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Impact of GST on SMEs in Manufacturing Sector

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ABSTRACT

The implementation of the Goods and Services Tax (GST) in India has significantly reshaped the tax landscape, particularly impacting Small and Medium Enterprises (SMEs) in the manufacturing sector. This study examines the effects of GST on the operational efficiency, cost structures, and overall business environment for SMEs engaged in manufacturing. Key areas of focus include compliance costs, cash flow management, and the utilization of Input Tax Credit (ITC). The findings indicate that while GST has streamlined the tax regime and reduced the cascading effect of taxes, it has also introduced new compliance challenges and financial burdens for SMEs. The study provides insights into the positive and negative repercussions of GST, highlighting the need for policy adjustments to support SME growth and sustainability in the post-GST era. Through a comprehensive analysis, this research aims to contribute to a better understanding of GST's role in shaping the future of India's manufacturing sector.

Keywords: GST, SMEs, manufacturing sector, compliance costs, Input Tax Credit (ITC), operational efficiency, cost structure, tax reform

BACKGROUND OF THE TOPIC

Implementing GST in India marks a significant milestone for the economy, poised to drive long-term growth. However, certain sectors, such as those presently benefiting from tax exemptions or service industries facing potential cost increases due to tax rate adjustments, may experience temporary challenges. The industry is currently engaged in conducting cost-benefit analyses in anticipation of GST implementation. Concurrently, this presents a prime opportunity for professionals like Chartered Accountants, among others, to offer value-added services to their clients by conducting thorough qualitative studies on the anticipated impacts of GST before its implementation.

Small and medium-sized enterprises (SMEs) are vital to the Indian economy, creating jobs, boosting GDP, and producing industrial output. For innovation, adaptability, and cost-effectiveness, SMEs are especially important to the manufacturing industry. Regulating compliance, financing availability, and market competitiveness are just a few of the many difficulties that SMEs frequently encounter. With the introduction of GST, it was anticipated that some of these issues would be resolved by simplifying the tax system and lessening the amount of taxes owed by companies.

NEED OF THE TOPIC

First off, in many nations, the manufacturing sector significantly contributes to economic expansion and the creation of jobs. SMEs, who make up a sizable share of manufacturing businesses, are the backbone of this industry. In order to evaluate GST's overall effects on the manufacturing sector's growth trajectory, production output, and employment levels, it is necessary to comprehend how SMEs are impacted by the tax. Second, SMEs in the manufacturing industry frequently deal with narrow profit margins and fierce competition on a national and international level. These businesses' competitiveness and profitability may be impacted by changes in input costs, supply chain dynamics, and pricing strategies brought about by the introduction of the Goods and Services Tax (GST).

Thirdly, there are several interconnectedness between the manufacturing sector and other economic sectors, such as commerce, services, and agriculture. Any disturbance in manufacturing operations brought on by the difficulties posed by the GST could have an impact on supply chains, market dynamics, and the stability of the economy as a whole. Consequently, policymakers, industry groups, and other stakeholders must comprehend the subtleties of how GST affects SMEs in the manufacturing sector in order to develop targeted interventions and support mechanisms that would lessen negative effects and encourage inclusive growth.

RECENT TRENDS RELATED TO THE TOPIC

1. Compliance weight: One of the main issues that SMEs now face in the wake of the GST implementation is the greater weight of compliance. In order to comply with GST requirements, SMEs—particularly those in the manufacturing sector—must maintain comprehensive records and submit several tax returns on time. This has resulted in higher administrative expenses and a more difficult time controlling business operations.

2. Transitional Challenges: Many SMEs found it difficult to adjust to the GST regime, especially those with insufficient funding and technological know-how. SMEs had ambiguity and misunderstanding about tax rates, input tax credits, and compliance procedures during the first phase of the GST implementation. Production and supply networks were disrupted as a result of certain SMEs' difficulty adjusting to the new tax structure.

