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Goods and Services Tax in India: Impact on Small and Medium Enterprises

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Abstract

The introduction of the Goods and Services Tax (GST) in India was a major reform in the indirect tax system. GST was introduced to simplify taxation, remove multiple taxes, and create a common national market. This study examines the impact of GST on Small and Medium Enterprises (SMEs) in India, with special focus on compliance requirements, costs, and business performance. The study follows a descriptive research approach and is based on secondary data collected from published research, government reports, and official documents. The findings show that GST has improved transparency, availability of input tax credit, and market access for SMEs. However, it has also increased compliance burden due to frequent return filing, technical issues, and lack of awareness. The study suggests that simplified procedures, policy support, and better digital training are necessary to help SMEs fully benefit from GST.

Keywords: Goods and Services Tax, Small and Medium Enterprises, GST Compliance, Tax Reform, Input Tax Credit

Introduction

The Goods and Services Tax (GST), implemented in India on 1 July 2017, brought a major change in the country's indirect tax system. It replaced various central and state taxes with a single tax structure to reduce complexity, avoid tax-on-tax, and promote a unified national market. GST was introduced with the objective of making taxation simpler, more transparent, and business-friendly.

Small and Medium Enterprises (SMEs) play an important role in the Indian economy by contributing to employment generation, industrial production, and exports. Due to their limited financial and technical resources, any major tax reform directly affects their business operations. Therefore, understanding how GST has influenced SMEs is important for policymakers, researchers, and business owners.

GST has created new opportunities for SMEs by improving tax transparency, enabling input tax credit, and easing interstate trade. At the same time, it has also created challenges such as higher compliance requirements, technological dependence, and lack of awareness among small businesses. In this context, the present study examines both the positive and negative impacts of GST on SMEs in India and highlights areas where further improvements are required.

Overview of GST in India

The Goods and Services Tax (GST) is a destination-based indirect tax levied on the supply of goods and services in India. It is applied at every stage of the supply chain, but tax is collected only on the value added at each stage. The main objective of GST is to remove multiple indirect taxes and create a simple and uniform tax system across the country.

A key feature of GST is the Input Tax Credit (ITC) mechanism, which allows businesses to claim credit for the tax paid on purchases used for business activities. This system helps in reducing the cascading effect of taxes and lowers the overall tax burden on businesses.

The GST structure in India includes Central GST (CGST), State GST (SGST), Integrated GST (IGST), and Union Territory GST (UTGST), depending on the nature and location of the transaction. All GST-related processes such as registration, return filing, tax payment, and refunds are managed through the GST Network (GSTN), an online platform designed to improve transparency and efficiency in tax administration. Overall, GST aims to simplify tax compliance, promote transparency, and support economic growth by creating a unified national market.

Impact of GST on Small and Medium Enterprises

The implementation of GST has introduced a paradigm shift, bringing about both commendable advantages and notable difficulties for Indian SMEs.

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Positive Impacts

1. A unified market and simplified tax system

The development of a single national market is one of GST's biggest advantages. GST has eliminated interstate tax barriers by absorbing a number of federal and state taxes, simplifying corporate processes and making it simpler for SMEs to expand over state lines. A more organized and predictable tax environment has resulted from this streamlining, which has decreased the difficulties formerly connected with several tax regimes.

2. A decrease in the cascading effect and an increase in cost effectiveness

A key component of GST's architecture is the Input Tax Credit system, which allows companies to deduct input taxes from their output tax obligations. The cascading effect of taxes, which historically resulted in taxes being imposed on taxes at various points of the supply chain, has been almost removed. This increases the competitiveness of SMEs by potentially lowering production costs and improving cost efficiency. Research shows that enterprises' overall costs have decreased and their operational effectiveness has increased as a result of the tax system's reorganization.

3. Increased Transparency and Formalization

In several instances, GST has helped to lessen corruption and promoted increased transparency in corporate dealings. Formalization of the economy is encouraged by the digital aspect of GST compliance made possible by the GSTN. For MSMEs, the move to paperless compliance has also been shown to save productive time. SMEs' access to official credit channels and government programs can be improved with further formalization.

4. Boost to Logistics and Supply Chain Efficiency

By doing away with checkpoints and different state-level levies, the unified tax regime has significantly increased the effectiveness of supply chain management and logistics. This improves warehousing costs, speeds up the flow of goods, and shortens travel times, all of which help SMEs operate more efficiently overall.

