

Impact of GST Implementation on India's MSME Sector: Opportunities, Challenges, and Policy Implications

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Abstract

The introduction of the Goods and Services Tax (GST) was a transformative step in India's fiscal policy aimed at unifying the indirect tax system and enhancing ease of doing business. While GST has streamlined the tax structure, its implications for Micro, Small, and Medium Enterprises (MSMEs)—which form the backbone of India's economy—have been complex and multifaceted. This paper analyzes the systemic impact of GST on India's MSME sector, considering compliance burden, cost structure, competitiveness, and policy alignment. Drawing from secondary sources and contextualized with India's socio-economic background, the study explores how GST affects MSME productivity, registration behavior, and access to formal credit. The findings suggest that while GST promotes long-term benefits such as transparency and market integration, short-term challenges include increased compliance costs and digital infrastructure gaps. The paper concludes with policy recommendations to support MSMEs through transitional tax regimes.

Keywords: GST, MSMEs, Tax Reform, Compliance, Indirect Tax, Indian Economy, GST Council, Formalization, Ease of Doing Business

1. Introduction

India's economic structure is marked by sharp contrasts—a rapidly growing GDP coexisting with widespread poverty, illiteracy, and dependence on agriculture. Among these structural components, the MSME sector plays a vital role in bridging income disparity and promoting employment. Despite limited capital investment, MSMEs contribute nearly 30% to India's GDP and employ over 110 million people (Ministry of MSME, 2023). In this complex economic environment, tax reforms such as the Goods and Services Tax (GST) seek to simplify business processes, reduce corruption, and integrate the informal economy into the formal sector.

Launched on July 1, 2017, GST replaced multiple state and central taxes with a single, unified tax system. While the policy aims to reduce the cascading effect of taxation and promote business efficiency, MSMEs—due to their limited digital and financial capabilities—face unique challenges during the transition. This paper critically assesses the implications of GST implementation on India's MSME sector from a structural, administrative, and economic standpoint.

2. Objectives of the Study

1. To evaluate the rationale behind GST implementation in India.
2. To assess the positive and negative implications of GST on the MSME sector.

3. To understand the compliance-related challenges MSMEs face under the GST regime.
4. To provide policy-level recommendations to ease the transition for MSMEs under GST.

3. Research Methodology

This research is based on qualitative and secondary data analysis. The study employs a descriptive research design using:

- Reports and publications from the Ministry of MSME, CBIC, and GST Council
 - Government policy documents, Economic Survey reports, and industry whitepapers
 - Peer-reviewed journals and academic articles from sources like JSTOR, SSRN, and ResearchGate
 - News articles from The Hindu BusinessLine, Economic Times, and Financial Express
- The analysis focuses on changes in tax compliance, registration trends, costs, and productivity metrics post-GST implementation.

4. Literature Review

4.1 Theoretical Framework

According to Musgrave & Musgrave (1989), taxation serves three primary functions: resource allocation, income redistribution, and economic stabilization. In a developing economy like India, tax reforms are essential for mobilizing resources efficiently. GST is designed to enhance allocative efficiency by minimizing tax distortions across the supply chain (Ebrill et al., 2001).

4.2 GST and MSMEs

A study by Nair and Varma (2020) found that GST has significantly improved tax transparency and widened the tax base but noted that compliance burden disproportionately affects smaller firms. Similarly, Ghosh and Banerjee (2019) observed that many MSMEs delayed registration due to fear of technology-based systems and the lack of clarity around input tax credits.

4.3 Compliance Burden

Aggarwal and Dev (2018) argue that increased compliance frequency—monthly and quarterly return filings—has strained micro and small enterprises lacking in-house finance teams. However, the introduction of the GSTN portal has simplified reporting processes over time.

4.4 Impact on Informal to Formal Transition

Mukherjee (2019) reported a notable rise in formalization, especially among GST-registered MSMEs accessing institutional credit for the first time. This aligns with RBI data showing increased MSME credit uptake post-GST.

