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Impact of GST on Micro Small and Medium Enterprises (MSMEs) in India

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Abstract

The Goods and Services Tax (GST), introduced in India in 2017, brought a unified and structured indirect tax system that replaced multiple cascading taxes with a single, destination-based tax regime. This structured framework simplified compliance, improved transparency, and created a common national market. Micro, Small and Medium Enterprises (MSMEs) play a vital role in India's economy by contributing significantly to employment generation, industrial output, and exports, while also promoting balanced regional development. The impact of GST on MSMEs has been mixed: on one hand, it has streamlined taxation, reduced logistics costs, and enabled easier interstate trade, thereby improving business efficiency and market access; on the other hand, MSMEs have faced challenges such as increased compliance requirements, digital filing burdens, and working capital constraints due to input tax credit mechanisms. Overall, GST has modernized the tax structure and holds long-term benefits for MSMEs, though its short-term impact required adaptation and capacity building. However, the study highlights that structure of GST, Importance of MSMES and Impact of GST on MSMEs.

Keywords: GST, MSMEs, Tax structure, India.

Introduction

Micro, Small, and Medium Enterprises (MSMEs) form the backbone of the Indian economy, playing a vital role in job creation, industrial output, and exports. According to the Ministry of MSME (2022), the sector contributes about 30% of India's GDP, employs over 110 million people, and accounts for 45% of the country's total exports. Despite their economic importance, MSMEs have historically faced challenges related to taxation, regulatory compliance, and access to finance. The introduction of the Goods and Services Tax (GST) in July 2017 marked a significant shift in India's taxation landscape, aiming to simplify the complex indirect tax structure and create a unified national market.

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Before GST, MSMEs were subject to various indirect taxes, including Value Added Tax (VAT), Central Sales Tax (CST), service tax, and excise duty, leading to a cascading tax effect and increasing the overall cost of doing business. GST replaced these multiple taxes with a single comprehensive tax system, theoretically reducing the tax burden and streamlining compliance. However, the transition to GST has not been smooth for MSMEs, which often lack the financial and technical capabilities required to comply with the new system.

The Goods and Services Tax (GST) was implemented, significantly altering nearly every area of India's economy and reorganizing the country's indirect tax system. Implementing the GST tax enables the government to control the taxpayers better, which enhances the whole tax system and has several additional advantages. For years, the MSME sector has been considered the main engine of the Indian economy's expansion. MSMEs have emerged as India's primary sector for creating jobs and have contributed to stable growth across several of our expanding country's industries. The impact of the GST on MSME has been profound.

Objectives of the study

1. To analyze the concept and structure of GST in India.
2. To examine the role and importance of MSMEs in the Indian economy.
3. To study the positive and negative impact of GST on MSMEs.

Methodology

The research methodology for an exploratory study on Impact of GST on MSMEs in the Indian economy, focusing on structure of GST, Importance of MSMES and Impact of GST on MSMEs typically involves a qualitative approach supported by secondary data collection from journals, books, web sources. Secondary data collected from government reports, journals, articles, and websites related to GST and MSMEs.

Concept and Structure of GST in India

GST (Goods and Services Tax) in India is based on creating a unified, transparent, and efficient indirect tax system across the country. Introduced on 1 July 2017, GST replaced multiple indirect taxes like excise duty, service tax, VAT, and others. The main idea behind GST is "one nation, one tax", meaning that goods and services are taxed uniformly across India. It is a destination –based tax, which means the tax is collected by the state where the goods or services are consumed, not where they are produced. GST also avoids the cascading effect of taxes (tax on tax) through a system called Input Tax Credit (TTC), allowing businesses to claim credit for taxes already paid on inputs.

Goods and Services Tax (GST) would be a very significant step in the field of indirect tax reforms in India. By amalgamating a large number of Central and State taxes into a single tax, it would mitigate cascading or double taxation in a major way and pave the way for a common national market. From the consumer point of view, the biggest advantage would be in terms of a reduction in the overall tax burden on goods, which is currently estimated to be around 25%-30%. Introduction of GST would also make Indian products competitive in the domestic and international markets. Studies show that this would have a boosting impact on economic growth. Last but not the least, this tax, because of its transparent and self-policing character, would be easier to administer.

The structure of GST in India is dual in nature, meaning both the Central and State Governments have the authority to levy and collect taxes. There are four main components: CGST (Central GST) collected by the central government, SGST (State GST) collected by the state government on intra-state transactions, IGST (Integrated GST) collected by the central government on inter-state transactions, and UTGST (Union Territory GST) applicable in union territories without legislatures. GST is levied at different tax rates - generally 5%, 12%, 18%, and 28% - depending on the type of goods or services. The system is governed by the GST Council, which decides tax rates, rules, and regulations. Overall, GST has simplified the tax system, improved compliance, and boosted economic integration in India.

Importance of MSMEs in the Indian Economy

Micro, Small, and Medium Enterprises (MSMEs) in India are businesses classified based on their investment and annual turnover, as defined under the Micro, Small and Medium Enterprises Development Act, 2006. Micro enterprises are the smallest units with limited investment and turnover, followed by small enterprises with moderate capacity, and medium enterprises which operate on a larger scale but are still smaller than big corporations. MSMEs play a vital role in the Indian economy by generating employment, promoting entrepreneurship, and supporting industrial growth, especially in rural and semi-urban areas. They contribute significantly to GDP and exports while also acting as suppliers and support systems for large industries. They are especially important in promoting balanced regional development by establishing industries in rural and semi-urban areas, thereby reducing migration to large cities. These enterprises are flexible, require lower capital investment, and are capable of adapting quickly to changing market conditions. MSMEs also support large industries by acting as ancillary units and supplying essential components and services.