3. Input Tax Credit: Businesses are now able to claim credits for taxes paid on inputs used in the production process thanks to the introduction of the input tax credit concept by the GST. SMEs in the manufacturing sector have difficulties in obtaining and efficiently managing input tax credits, despite the fact that this was meant to lessen the overall tax burden on enterprises. The efficient operation of SMEs has been hampered by lengthy processing times for input tax credit refunds and onerous documentation requirements.

4. More Competition: SMEs in the manufacturing sector now face more rivalry as a result of the GST's creation of a single market. SMEs now compete not just with local players but also with larger firms that have higher economies and resources thanks to the removal of interstate barriers and the establishment of a single tax rate.

5. Technology use: The introduction of the GST has expedited the manufacturing sector's SMEs' use of technology. To simplify their business processes and guarantee that they are in compliance with GST laws, numerous SMEs have made investments in digital accounting systems, ERP software, and tax compliance solutions. The efficiency and transparency of business procedures have increased as a result, but SMEs—especially those with little funding—have also had to bear the higher costs.

6. Restructuring Supply networks: To maximize tax efficiency and cut expenses associated with logistics, SMEs in the manufacturing sector have been forced by the GST to restructure their supply networks. To comply with the new tax laws, many SMEs have reorganized their supplier bases, reviewed their distribution networks, and renegotiated vendor contracts. However, supply chain restructuring entails initial investment and operational adjustments, which may pose challenges for SMEs in the short term.

7. Export Opportunities: A possible advantage of the GST for SMEs in the manufacturing sector is the growth of export prospects. It is now simpler for SMEs to reach foreign markets and compete globally because to the GST's unified tax system and streamlined export procedures. Small and medium-sized enterprises (SMEs) can improve their competitiveness and expand their export share by utilizing GST benefits including input tax credits and export incentives.

Overview:

The Goods and Services Tax (GST) is a significant tax reform that will impact both individuals and businesses in the ever-changing world of taxation. GST was hailed as a revolutionary step toward a more effective and equitable tax system since it was intended to streamline the complex tax environment. Underneath its apparent surface, however, is a mosaic of difficulties, chances, and consequences, especially for Small and Medium Enterprises (SMEs), which are the backbone of global economies. The famous quote from Winston Churchill goes, "We shape our buildings; thereafter, they shape us." The introduction of GST has also had a major impact on the development of SMEs, which emphasizes the necessity to assess its effects on this important industry.

Roughly 90% of enterprises worldwide are SMEs, and they are essential to the development of employment and economic expansion in many countries. Small and medium-sized enterprises (SMEs), well-known for their inventiveness and agility, significantly boost the GDP and advance society.

Goods and Services Tax (GST). All supply of commodities, provision of services, and combinations of both are subject to GST. Every area of the economy, including business, industry, government departments, and service sectors, will be impacted by the Goods and Services Tax (GST). This includes all major, medium, and small-scale businesses, intermediaries, importers, exporters, traders, professionals, and consumers. The Goods and Services Tax is one of India's most significant tax reforms. Experts predicted that by removing tax obstacles between States and uniting India through a unified tax rate, GST will increase tax collections and accelerate India's economic development. Manufacturing and services will bear an equal share of the tax burden under the GST, which will reduce the tax rate by broadening the tax base and reducing exemptions.

The Concept of Goods and Services Tax (GST):

On July 1, 2017, India implemented a historic tax change known as the Goods and Services Tax (GST). A single tax structure took the place of a convoluted array of indirect taxes imposed by the federal and state governments, including value-added tax (VAT), service tax, and excise duty. The goal of the products and Services Tax (GST) is to minimize the cascading impact of taxes, streamline the tax system, and establish a single market for products and services. It is applicable to the supply of goods and services throughout the nation.

Four tax slabs: 5%, 12%, 18%, and 28% make up the GST framework. Certain items are also taxed at 0%, and there is an additional cess on some luxury and sin goods. It functions using a dual model that has state and central components.

