

GST and Micro, Small and Medium Enterprises (MSMEs)

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ABSTRACT

In view of the crucial role of MSMEs in employment generation and the development of the economy, it is imperative for the government to make it easier for this sector to do business and comply with the rules and regulations in force. In recognition of the same, relief to this sector in GST laws has been a priority area for the tax authorities. This paper discusses the various provisions related to GST that are of particular significance to MSMEs such as the composition levy scheme, soft tax rate policy for MSMEs, simplified compliance procedures for MSMEs and sector-specific concessions and reliefs.

Keywords: Goods and Services tax (GST); Micro, Small and Medium Enterprises (MSMEs); Composition levy scheme.

1.0 Introduction

GST was introduced in India from July 1, 2017. GST is a tax on goods and services with comprehensive and continuous chain of set-off benefits up to the retailer level. It is essentially a tax only on value addition at each stage, and a supplier at each stage is permitted to set-off, through a tax credit mechanism, the GST paid on the purchase of goods and services. Ultimately, the burden of GST is borne by the end-user (i.e. final consumer) of the commodity/service.

According to clause 12A of Article 366 of the Constitution, goods and services tax means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption. According to the same Article, goods includes all materials, commodities, and articles (clause 12), services means anything other than goods (clause 26A) and State with reference to Articles 246A, 268, 269, 269A and Article 279A includes a Union Territory with legislature (clause 26B).

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The power to levy GST is derived from Article 246A of the Constitution which confers concurrent powers to both Parliament and State Legislatures to make laws with respect to GST. However, clause 2 of Article 246A read with Article 269A provides exclusive power to the Parliament to legislate with respect to inter-state trade or commerce. The taxable event under GST is the supply of goods and/or services.

GST is a comprehensive indirect tax levy on manufacture, sale and consumption of goods as well as services at the national level. GST is an indirect tax for the whole of India to make it one unified common market. GST is designed to give India a world class tax system and improve tax collections. It would end the long-standing distortions of differential treatment of manufacturing sector and services sector. GST will facilitate seamless credit across the entire supply chain and across all States under a common tax base.

1.1 Objectives of GST

The basic objective of tax reforms in any country should be to establish a tax system that is economically efficient, distributionally acceptable, and simple to administer. GST is India's most ambitious and remarkable indirect tax reform. Its objective is to levy a single uniform tax across India on all goods and services. Implementing a new tax, encompassing both goods and services, by the Centre and the States in a large and complex federal system, is perhaps unprecedented in modern global tax history.

Signifying the spirit of co-operative federalism, GST is a historic and game-changing tax reform. Domestically, it will help improve governance, strengthen tax institutions, facilitate *make-in-India by making-one-India*, and impart buoyancy to the tax base. The Indian GST is 21st century's global standard for VAT in large federal systems.

As the world economy slows, and increasing financial volatility and turbulence become the *newest normal*, only a few economies have the resilience to be a refuge of stability and the potential to be an outpost of opportunity. India is one of those few. Macroeconomic stability seems reasonably assured for India. This bedrock of stability coupled with reforms can propel the economy to a high growth trajectory. Key amongst these reforms is the national level GST.

Implementation of GST leaves behind an inefficient, complicated and fragmented indirect tax system. Switch over to GST is fraught with many problems—administrative and technical. However, such problems are endemic of any change of revolutionary proportions. Many of the problems will be transitory in nature. No one should expect a foolproof GST from day one. GST Council¹ has successfully sorted out

political, administrative and implementation differences among the stakeholders and it is competent enough to grapple with any future challenges and rectifications

GST requires a very high level of compliance. The age of hand-written ledgers, account books, balance sheets and manual record-keeping is gone. Everything will now be online and need to be updated regularly.

Since major Central and State indirect taxes have got subsumed under GST, the multiplicity of taxes has been substantially reduced which, in turn, would decrease the operating costs of the country's tax system. With GST in place, the burden of Central sales tax (CST) has also been removed. The uniformity in tax rates and procedures across the country will go a long way in reducing compliance costs.