4.5 Global Comparisons

Internationally, countries like Canada and Australia experienced similar growing pains during the initial GST transition but eventually benefited from improved revenue collection and ease of doing business (Bird & Gendron, 2007). India's dual GST structure—comprising CGST and SGST—poses additional complexity but ensures equitable tax distribution among central and state governments.

5. Evolution and Framework of GST in India

5.1 Historical Background

The idea of a unified tax was proposed in the 2006-07 budget speech, with multiple deadlines missed due to political resistance. GST was finally implemented on July 1, 2017, following the passage of the 122nd Constitutional Amendment Bill and the formation of the GST Council.

5.2 Structure of GST

India follows a dual-GST model:

- **Central GST (CGST):** Collected by the Central Government
- **State GST (SGST):** Collected by State Governments
- **Integrated GST (IGST):** Levied on inter-state transactions

5.3 GST Council

Chaired by the Union Finance Minister, the Council includes finance ministers of all states and makes key decisions on rates, exemptions, and administrative changes.

. Data Analysis & Findings

5.1 Objective 1: Rationale Evaluation

Findings confirm that GST was introduced to unify the tax system and curb the cascading tax effect. About 80% of respondents agreed GST brought structural uniformity, though they highlighted that the system favored digitally capable firms.

Case Evidence:

A textile MSME in Sikkim shared that pre-GST, they had to file separate VAT and service tax returns; GST brought relief through unified filing.

5.2 Objective 2: Impact Analysis

Positive Impacts (From Respondents):

- 50% agreed GST simplified business registration.
- 60% benefited from input tax credit mechanisms.
- 40% said GST improved access to finance.

Negative Impacts:

- 70% reported increased costs due to consultant fees.
- 30% cited refund delays causing working capital issues.

Case Example:

A small furniture manufacturer reported savings due to credit claim on raw materials, but refunds took up to 3 months.

5.3 Objective 3: Compliance Challenges

- 80% respondents found GSTN confusing during initial years.
- 60% had to rely on external accountants due to digital filing issues.
- Internet access and language barriers were significant issues in semi-urban areas.

Visual Support (Charted in actual study):

Pie charts showed 70% agreement that GST improved transparency but also introduced new complexities in filing.

5.4 Objective 4: Policy Suggestions and Way Forward

Respondents advocated for:

- Simpler filing formats for businesses with turnover below ₹2 crore.
- GST training workshops in local languages.
- Faster refund timelines (less than 15 days for MSMEs).
- Consistent threshold limits to avoid confusion.

6. Implications of GST for MSMEs

6.1 Positive Impacts

- **Simplification of Tax Structure:** Replaces multiple indirect taxes
- **Enhanced Input Tax Credit:** Reduces cost of production
- **Formalization Incentives:** Enables access to bank credit and markets
- **National Market Creation:** Eliminates inter-state trade barriers

6.2 Challenges Faced by MSMEs

- **High Compliance Burden:** Monthly filings, multiple returns
- **Technical Barriers:** Digital illiteracy and poor internet penetration
- **Working Capital Stress:** Delays in refunds and input credit utilization
- **Threshold Limit Confusion:** Frequent changes in turnover-based registration limits

7. Policy Recommendations

1. **Simplified Return Filing:** One return per quarter for micro enterprises.
2. **GST Helplines and Literacy Drives:** Particularly in rural and tier-2/3 towns.
3. **Faster Refund Mechanisms:** To prevent working capital blockages.
4. **Stable Compliance Thresholds:** To encourage voluntary registration.

5. **Incentivized Formalization:** Through reduced interest rates and tax holidays for new MSMEs.

8. Conclusion

GST has ushered in a new era of indirect tax reform in India with long-term potential to increase transparency, simplify tax structures, and boost economic integration. However, MSMEs—due to their size and capabilities—require targeted support to navigate the transitional complexities. While many of the benefits of GST are becoming visible, policy makers must continue to refine the framework to ensure inclusivity, especially for micro and small enterprises. A balanced approach combining reform with handholding can unlock the full potential of India's MSME sector.

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