GST Rate (%)	Goods
0%	Grains, milk, fresh fruits, vegetables, newspapers, healthcare services, education services.
5%	Processed foods, tea, coffee, edible oils, transportation services (railways, air travel for economy class), household items like sewing machines, coal, fertilizers, cinema tickets below ₹100, apparels below ₹1000, hotels with tariff below ₹1000.
12%	Processed foods, computers, mobile phones, apparel, non-AC restaurants, business class air travel, works contract services, fertilizers, construction materials, cinema tickets above ₹100.
18%	Air conditioners, refrigerators, luxury hotels, restaurants with AC dining, telecom services, financial services, household electronic items, cement, iron and steel products, real estate services, cinema tickets above ₹100.
28%	Luxury cars, cigarettes, aerated drinks, 5-star hotels, restaurants with liquor licenses, consumer durables, automobiles, cement, tobacco products, luxury goods and services.

This table categorizes goods and services based on their GST rates, ranging from 0% to 28%. Essential items like grains and healthcare have a 0% rate, while luxury goods like cars and tobacco products fall under the highest 28% rate. Intermediate rates apply to processed foods, electronics, and various services, reflecting their relative necessity and luxury.

What are the advantages of Composition Scheme?

The following are the advantages of registering under composition scheme:

- Lesser compliance (returns, maintaining books of record, issuance of invoices)
- Limited tax liability
- High liquidity as taxes are at a lower rate

What are the disadvantages of Composition Scheme?

Let us now see the disadvantages of registering under GST composition scheme:

- A limited territory of business. The dealer is barred from carrying out inter-state transactions
- No Input Tax Credit available to composition dealers
- The taxpayer will not be eligible to supply non-taxable goods under GST such as alcohol and goods through an e-commerce portal.

REVIEW OF LITERATURE

1. The Impact of GST on the Micro, Small and Medium Enterprises:

(V. Lakshmi, Dr.G.V.K.Kasturi **,**May 30, 2020,**Open Journal of Business and Management**)

In 2017, India made a major change in its tax system with the introduction of GST (Goods and Services Tax), replacing the old and complex tax structure. This had an impact on small and medium-sized businesses, altering how they function and influencing the overall economy. The GST notably affects small businesses in production, employment, and exports. This paper delves into the way these changes are shaping the economy and market dynamics. Essentially, it explores how the new tax system is impacting the day-to-day operations and growth of small and medium-sized enterprises in India.

2. Impact of GST on Micro, Small and Medium Enterprises (MSMEs). :

(Jayalakshmi, M., & Venkateswarlu, G. (2018).**International Journal of Engineering and Management Research**.)

In 2017, India introduced a new tax system known as Goods and Services Tax (GST) to simplify and lighten the tax load on businesses, especially Micro, Small, and Medium Enterprises (MSMEs). GST, or the 'Great Step towards Transformation' and 'Great Step towards Transparency,' aimed to streamline taxes, creating a unified system for goods and services. This shift is now influencing the economy, particularly smaller businesses. Despite challenges, efforts are underway to support and strengthen these essential small and medium-sized enterprises, fostering simplicity and transparency in India's evolving economic landscape.

3. Evaluation of GST Impact on the Manufacturing Organizations in South-East Rajasthan.

(Boyal, V., Kaneria, P., & Jangid, M. (2022). **Asian Journal of Agricultural Extension, Economics & Sociology.)**

This research examined the impact of Goods and Services Tax (GST) on manufacturing firms in South-East Rajasthan's Kota region. Initially facing challenges, these companies, mostly small or micro-sized, found that GST, despite the initial hurdles, is a convenient and straightforward tax system. Surprisingly, some opted for the composition scheme among the two choices provided by GST. Located in Kota city, the small-sized manufacturing organizations in the south-eastern part of Rajasthan ultimately experienced a positive outcome from GST, showcasing its favorable impact on the region's manufacturing sector.