1.2 Why are MSMEs important in the Indian economy?

MSMEs sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the years. It contributes significantly in the economic and social development of the country by fostering entrepreneurship and generating largest employment opportunities, at comparatively lower capital cost than large industries, next only to the agricultural sector. MSMEs are complementary to large industries as ancillary units and this sector contributes significantly in the inclusive industrial development of the country. The MSMEs are widening their domain across sectors of the economy, producing diverse range of products and services to meet demands of domestic as well as global markets. MSMEs also help in industrialization of rural and backward areas, thereby reducing regional imbalances, and assuring more equitable distribution of national income and wealth.

In view of the crucial role of MSMEs in employment generation and development of the economy, it is imperative for the government to make it easier for this sector to do business and comply with rules and regulations in force. In recognition of the same, relief to this sector in GST laws has been a priority area for the tax authorities. In fact, MSMEs sector is the pampered child of GST. Small manufacturers, traders and service providers have been given special consideration under the GST regime.

1.2.1 Social face of MSMEs

Being the largest source of employment after agriculture, MSMEs sector in India enables lakhs of men, women and children living in urban slums, upcoming towns, remote villages and isolated hamlets to use indigenous knowledge, cultural wisdom, and entrepreneurial skills for the sustenance of their lives and livelihoods. Apart from contributing to national income, MSMEs are instruments of inclusive growth, touching the lives of the most vulnerable, the most marginalized, viz. women,

Muslims, scheduled castes (SCs) and scheduled tribes (STs). For many families, it is the only source of livelihood. For others, it supplements family income. Thus, instead of taking a welfare approach, this sector seeks to empower people to break the cycle of poverty and deprivation. It focuses on people's skills and agency.

Different segments of the MSMEs sector are dominated by different social groups. Women are mostly found in the unregistered sector—food processing enterprises, manufacturing enterprises and weaving—and often work part-time in family enterprises. Women and small children roll *bidis*, make *agarbattis*, do *zari* and sequin work for meagre wages. Muslims in large number are found in the unorganised weaving sector and in powerlooms. STs produce handcrafted articles and are involved in sericulture. In the North-East of India, most women engage in weaving.

1.3 Goods and services exempted from GST

Under GST law, Central and State Governments, on the recommendation of the GST Council, can exempt the supplies from the levy of GST either generally or subject to conditions. Hence, to understand the taxability of GST, it is important to know if an item is exempt or not under GST. It is noteworthy that most of the exempted goods and services are supplied by MSMEs.

Some of the exempted goods under GST law include bread, fresh fruits and vegetables, fresh milk, curd, and hearing aids. Similarly, exempted services include, *inter alia*, electricity, services provided by an educational institution to its students, faculty and staff, and healthcare services by a clinical establishment, an authorised medical practitioner or paramedics.

1.4 Goods and services supplied by businesses within prescribed threshold limits of aggregate turnover

Just like a basic exemption is allowed to individual taxpayers under the Income Tax Act, 1961, so also exemption from registration and payment of GST is allowed to small businesses the aggregate annual turnover of which is within prescribed limits. Threshold for exemption is built into GST to keep small businesses out of tax net. This has following advantages:

- Administrative cost of dealing with small businesses is relatively high.
- Compliance costs and efforts are saved for small businesses.
- Small businesses get relative advantage over large enterprises on account of lower or nil tax incidence.

Prior to the introduction of GST from July 1, 2017, thresholds prescribed in different VAT Acts of States varied from State-to-State.

Threshold limit of aggregate turnover for exemption from registration and payment of GST for the suppliers of goods is ` 40 lakh. It is ` 20 lakh in the case of Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Puducherry, Sikkim, Telengana, Tripura and Uttrakhand.

The benefit of threshold exemption, however, is not available in the case of inter-state supplies of goods.