5. Enhanced Business Performance

Research suggests an overall positive impact of GST on the business performance of Micro, Small, and Medium Enterprises. Factors such as a refined tax system, technological transitions, and increased tax awareness have contributed to ease of doing business, improved operational efficiency, higher profitability, and reduced blockage of working capital funds.

Challenges Faced by SMEs

1. High Compliance Burden and Costs

For numerous small and medium-sized enterprises (SMEs), the Goods and Services Tax (GST) has

imposed a significant compliance challenge, despite its goal of simplification. This has led to increased staff hours and overall compliance costs due to the frequent need for return filing, intricate procedures, and extensive record-keeping. Many micro, small, and medium enterprises (MSMEs) view these high compliance costs as a major concern, particularly those accustomed to traditional business practices. These costs are further exacerbated by the necessity for expert assistance or digital accounting solutions. One small business respondent emphasized the perceived complexity of the GST system, noting the difficulty in transitioning from previous tax systems due to a lack of support and understanding.

2. Technological Adoption and Digital Literacy Barriers

Technology, through the GSTN, is integral to the GST system. However, in parts of India where computer literacy is low or IT infrastructure is lacking, this compulsory IT-based tax reporting system presents considerable challenges. Many small and medium-sized enterprises struggle with maintaining detailed records, managing digital platforms, and adapting to technological changes, making compliance difficult. The main obstacles to businesses adhering to tax regulations are a lack of skilled personnel and inadequate IT infrastructure..

3. Lack of Awareness and Knowledge

Lack of knowledge and comprehension of the complex GST regulations and processes has been a major obstacle for many MSMEs. This knowledge gap frequently leads to mistakes, non-compliance, and a dependence on outside consultants, which raises expenses and stress levels for business owners. The belief that "GST is good in theory." "However, I am critical of the manner in which GST has been implemented" highlights the challenges firms face in adjusting to the new system in the absence of adequate direction.

4. Operational Difficulties and Working Capital Issues

SMEs have also had to deal with operational challenges such regular modifications to GST rates and regulations, technological issues with the GSTN system, and delays in refund processing. In particular, a SME's working capital can be severely impacted by delays in getting Input Tax Credit, which can cause cash flow issues and lower profitability. In addition to raising working capital requirements for registered enterprises, the Reverse Charge Mechanism for purchases from unregistered traders may disadvantage unregistered suppliers.

5. Diverse Sectoral Impacts

The implications of GST on MSMEs vary across different industries and states, indicating that a one-

size-fits-all approach may not be optimal. This diversity underscores the need for tailored strategies and understanding of specific industry dynamics.

Policy Recommendations and Future Outlook

To maximize the advantages of GST for the SME sector while addressing its challenges, several policy actions and supportive measures are essential: Streamlining Compliance Processes: Experts widely concur that the government should take decisive actions to simplify GST compliance processes and reassess the GST framework to make it more accommodating for MSMEs. This involves addressing issues related to dual taxation, penalties, and job work. Enhanced Education and Training Initiatives: MSMEs need ongoing education about GST regulations, their benefits, and compliance requirements. Government-funded workshops and training sessions can significantly boost MSME owners' digital skills and tax knowledge, enabling them to effectively manage their GST responsibilities. Bolstering Technological Support and Infrastructure: Policymakers should prioritize overcoming obstacles related to insufficient IT infrastructure and the shortage of skilled personnel. Efforts to enhance the acceptance and comprehension of the GSTN among small and medium-sized enterprises are crucial for improved compliance. Effective Grievance Redressal and Feedback Systems: Creating a strong feedback and resolution system is vital to address persistent issues and stabilize the GST framework. Regular communication between government officials and businesses can aid in promptly identifying and resolving problems. Tackling Working Capital Challenges: Accelerating refund processes and reviewing provisions that inadvertently impact SME working capital are necessary measures to alleviate financial pressures on these businesses.

Conclusion

Unquestionably, the Goods and Services Tax has changed India's indirect tax environment, bringing with it both new opportunities and particular difficulties for small and medium-sized businesses. Even though GST has increased market access, increased transparency, and simplified tax efficiency, a sizable section of the SME sector is still impacted by the difficulties associated with compliance, technological adoption, and low knowledge. It is crucial to take a fair and inclusive approach that combines streamlined processes, focused educational programs, strong technology assistance, and adaptable legislative changes. India can guarantee that GST genuinely supports the long-term expansion, competitiveness, and general prosperity of its priceless SME sector by tackling these crucial issues.

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Conflicts of interest

The authors declare that there are no conflicts of interest regarding the publication of this paper.

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