4. GST Effect on Manufacturing Industry - India.

(Mahender, P. (2017). **International Journal of Managerial Studies and Research (IJMSR))**

In India, the government imposes taxes for development, and a recent law, GST (Goods and Services Tax), was introduced to streamline the process. This paper discusses the effects of GST on the Indian manufacturing industry, focusing on Pharmacy, Revenue, Automobile, and Consumer goods. GST, introduced during P. Chidambaram's term as Finance Minister, replaces the earlier VAT system, aiming for more organized tax collection. Approved by the Indian parliament, GST is expected to bring positive impacts, especially in sectors like FMCG, Automobile, Cement, Light Electrical, Multi Flex, Rail, and Logistics, potentially improving their market conditions.

DATA ANALYSIS:

COMPSITION COST COMPARISON BETWEEN PRE - POST GST SCENARIOS

Compliance Costs	Pre-GST (2014-15)	Post-GST (2019-20)
Sales Tax	₹ 96,240	₹ 0
Service Tax	₹ 60,000	₹ 0
VAT (Value Added Tax)	₹ 120,000	₹ 0
Excise Duty	₹ 36,005	₹ 0
Customs Duty	₹ 0	₹ 0
Professional Fees	₹ 60,000	₹ 42,000

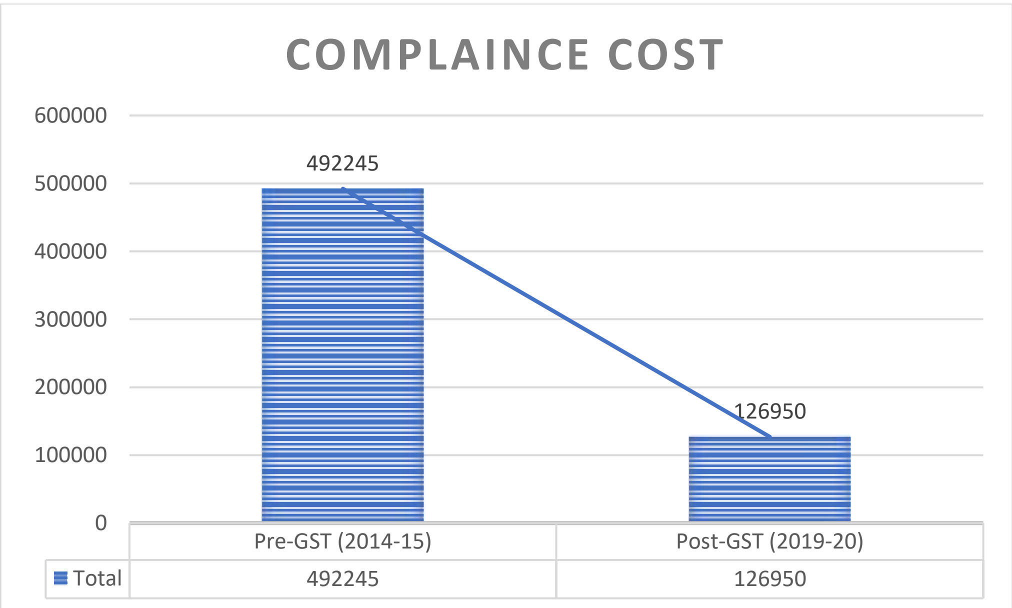
Legal and Regulatory Compliance	₹ 42,000	₹ 30,000
Training and Education	₹ 18,000	₹ 12,500
Software and Technology	₹ 24,000	₹ 18,000
Record Keeping and Documentation	₹ 36,000	₹ 24,450
Total	492245	126950

Compliance Costs	Amount
Before GST	492245
After GST	126950
Reduction	365295
Percentage Reduction	74.20999705

