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NAVIGATING THE GST TERRAIN: IMPACT ON MSMES AND PATHWAYS TO MITIGATION

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I. ABSTRACT

The Goods and Services Tax (GST) Act of 2017 aimed to revolutionize trade by consolidating 17 diverse taxes into a cohesive system with four tax slabs, marking a significant shift in India's indirect tax regime. However, its journey witnessed nearly 2000 amendments in seven years, prompting concerns about stability and effectiveness. Challenges persist for Micro, Small, and Medium Enterprises (MSMEs), notably in GST registration, compliance burdens, and selection dilemmas between composition and regular tax regimes. These challenges exacerbate operational inefficiencies, particularly affecting small-scale businesses. Additionally, the lack of clarity in tax regulations and the reverse charge mechanism add to the burden, hindering business operations. Addressing these challenges requires simplifying the composition scheme, extending Input Tax Credit (ITC) benefits, and streamlining processes to foster smoother business operations under the GST regime. Efforts to enhance government systems can prevent minor mistakes from disrupting entities' core operations. This paper provides valuable insights into the challenges faced by MSMEs under the GST regime and proposes solutions to alleviate their impact, making it essential reading for policymakers, business owners, and researchers seeking to understand and address the implications of GST implementation in India. The comprehensive analysis offered in this study serves as a roadmap for navigating the complexities of GST for MSMEs and underscores the importance of policy interventions urging policymakers to simplify GST compliance for MSMEs and offers researchers a framework to assess policy effectiveness, fostering informed decisions and further study.

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II. KEYWORDS

Goods and services Tax, Micro, Small, and Medium Enterprises (MSMEs),Compliance burdens ,Input Tax Credit (ITC), Composition scheme

III. IMPLEMENTATION OF THE GST ACT

The implementation of the Goods and Services Tax (GST) Act in 2017[3] aimed at revolutionizing trade and supply chains by consolidating 17 diverse types of indirect taxes into a singular, cohesive system. This innovative framework introduced four distinct tax slabs – 5%, 12%, 18%, and 28% along with lesser used 0.25% and 3% rates[4], categorizing over 1200 commodities accordingly. However, it's noteworthy that certain essential items like petroleum, gas, and liquor remained excluded from the GST purview. Despite the laudable intent behind GST, its journey witnessed nearly 2000 amendments within a mere seven years, prompting valid concerns about its stability and effectiveness. While the GST regime undeniably fostered improvements in trade facilitation and supply chain efficiency, it also brought forth a myriad of challenges. These challenges, including compliance burdens, inflationary pressures, and logistical bottlenecks, have significantly impacted businesses across various sectors. Among the worst-hit segments, the Micro, Small, and Medium Enterprises (MSMEs) sector stands out, grappling with the brunt of these repercussions.

As per the Micro, Small & Medium Enterprises Development (MSMED) Act of 2006[5], Micro, Small, and Medium Enterprises (MSMEs) are categorized into two classes: Manufacturing and Services. Manufacturing enterprises are delineated by a turnover of up to 10 crore rupees, while service enterprises fall within the 5 crore rupees range, with further internal distinctions between micro, small, and medium enterprises[6]. The MSME

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[3] https://indiacode.nic.in/handle/123456789/15689

[4] Rate of GST on Goods, Goods and Services Tax Council https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://gstcouncil.gov.in/sites/default/files/goods-rates-booklet-03July2017.pdf&ved=2ahUKEwjS-qWv2vaFAxXn6zgGHXZUAFoQFnoECC0QAQ&usg=AOvVaw0f2jwBOmJ4CGcEoCCmjyay

[5] https://samadhaan.msme.gov.in/WriteReadData/DocumentFile/MSMED2006act.pdf

[6] https://icmai.in/TaxationPortal/Publication/Books/Impact_GST_01012020.pdf

sector contributes to 50% of India's Total Exports and 95% of all industrial units of the country[7] and provides employment to 11.10 crore people[8].

IV. CHALLENGES OF REGISTRATION AND COMPOSITION SCHEMES

Registration stands as a cornerstone of GST implementation; it is necessary if aggregate turnover of an entity exceeds Rs.10 lakhs in special category states and Rs.20 lakhs in other states[9] unless business opts for a composition scheme. Therefore, even small businesses are required to register themselves and do several compliance. For entities with an annual turnover below 2 million, the task of providing goods without proper registration presents formidable hurdles and administrative complexities because, they are unable to benefit from different schemes and the suppliers or buyers are also disdained by the thought. This poses a significant concern as there are 91,46,216 unregistered SSI entities in India.[10] Similarly, for those entities surpassing the 2 million mark but falling below the 15 million threshold on an annual basis, they find themselves at a crossroads at the outset of each fiscal year, faced with a dual selection dilemma one of opting composition or the regular tax regime.