1.5 Composition levy scheme

Composition scheme is an important feature of GST to protect the interests of small manufacturers, traders and service providers. A composition option (i.e. to pay tax at a flat rate without credits) is available to small taxpayers whose annual aggregate turnover does not exceed a specified limit. The objective of composition scheme is to bring simplicity and reduce compliance cost for small taxpayers. Composition scheme allows small businesses to avail a hassle-free compliance regime. It is noteworthy that these segments are large job creators and hence a priority area for the government.

As per provisions effective April 1, 2019, small businessmen—being suppliers of goods and suppliers of restaurant services—with annual aggregate turnover up to 1.5 crore are eligible for the scheme. In the case of Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, and Uttarakhand, the eligibility limit is 75 lakh.

1.6 Soft tax rate policy for MSMEs

GST Council has taken measures in its various meetings for the benefit of MSMEs. Resultantly, goods predominantly manufactured and/or used in the unorganized MSMEs sector are either exempt or bear low rate of GST. Rate on jute and coir goods (like hand bags, ropes etc.), which are produced mainly in the cottage sector, has been reduced from 12 percent to 5 percent. Similarly, rate on fishing hooks, largely used by the fishermen, and the industry being labour-intensive, has been reduced from 12 percent to 5 percent. Electrical switches and wires, pipelines, plastic products etc. are largely produced by MSMEs and tax rate on these has been brought down from 28 percent to 18 percent.

1.6.1 Soft tax rate policy in relation to goods

Following the recommendations of GST Council in its various meetings, GST rates on goods produced mainly in the MSMEs sector have been reduced from time-to-time. Table 1 depicts these rate reductions.

Table 1: Reduction of GST Rates on Goods Produced Mainly in the MSMEs Sector

Description of the item	GST rate (percent)	
	From	To
Twenty-first Meeting, September 9, 2017, Hyderabad		
• Rubber bands.	28	12
• Idols of wood and stone including marble and metals (other than those made of precious metals).	28	12
• Idols made of clay.	28	Nil
• Textile caps.	18	12
• Cotton quilts.	18	5 and 12*
• Rough industrial diamonds including unsorted diamonds.	3	0.25
Twenty-second Meeting, October 6, 2017, New Delhi		
• <i>Khakra</i> .	12	5
Twenty-third Meeting, November 10, 2017, Guwahati (Assam)		
• Wet grinder consisting of a stone as a grinder.	28	12
• Refined sugar and sugar cubes, pasta and curry paste.	18	12
• Puffed rice <i>chikki</i> , peanut <i>chikki</i> , sesame <i>chikki</i> , <i>gajak</i> .	18	5
• Finished leather.	12	5
• <i>Idli</i> , <i>dosa</i> .	12	5
• Fly ash bricks.	12	5
• Bangles of lac/shellac.	3	Nil
Twenty-fifth Meeting, January 18, 2018, New Delhi		
• Bamboo wood.	18	12
• Boiled sugar confectionary.	18	12
• Tamarind kernel powder.	18	5
• <i>Mehendi</i> paste in cones.	18	5
• Articles of straw, basketware and wickerwork.	12	5
Twenty-eighth Meeting, July 21, 2018, New Delhi		
• <i>Rakhi</i> , sanitary napkins, coir pith compost, sal leaves.	18, 12, 5	Nil
• Handloom dari, knitted caps.	12	5
• Bamboo flooring, brass kerosene pressure stove, zips and slide fasteners.	18	12
• Solid biofuel pellets.	18	5

*5 percent on those not exceeding 1,000 per piece and 12 percent on those exceeding 1,000 per piece.

1.6.2 Soft tax rate policy in relation to services

Following the recommendations of GST Council in its various meetings, GST rates

on services provided/received mainly by MSMEs sector have been reduced as under.