ANALYSIS

1. **Total Compliance Costs Analysis:**
   - Before GST: ₹ 96,240 + ₹ 60,000 + ₹ 120,000 + ₹ 36,005 + ₹ 60,000 + ₹ 42,000 + ₹ 18,000 + ₹ 24,000 + ₹ 36,000 = ₹ 492,245
   - After GST: ₹ 0 + ₹ 0 + ₹ 0 + ₹ 0 + ₹ 42,000 + ₹ 30,000 + ₹ 12,000 + ₹ 18,000 + ₹ 24,000 = ₹ 126,950
2. **Reduction in Compliance Costs:**
   - Reduction = Total Compliance Costs Before GST - Total Compliance Costs After GST = ₹ 492,245 - ₹ 126,950 = ₹ 365295
3. **Percentage Reduction:**
   - Percentage Reduction = (Reduction / Total Compliance Costs Before GST) * 100% = (₹365295/ ₹ 492,245) * 100% ≈ 74.20999705%

The percentage reduction in compliance costs measures the decrease in costs between the pre-GST and post-GST periods as a percentage of the total compliance costs before GST implementation. In this case, the 74.20% reduction indicates a significant decrease in compliance costs after the implementation of GST. This reduction can be attributed to various factors such as the elimination of multiple taxes, input tax credits, simplified tax processes, and reduced compliance burden, resulting in improved operational efficiency and cost savings for the business.



INTERPRETATION:

From the calculation, it's evident that the total compliance costs post-GST is 126000 which is significantly lower compared to pre-GST. Therefore, in terms of compliance costs, the post-GST scenario is better for the business. The reduction in compliance costs indicates potential cost savings and improved operational efficiency for the business after the implementation of GST.

COMPSITION COST COMPARISON BETWEEN PRE - POST GST SCENARIOS

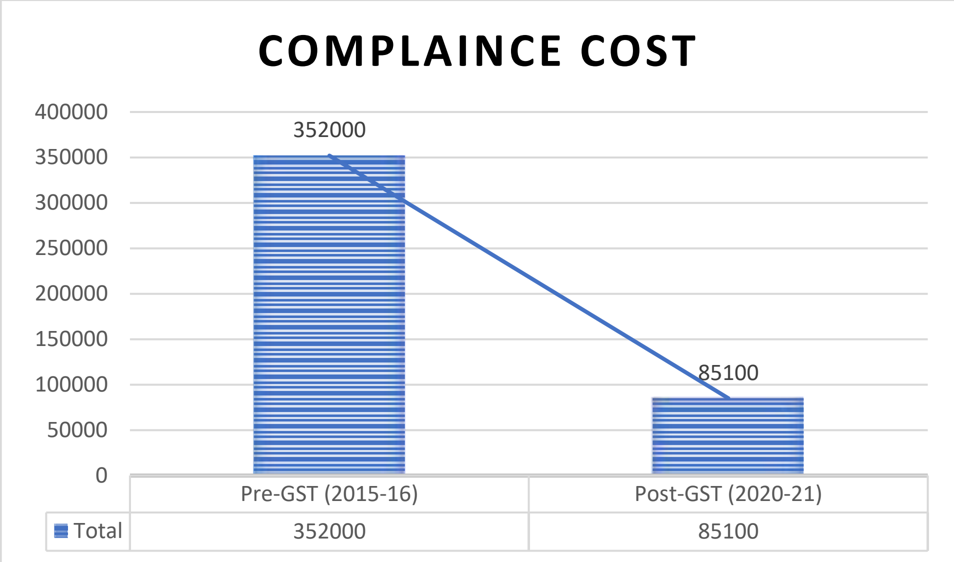
Compliance Costs	Pre-GST (2015-16)	Post-GST (2020-21)
Sales Tax	₹ 85,000	₹ 0
Service Tax	₹ 45,000	₹ 0
VAT (Value Added Tax)	₹ 90,000	₹ 0
Excise Duty	₹ 23,000	₹ 0
Customs Duty	₹ 0	₹ 0
Professional Fees	₹ 28,500	₹ 35,000
Legal and Regulatory Compliance	₹ 21,000	₹ 23,000
Training and Education	₹ 15500	₹ 7,600
Software and Technology	₹ 19000	₹ 9,000
Record Keeping and Documentation	₹ 25,000	₹ 10,500
Total	352000	85100