Should they opt for the composition scheme, an eligible manufacturer must remit 2%, while a supplier of restaurant services must pay 5%, and any other supplier must contribute 1% of their turnover, accurately distributed between CGST and SGST or UTGST as applicable.[11] Registration under GST law is compulsory for opting for the Composition scheme and the option for composition levy can only be availed by submitting a form electronically prior the commencement of the financial year. A registered individual is not permitted to select the Composition scheme in one state while

[7] Ibid.
[8] EMPLOYMENT OPPORTUNITIES IN MSMEs , PIB, Ministry of Micro, Small & Medium Enterprises, https://pib.gov.in/Pressreleaseshare.aspx?PRID=1778406
[9] The Central Goods and Services Tax Act, 2017, section 22, No. 12, Acts of Parliament, 2017 (India)
[10] Unregistered SSI Sector Review Of Results, Ministry of Micro, Small and Medium Enterprises, https://dcmsme.gov.in/ssiindia/census/ch5.htm
[11] https://old.cbic.gov.in/htdocs-cbec/gst/51_GST_Flyer_Chapter11.pdf

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abstaining from it in other states.[12] A service provider, excluding those involved in restaurant services, is not eligible to choose the composition levy. Furthermore, for those falling within the ambit of the high tax slab, i.e. 28%, the privilege of availing Input Tax Credit (ITC) remains elusive, alongside the inability to furnish intra-state services as entities doing inter-state supply are ineligible for opting composition. This ineligibility also leads to operational and financial overheads as registration and supply set-up has to be done in different states altogether. A manufacturer involved in producing ice cream, pan masala, or tobacco, individuals engaged in inter-state supplies, as well as casual or non-resident taxable persons, are ineligible to choose the Composition Scheme. Consequently, these entities must navigate through the complexities of the tax regime and encounter operational challenges.

V. COMPLIANCE BURDEN AND OPERATIONAL INEFFICIENCIES

In contrast, selecting the alternative avenue mandates the engagement of a professional accountant due to various complexities such as quarterly tax payment and different tax payment according to supply falling under different tax slabs and distinct categories of central tax, state tax and integrated tax, thereby incurring additional financial overheads. Consequently, this financial burden necessitates small-scale service providers or producers to contemplate augmenting the selling price of their products, consequently diminishing their market viability and impeding their capacity to compete effectively against larger market incumbents offering analogous product offerings.

Moreover, the compliance burden imposed by the choice between registration and composition schemes often leads to operational inefficiencies and diverting resources from core business activities. Small scale businesses are the worst hit by this as they already are in their budding stage with a lot of consideration in respect to financial and operational constraints. Additionally, the lack of clarity and consistency in tax regulations

[12] Ibid.

further compounds the challenges faced by businesses, leading to uncertainty and reluctance in investment and expansion initiatives.

E-commerce operators face heightened complexity as they lack a threshold exemption from the law, necessitating registration and meticulous tracking of each product's supply.[13]

VI. REVERSE CHARGE MECHANISM AND ACCOUNTING BURDENS

The provision of transfer goods or services between associated or separate entities, regardless of consideration, falls under GST when conducted as part of business activities.[14] Additionally, the transfer of goods or services from one state to another, even within the supplier's own network or through an agent, qualifies as a supply and is liable to IGST, i.e., a tax levied on all interstate supplies of goods and/or services or across two or more states/Union Territories. If an unregistered vendor supplies goods to a GST-registered individual, the reverse charge mechanism becomes applicable[15]. This implies that the recipient must directly pay the GST instead of the supplier. The registered buyer subject to GST under reverse charge must generate self-invoices for the purchases conducted.[16] The reverse charge mechanism presents a dual challenge. If MSMEs are unregistered, buyers may hesitate to engage in transactions due to the tax liability they would incur. Conversely, if suppliers are unregistered, a common occurrence in the MSME ecosystem where reliance on fellow small enterprises is frequent due to financial and operational interdependencies, it introduces additional accounting burdens for the registered MSMEs. This added complexity is often unfavorable for these businesses.

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[13] Ibid.

[14] The Central Goods and Services Tax Act, 2017, section 7, No. 12, Acts of Parliament, 2017 (India). https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://www.gstzen.in/a/schedule-1-of-cgst-act-2017-until-2018.html&ved=2ahUKEwju4NP9i9GEAxWIcmwGHZjXCxUQFnoECCQQAQ&usg=AOvVaw36FNVYCpC-S0OC7QrRx-qg

[15] The Central Goods and Services Tax Act, 2017, section 9(4), No. 12, Acts of Parliament, 2017 (India).

