemption limit under GST is Rs 20 lakh and Rs 10 lakh for special states, which will bring relief to a large number of small dealers and traders.

Elimination of distinction between goods and services:

GST ensures that there is no ambiguity about what constitutes goods and services. This will simplify various legal proceedings related to 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.

Improved logistics and faster delivery of services:

Under the GST bill, no entry tax will be charged for goods manufactured or sold in any part of India. As a result, delivery of goods at interstate points and toll check posts will be expedited. According to a CRISIL estimate, the logistics cost for manufacturers of bulk goods will get reduced significantly — by about 20 percent. This is expected to boost e-commerce across the nation.

Removal of multiple taxation:

GST will ease 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.

Negative Impact of GST on SMES

Registration woes:

Under the GST law, every supplier of goods or services is required to be registered under the GST Act in the state or union territory from where they operate, if their turnover in a financial year is Rs. 20 lakh or more (for special category states such as those from the northeast, this threshold is Rs 10 lakh). Thus, one would think that there is no need for smaller players to register under GST.

Concept of 'Casual Taxable Person':

This means that someone who occasionally undertakes transactions involving supply of goods or services or both, in the course or furtherance of business, whether as a principal, agent, or in any other capacity, in a state or union territory where he has no fixed place of business, also needs to register. Other than registering under the GST Act, the casual taxable person also has to pay tax at the time of applying for registration on an estimated basis. Since he or she doesn't have a place of business in that state, there would be no output tax in that state, thus the state GST cannot be adjusted as an input tax credit. To that extent, the GST is a sunk cost for such individuals.

Composition levy mechanism is very restrictive:

It is an alternative method of levy of tax designed for small taxpayers whose turnover is up to Rs 50 lakh. Those who opt for this mechanism are not allowed to take input tax credit, or collect any tax from the recipient. To such an extent, it seems fair. After all, the rate of GST under the composition levy is low. It is 2.5 percent of the turnover in case of a manufacturer or 1 percent for dealers. But there are restrictions attached. For instance, once again no inter-state supply is permissible. Or for that matter, a person opting for a composition scheme, cannot sell via an e-marketplace (GST requires e- marketplaces to collect tax at source).

The draconian reverse charge mechanism:

If a small businessman (who as per the threshold limits is not required to obtain GST registration) supplies goods or services to a customer who is registered under the GST Act, the customer (buyer) is liable to pay the GST on such a purchase. Not only this, but the buyer also must self- invoice. In other words, the buyer must issue an invoice for the purchase made by him from the unregistered seller. This invoice is to be uploaded onto the GST system.

Technological challenge:

Not all SMEs have the technical expertise to deal with online systems. Thus, most of them will need intermediaries to take them through the registration process. This will add to their registration cost.

Working capital blockage:

Since GST requires businesses to maintain funds in the form of electronic credit ledger with the tax department, it may result in liquidity crunch. Also, the harsh 'input tax credit' mechanism will also lead to working capital blockage.

Harsh mechanism of 'Input Tax Credit':

Input Tax Credit is available to a buyer only if the supplier has paid tax inside a given window. This is one problem which a reasonable percentage of small businesses will face in their life-cycle. Most (if not all), will have no bad 'intent' of evasion or not paying.

Compliance rating:

Another interesting provision is the 'Compliance Rating', a system which assigns ratings to businesses based on their discipline, so you will know whether your supplier has a 'good or poor' rating before buying from them. Thus, businesses will try to avoid buying from people with 'poor' rating, which means that people will do everything they can to AVOID a poor rating. The rating becomes 'poor' not just due to a delay in filing data, but also due to delays in payments.

Added compliances for exports:

Hundreds of Startups / SMEs earn revenue by exporting their services mostly in the technology sector. Now, with GST they have to mandatorily register and file returns. Yes, there is an option to claim refunds of input taxes.

Opportunities and Challenges for SMEs under GST Regime

A sizeable portion of SMEs are of the opinion that GST is not all good for the sector and their fears may not be totally disapproved or ignored. The tax neutrality that the SMEs enjoy may be one of the prominent benefits. However, reduction in duty threshold is one of the key concerns that have led them to be wary of the GST bill. Under the previous excise tax, no duty is paid by a manufacturer having a turnover of less than rupees 1.50 crores. But, under GST implementation; the exemption limit will get significantly lowered. During a speech at a news conference, Finance Minister, ArunJaitley estimate said, the limit can be as low as rupees 25 lakh. As a result, a large number of SMEs and start-ups will be mandated to come under the tax net and will have to pay a large chunk of their earnings towards tax. Furthermore, there are other flipsides to the proposed tax neutrality. GST regime won't differentiate between luxury goods and normal goods; these will it hard for the SMEs to compete against large enterprises. GST that is ultimately levied on supply will not be available for input credit. This will lead to an increase in the cost of the products for businesses that supply directly to end users.

Conclusion

The GST system was basically structured to simplify current indirect tax system in India. A well-designed GST is an attractive method to get rid of deformation of the existing process of multiple taxation, also government has promised that GST will reduce the compliance burden at present. Small and Medium Enterprises (SMEs) are the primary growth drivers of the Indian economy with more than three million SMEs operating in India, contributing to almost 50 percent of the industrial output and 42 percent of India's total exports. A leading employment-generating sector, SMEs have provided balanced development across sectors.GST will enhance the taxpayer base by bringing more SMEs under its ambit, and will definitely pass on the burden of compliance and associated costs to them. However, eventually GST will turn these SMEs more competitive, and level the playing field between large enterprises and them. Further, these Indian SMEs would be able to compete with foreign competitors from cheap cost centres such as China, Philippines, and Bangladesh.

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