Compliance Costs	Amount
Before GST	352000
After GST	85100
Reduction	266900
Percentage Reduction	75.82386364

ANALYSIS

2. **Total Compliance Costs Analysis:**
   - Before GST: ₹ 85,000 + ₹ 45,000 + ₹ 90,000 + ₹ 23,000 + ₹ 28,500 + ₹ 21,000 + ₹ 15,500 + ₹ 19,000 + ₹ 25,000 = ₹ 352,000
   - After GST: ₹ 0 + ₹ 0 + ₹ 0 + ₹ 0 + ₹ 35,000 + ₹ 23,000 + ₹ 7,600 + ₹ 9,000 + ₹ 10,500 = ₹ 85,100
3. **Reduction in Compliance Costs:**
   - Reduction = Total Compliance Costs Before GST - Total Compliance Costs After GST = ₹ 352000- ₹ 85100= ₹ 266900
4. **Percentage Reduction:**
   - Percentage Reduction = (Reduction / Total Compliance Costs Before GST) * 100% = (₹266900/ ₹ 352000) * 100% ≈ 75.82386364%

The percentage reduction in compliance costs measures the decrease in costs between the pre-GST and post-GST periods as a percentage of the total compliance costs before GST implementation. In this case, the 75.82% reduction indicates a significant decrease in compliance costs after the implementation of GST. This reduction can be attributed to various factors such as the elimination of multiple taxes, input tax credits, simplified tax processes, and reduced compliance burden, resulting in improved operational efficiency and cost savings for the business.



INTERPRETATION:

From the calculation, it's evident that the total compliance costs post-GST is 85100 which is significantly lower compared to pre-GST. Therefore, in terms of compliance costs, the post-GST scenario is better for the business. The reduction in compliance costs indicates potential cost savings and improved operational efficiency for the business after the implementation of GST.

COMPSITION COST COMPARISON BETWEEN PRE - POST GST SCENARIOS

Compliance Costs	Pre-GST (2016-17)	Post-GST (2021-22)
Sales Tax	₹ 76,000	₹ 0
Service Tax	₹ 50,000	₹ 0
VAT (Value Added Tax)	₹ 110,000	₹ 0
Excise Duty	₹ 30,000	₹ 0
Customs Duty	₹ 0	₹ 0
Professional Fees	₹ 50,000	₹ 35,000
Legal and Regulatory Compliance	₹ 35,000	₹ 25,000
Training and Education	₹ 20,000	₹ 15,000
Software and Technology	₹ 30,000	₹ 20,000
Record Keeping and Documentation	₹ 40,000	₹ 30,000
Total	441000	125000

Compliance Costs	Amount
Before GST	441000
After GST	125000
Reduction	316000
Percentage Reduction	71.6553288