[16] Section 9(4), Central Goods and Service Tax,2017

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VII. CHALLENGES WITH INPUT TAX CREDITS

There are numerous challenges associated with claiming Input Tax Credits (ITCs), one of which pertains to the timing of availing the credit. In cases where goods are received in multiple lots or installments, the ITC can only be claimed upon receipt of the final lot or installment.[17] This poses a significant hurdle for small businesses, as they often lack the capacity to purchase in bulk and must resort to acquiring goods in smaller lots or installments. Being unable to claim the credit until the entire supply is received places unfair financial constraints on these enterprises, hindering their operations. Another issue with Input Tax Credits (ITCs) is that taxpayers are unable to report them on the tax invoice; instead, they can only claim them in the future once the goods are delivered. This interruption in cash flow significantly impacts business dealings and can pose substantial challenges to trading practices. The law also imposes a 180-day deadline for settling invoices. Failure to meet this deadline results in the need to repay the Input Tax Credits (ITCs) already claimed to the government, along with interest under Section 50 which can be as much as 18% of the unpaid tax.[18] ITC can only be reclaimed once payment is made to the supplier. This convoluted process of paying, reclaiming, facing penalties, and reclaiming again creates significant disruption and frustration. Coupled with the time limit, it feels like a constant threat looming over enterprises, deviating from standard trade practices

VIII. DESTINATION TAX AND TAX OBLIGATIONS

As GST operates as a destination tax, tax obligations arise in the state where the goods or services are received, in the case of inter-state supply. If the place of supply is inaccurately

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[17] A.J, All about Reverse Charge Mechanism (RCM) under GST, Cleartax (last visited April 27, 2024) https://cleartax.in/s/reverse-charge-gst

[18] The Central Goods and Services Tax Act, 2017, section 50, No. 12, Acts of Parliament, 2017 (India) read with Rule 8B, Goods and Services Tax Rules, 2022 https://caclub.in/gst/section-50-of-cgst-act-2017-interest-on-delayed-payment-of-tax/#:~:text=Section%2050%20of%20CGST%20Act%202017%3A%20Interest%20on%20Delayed%20Payment%20of%20Tax,-Provisions%20under%20Section&text=(2)%20The%20interest%20under%20sub,was%20due%20to%20be%20paid.&text=Note%3A%20CBEC%20notifies%2001%2F07,date%20vide%20Notification%209%2F2017.

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determined, the tax must be remitted to the correct government having jurisdiction, and any taxes paid erroneously must be claimed as a refund. However, considering the provision stipulating that a person may be subject to arrest if they collect GST but fail to remit it to the government within three months[19], a dilemma arises. If an individual mistakenly submits the tax to a different government and then awaits a refund before repaying it, this delay may lead to their arrest and economic repercussions. To address this issue, enhancements to government systems and networks can be enacted to prevent minor mistakes from disrupting the core operations of entities.

IX. EXPLORING SOLUTIONS

When discussing the persistent issues in the GST system, it is important to explore potential solutions that, if properly implemented, could alleviate these challenges. One such solution involves simplifying the composition scheme to make it more accessible for MSMEs, thereby incentivizing their participation. Additionally, extending the benefit of Input Tax Credit (ITC) to entities registered under the composition scheme could further encourage their involvement by ensuring financial advantages contrary to them currently being ineligible[20]. Currently, transitioning to the composition scheme entails forfeiting previously availed ITC[21], which hampers its attractiveness. Similarly, including inter-state supply within the purview of the composition scheme could address obstacles faced by businesses, particularly in border areas between states, where the costs and complexities of registering and establishing units in different states can pose significant challenges and hinder supply expansion. This situation, though ironic, underscores the need to streamline processes and remove barriers to facilitate smoother business operations.

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[19] The Central Goods and Services Tax Act, 2017, section 221(1), No. 12, Acts of Parliament, 2017 (India)

[20] https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://cbic-gst.gov.in/pdf/faq-manual/faq-composition-levy-revised.pdf&ved=2ahUKEwj7pdCf_fSFAxUu4zgGHXEpCDkQFnoECCAQAQ&usg=AOvVaw0D1AcPpGbvT63pl4z_YR22

[21] The Central Goods and Services Tax Act, 2017, Section 18, No.12, Acts of Parliament,2017 (India) https://cleartax.in/v/gst/gst-acts/cgst-section-18-availability-of-credit-in-special-circumstances-2

X. CONCLUSION

The implementation of the Goods and Services Tax (GST) Act in 2017 aimed to simplify India's taxation system and enhance trade efficiency. While the introduction of tax slabs and categorization of commodities under the GST framework sought to streamline tax compliance, challenges have arisen over time. The GST regime has undergone numerous amendments, reflecting the need for ongoing refinement. Despite improvements in trade facilitation, businesses across sectors, particularly Micro, Small, and Medium Enterprises (MSMEs), face compliance burdens and operational challenges. Complexities with registration and composition schemes, Input Tax Credits, and compliance deadlines have hampered business operations. Additionally, e-commerce transactions and issues related to tax obligations have added to the challenges. Addressing these challenges requires simplifying the composition scheme, extending benefits to entities registered under it, and streamlining processes for inter-state supply.

In conclusion, while the GST regime has transformed India's taxation landscape, ensured smooth implementation and addressed challenges are essential for fostering a conducive business environment. Collaborative efforts are necessary to optimize the benefits of the GST regime and support economic growth.