- Two major services—in which large number of MSMEs are engaged, namely healthcare services provided by clinical establishments and educational services provided by educational institutions—are exempt from GST.
- GST rate on most of the job work services, particularly in textile, leather, food processing, printing, jewellery and diamonds, handicrafts, has been reduced from 28 percent to 5 percent.
- GST rate on government contracts for construction of roads, bridges, canals has been reduced from 18 percent to 12 percent.
- Effective GST rate on construction of houses for poor under Pradhan Mantri Awas Yojana (PMAY) has been reduced from 12 percent to 5 percent.
- GST rate on services provided by restaurants has been reduced from 18 percent to 5 percent (except restaurants in hotels having tariff of ` 7,500 per unit per day or more).
- Hotel accommodation having tariff of less than ` 1,000 per day has been exempted and those having tariff up to ` 2,500 per day attract reduced rate of 12 percent. Both these types of accommodation are mainly provided by hotels in MSMEs sector.
- Services of goods transport agencies (GTAs), which are mainly in the MSMEs sector, have been kept under reverse charge mechanism (RCM), thereby shifting the compliance burden on recipient of services. GTAs have also been given option to pay GST at 12 percent with full input tax credit (ITC) under forward charge.
- Services supplied by an insurance agent, recovery agent or individual direct selling

1.7 Simplified compliance procedures for MSMEs

It is understandable that the cost of compliance in terms of statutory laws is proportionately much higher for MSMEs as compared to large companies. Hence some relaxation benefits are necessary in order to help them cope with sudden increase or change in compliance challenges.

Large companies can hire the services of chartered accountants, software engineers, and computer operators to meet the compliance requirements of GST regime. The real problem of compliance lies with small businesses who cannot afford the services of experts to comply with GST laws and procedures.

1.7.1 Simplified return filing

Filing return under the GST regime is crucial as non-compliance or delay can result in penalties and adversely affect taxpayer's compliance rating and timely refunds.

Returns are self-assessed by the registered persons. A taxable person can take

help of GST practitioner in filing returns etc. He can file return through GST Suvidha Providers (GSP). GSPs are third-party service providers, having access to the GST system, who can help taxpayers for GST compliance.

There is a provision for electronic filing of returns by different classes of persons at different cut-off dates. Returns, that allow the auto-population of data from the vendors and automated matching of invoices, are filed online by a normal/casual taxpayer in a sequential manner within different cut-off dates.

It may be noted that most of the returns are auto-generated by the GSTN system and the dealer is expected to validate the data and also fill in the missing data. The payment of tax due is a must for filing valid returns under the GST regime.

The return filing process, which faced severe criticism in the initial months of the roll out of GST, has been revamped for simplification. In its Twenty-eighth Meeting held on July 21, 2018, the GST Council approved the new return formats and associated changes in law to simplify the filing of returns.

On June 11, 2019, Government unveiled a transition plan for taxpayers under GST to switch to new and simpler return forms.

1.7.2 GST on advances received

Earlier, whenever a taxable person received advance, an advance receipt voucher was issued and the GST on the advance received was remitted to the Government. In case supply was later not provided and refund of advance was provided to the customer, then the supplier had to claim refund.

The requirement to pay GST on advances received was proving to be burdensome for small dealers and manufacturers. In order to mitigate their inconvenience on this account, the Twenty-second Meeting of the GST Council held on October 6, 2017 decided that taxpayers having annual aggregate turnover up to ` 1.5 crore shall not be required to pay GST at the time of receipt of advances on account of supply of goods. The GST on such supplies shall be payable only when the supply of goods is made.

1.7.3 Other trade-friendly measures for MSMEs

GST Council in its various meetings has been recommending trade-friendly measures for the benefit of MSMEs. Some of these measures are as under:

- Small retailers doing a large number of small transactions for up to a value of ` 200 per transaction to unregistered customers are not required to issue invoice for every such transaction. They can issue one consolidated invoice at the end of each day for all transactions done during the day. However, they should issue the invoice where the customer so demands. Similarly, in order to keep compliance burden low for small

taxpayers, GST law provides that taxpayers with annual turnover of up to ₹ 1.5 crore need not mention the HSN Code of the goods in the invoices.