<u>ANALYSIS</u>

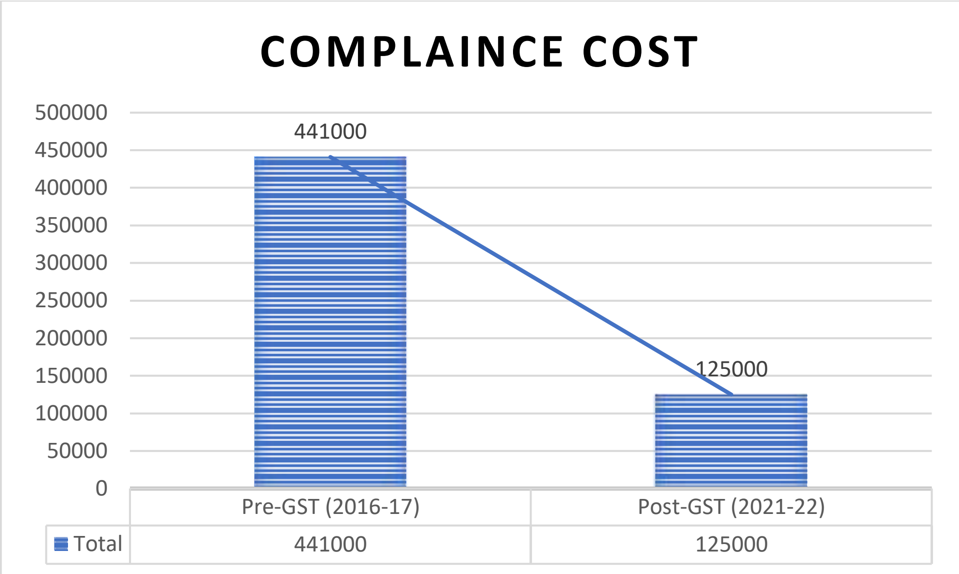
3. **Total Compliance Costs Analysis:**

- Before GST: ₹ 76,000 + ₹ 50,000 + ₹ 110,000 + ₹ 30,000 + ₹ 50,000 + ₹ 35,000 + ₹ 20,000 + ₹ 30,000 + ₹ 40,000 = ₹ 450,000

- After GST: ₹ 0 + ₹ 0 + ₹ 0 + ₹ 0 + ₹ 35,000 + ₹ 25,000 + ₹ 15,000 + ₹ 20,000 + ₹ 30,000 = ₹ 125,000

5. **Reduction in Compliance Costs:**
   - Reduction = Total Compliance Costs Before GST - Total Compliance Costs After GST = ₹ 441000- ₹ 125000= ₹ 316,000
6. **Percentage Reduction:**
   - Percentage Reduction = (Reduction / Total Compliance Costs Before GST) * 100% = (₹316000/ ₹ 441000) * 100% ≈ 71.6553288%

The percentage reduction in compliance costs measures the decrease in costs between the pre-GST and post-GST periods as a percentage of the total compliance costs before GST implementation. In this case, the 71.6% reduction indicates a significant decrease in compliance costs after the implementation of GST. This reduction can be attributed to various factors such as the elimination of multiple taxes, input tax credits, simplified tax processes, and reduced compliance burden, resulting in improved operational efficiency and cost savings for the business.



INTERPRETATION:

From the calculation, it's evident that the total compliance costs post-GST is 125000 which is significantly lower compared to pre-GST. Therefore, in terms of compliance costs, the post-GST scenario is better for the business. The reduction in compliance costs indicates potential cost savings and improved operational efficiency for the business after the implementation of GST.

Conclusion:

Impact of GST on SMEs in the Manufacturing Sector

The implementation of the Goods and Services Tax (GST) in India has brought about significant changes in the manufacturing sector, particularly for Small and Medium Enterprises (SMEs). While the introduction of GST aimed to simplify the tax structure and eliminate the cascading effect of multiple indirect taxes, its impact on SMEs has been multifaceted.

Positive Impacts:

Simplification of Tax Compliance:

GST has replaced a plethora of state and central taxes with a single, unified tax, thereby simplifying the tax compliance process for SMEs. The need for multiple registrations, returns, and payments has been significantly reduced, making the tax administration process more streamlined.

Input Tax Credit (ITC):

One of the most significant benefits for SMEs under GST is the availability of Input Tax Credit. This has allowed businesses to claim credit for the tax paid on inputs, reducing the overall tax burden and enhancing profitability. The seamless flow of ITC has improved the cash flow and working capital management for SMEs.

Market Expansion:

The uniform tax structure under GST has reduced the barriers to interstate trade, encouraging SMEs to expand their market beyond regional boundaries. This has opened up new opportunities for growth and competitiveness in the national market.

Overall Impact:

While GST has undoubtedly simplified the tax structure and created a more unified market, its impact on SMEs in the manufacturing sector has been a mix of benefits and challenges. The positive aspects, such as simplified compliance, the benefit of ITC, and market expansion opportunities, have the potential to significantly enhance the growth prospects of SMEs. However, the increased compliance costs, technological challenges, and working capital issues need to be addressed to ensure that the full benefits of GST are realize.