MSMEs generate millions of jobs, making them one of the largest sources of employment after agriculture. They play a key role in fostering entrepreneurship and innovation by encouraging individuals to start their own businesses. MSMEs also contribute significantly to India's exports, especially in sectors like textiles, handicrafts, and engineering goods. The government supports this sector through various schemes, subsidies, and initiatives under the Ministry of MSME to promote growth and competitiveness. Overall, MSMEs are vital for inclusive economic development, poverty reduction, and strengthening the country's industrial base.

Positive Impact of GST on MSMEs

The Good and Service Tax (GST) has brought several positive changes for Micro, Small, and Medium Enterprises (MSMEs) in India. Here are the key benefits explained clearly:

1. **Launching a new business becomes easier:** Under the previous tax regime, if your business had operations across multiple states, you would need to register for VAT with each state's sales tax department in order to carry out trade activities there. Under GST, the registration is centralized and the rules are uniform for all the states across the country. All you have to do is

complete and submit an online form to obtain a GSTIN (GST Identification Number). Launching a new business, and subsequently expanding it, will be comparatively easier under the GST regime.

2. **The entire process of taxation becomes simpler:** The prime reason GST is implemented is to remove cascading taxation. It reduces the complications caused by the overlap between Central taxes (Excise duty, customs duty, service tax, etc.) and State taxes (VAT, purchase tax, luxury tax, etc.), because it levies a uniform tax on goods and services all over India. If you've spent a large portion of your time on managing multiple taxes, you can relax under the new regime because filing and paying taxes is easier with the GSTN portal.
3. **Reduced cost of logistics:** The current tax regime has created a lot of hassles for the transportation sector. The long queues at checkpoints and inter-state entry points have caused vehicles to stand idle for long periods of time, adding to labor and fuel costs. Businesses transporting goods to other states have had a hard time filing paperwork and paying entry taxes at the inter-state borders, further delaying the delivery of goods. Under GST, the current Central Sales Tax (CST) on interstate sales will be replaced with a combined tax called IGST, which is composed of CGST and SGST and collected by the Central Government.
4. **Encouragement of Digitalization** GST compliance (returns, invoices, payments) is mostly online through platforms like the Goods and Services Tax Network. This pushed MSMEs to adopt digital accounting and filing systems, improving efficiency and transparency. This encourages MSMEs to adopt digital tools, improving efficiency and record-keeping.
5. **Aids MSMEs dealing in sales and services:** GST will not distinguish between ·sales and services. This is good news for the MSMEs that deal with sales and services model of business, for them the taxation is simplified and will be calculated on total.
6. **Purchase of Capital Goods:** In the current system, only 50% of the input tax credit against purchase of Capital Goods is available in the year of purchase and the balance amount in subsequent years. Under GST regime, entire amount of input tax credit can be availed in the year of purchase itself. This will support "Make in India" campaign.

Negative Impact of GST on MSMEs

1. **Excess Working Capital Requirement:** Taxation of stock transfer will primarily impact the working capital requirements. The quantum of impact will vary depending on stock turnaround time at warehouse, credit cycle to customer, quantum of stock transfer, etc. Higher amount of Capital Requirement Jill increase interest cost which ultimately will increase the price of Finished Goods.
2. **No tax differentiation for luxury items and services:** The tax neutrality will not differentiate luxury goods and normal goods. Currently the state and central government levy higher taxes on luxury goods and services. Under GST implementation, all goods and services.

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3. **The burden of higher tax rate for Service Provider:** Presently Service Tax rate is 15%. GST rate will be around 18%. The scenario in the service sector will further be impacted different states will have to take separate registration. Thus even if services are supplied by company's one Unit in State A to another Unit in State B , then also taxes will be payable.
4. **The burden of lower threshold:** The GST bill proposes a reduction in threshold to be Rs. 9 lakh to increase the tax net, Rs. 41akh for North Eastern states. (However, GST council has increased the threshold limit from 10 lakh to 20 lakh and from 41akh to 10 lakh for North eastern states) Under the reform, any service provider or retailer will be subject to tax levy. In the current central excise law threshold is Rs.1.5 crore. This reduction will significantly impact the MSMEs' working capital.
5. **Starting business becomes easier:** Currently, the Sales Tax department has various turnover slabs which require VAT registration. A business with multi-state operation in this case has to follow varied tax rules applicable to different states. This not only creates excess complication but also adds to procedural fees, due to which the price sensitive MSMEs will be burdened. Uniform GST will standardize the process.
6. **Improved MSME market expansion:** In the current system, big corporations procured goods based on MSME's - locality in order to reduce overheads. Thus MSMEs limit their customers within state as they will bear the ultimate burden of tax on interstate sales, reducing their customer base. With implementation of GST, this will be nullified as tax credit will transfer irrespective of location of buyer and seller. This allows MSME segment to expand their reach across borders.

Conclusion

The Goods and Services Tax (GST) has had a mixed but largely transformative impact on Micro, Small, and Medium Enterprises (MSMEs) in India. On one hand, GST simplified the complex indirect tax structure by unifying multiple taxes into a single system, improving transparency, and creating a more organized market. It enabled MSMEs to expand beyond state boundaries with fewer compliance barriers and benefited them through input tax credit mechanisms. On the other hand, the transition to a digital and compliance-heavy system posed initial challenges, especially for smaller enterprises with limited resources and technological readiness. Despite these difficulties, over time, GST has encouraged formalization, improved efficiency, and enhanced competitiveness among MSMEs, positioning them for long-term growth in a more structured economy.

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