- Registered persons are allowed to issue consolidated credit/debit notes in respect of multiple invoices issued in a financial year.
- Commissioners are now empowered to extend the time limit for return of inputs and capital goods sent on job work, up to a period of 1 year and 2 years respectively.
- Amount of pre-deposit payable for filing of appeal under the CGST Act, 2017 before the Appellate Authority and Appellate Tribunal is capped at ₹ 25 crore and ₹ 50 crore respectively.
- Traders will not be denied credits for taxes paid while sourcing goods that are eventually given away free under discount schemes such as buy one, get one free.

1.8 Sector-specific concessions and reliefs

1.8.1 Handicrafts

Handicrafts are items made by hand with the use of simple tools, generally artistic and/or traditional in nature, which are used for decorative purposes, including as gifts and souvenirs as well as for utility purposes.

Handicrafts activity is predominantly carried out in the unorganized household sector. Handicrafts sector is identified as the largest sector of rural employment after agriculture. This sector also touches upon the lives of the most marginalized and has the potential to transform the economy of difficult areas like the North East, Jammu and Kashmir, and desert habitations. It produces a range of items from utility goods, to clothing and variety of lifestyle items.

Handicrafts sector has its roots in the rich traditional, historical and cultural diversity that distinguishes India from the rest of the world. The sector is particularly significant as it provides low-cost and green livelihood opportunities to lakhs of families, besides supplementing incomes in times of agrarian distress, checking migration and preserving the traditional economic relationship between different sections of the society.

The following decisions were taken with regard to handicrafts at the Twenty-first Meeting of the GST Council (September 9, 2017).

A. Exemption from registration for making inter-state supplies: Previously, any person making inter-State taxable supplies was not eligible for threshold exemption of ₹ 20 lakh (₹ 10 lakh in special category states except J&K) and was liable for registration. It was decided to allow an exemption from registration to persons making inter-State

taxable supplies of handicraft goods up to aggregate turnover of ` 20 lakh as long as the person has a permanent account number (PAN) and the goods move under the cover of an e-way bill, irrespective of the value of the consignment.

B. Reduction in rates on handicraft items: GST rate was reduced from 28 percent to 12 percent on the following items:

- Statues, pedestals, high or low reliefs, crosses, figures of animals, bowls, vases, cups, cachou boxes, writing-sets, ashtrays, paper weights, artificial fruit and foliage, other ornamental goods essentially of stone.
- Stones inlay work.
- Worked ivory, bone, tortoise-shell, horn, antlers, coral, and other animal carving material, and articles of these materials (including articles obtained by moulding).
- Pots, jars and similar articles used for conveyance and packing of goods of ceramic.
- Cane furniture.

GST rate was reduced from 18 percent to 12 percent on the following items:

- Glass statues.
- Table and kitchenware of wood.
- Carved wood products like boxes, inlay work cases, casks etc.
- Bells, gongs, mirrors of base metal, metal bidriware etc.

GST rate was reduced from 18 percent to 5 percent on paper mache articles.

GST rate was reduced from 12 percent to 5 percent on grass, leaf and reed and fibre products including mats, pouches, wallets.

C. Another round of reduction in rates on handicraft items: In its Twenty-eighth meeting held on July 21, 2018, the GST Council reduced GST rate from 18 percent to 12 percent on the following handicraft items:

- Handbags including pouches, purses and jewellery boxes.
- Wooden frames for paintings, photographs, mirrors etc.
- Artware of cork.
- Stone artware.
- Ornamental framed mirrors.
- Glass statues.
- Glass artware.
- Artware of iron.
- Artware of brass, copper etc.
- Aluminium artware.
- Handcrafted lamps.

Endnote

1. GST Council is a joint forum of the Centre and the States created under Article 279A of the Constitution. The recommendations made by the Council act as benchmark or guidance to Union as well as State Governments. Recommendations made by the GST Council take effect after changes are made in the relevant GST laws by the Parliament and the legislatures of the States and the Union Territories with legislature.

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