

# A Critical Assessment of the Impact of GST on MSMEs in the state of Punjab

FCS Manjeet S Dhillon<sup>1\*</sup> and Dr. RK Gautam<sup>2</sup>

<sup>1</sup>Company Secretary in Practice

<sup>2</sup>Assistant Professor, University School of Applied Management, Punjabi University, Patiala

\*Corresponding author: [csmanjeetdhillon25@gmail.com](mailto:csmanjeetdhillon25@gmail.com) (FCS Manjeet S Dhillon)

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## ABSTRACT

On July 1, 2017, businesses in India had experienced a paradigm shift in the indirect taxation system, which integrated a large number of Central and State taxes into a uniform Goods and Services Tax (GST) law.

GST has its Impact on every business across the industries. However, the impact on small & medium businesses has been more severe as compared to large ones. Therefore, MSME's ability to withstand this significant tax & infrastructural reform needs to be studied in the light of their small scale & lower margins. In this regard, some pertinent queries need to be answered such as, how MSME has been impacted due to introduction of GST in terms of various costs such as cost of implementation, cost of compliances, as well as the cost of non-compliances etc likewise, challenges if any posed due to the development & alignment of new software systems with GSTN, training of human resources, and issues associated with the new accounting system.

The research is significant as it strives to study multiple challenges being encountered such as the implementation cost, compliance/non-compliance costs, etc. among MSMEs in the state of Punjab as well as drafting recommendations and suggesting to the government and tax authorities in Punjab so that they could raise the voice and share the concern of Punjab's MSME in the various GST Council meeting held from time to time. It is pertinent to mention and draw councils attention to increasing costs

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attributing to GST vis-a-vis its benefits that may accrue to the MSMEs in Punjab.

The findings of the study must be observed in the backdrop of several events that took place in the economy in the past 5 years. The performances of MSME units were adversely impacted by series of events such as demonetisation in the year 2016, enactment of GST law in the year 2017, and uncertainty caused by the present-day pandemic causing the lockdown in the year 2020 and 2021. According to some estimates, nearly 20% to 40% of MSMEs in Punjab may shut down permanently.

## Introduction

India has witnessed a very significant indirect tax reform by the implementation of the Goods and Services Tax Act, and become effective from 1 July 2017 and made applicable throughout India.

The act has replaced multiple taxes such as VAT, Excise duty, etc. hitherto levied by the Central and State Governments. According to many economist and scholars, it was a noble step towards transformation and transparency in businesses. It has been adopted as a solution to the long-pending problem to integrate the national market with the objectives such as to ease the conduct of business, augment the financial resources and keep the fiscal deficit under check thus leading to spur in economic growth (**Jayalakshmi & Venkateswarlu, 2018**).

S&P Global Ratings credit analyst YeeFarn Phua in the report titled “Public Finance System Overview: Indian States” noted that the passage of the GST bill in 2017 is a major overhaul of tax structure and will help to widen the tax base and improve revenues of state governments. GST operates as an aid to industry, trade, agriculture and common consumers, as well as to the central and the state governments, and thus paving way to the growth of the Indian economy (**Leemput and Wiencek, 2017**).

GST would ensure the obvious benefit for industry, trade and agriculture (**Kawle Pooja and Aher Yogesh 2017**). It will offer substantial relief to industry, trade, agriculture and consumers through seamless availability of the input tax credit, and subsuming of

many taxes into GST taxes and the phasing-out of the CST (**Jaiprakash, 2014**).

According to CBIC, GST is expected to bring buoyancy to the Government Revenue by widening the tax base and improving the taxpayer compliance. GST is likely to improve India's ranking in the Ease of Doing Business Index and is estimated to increase the GDP by 1.5% to 2%. GST will boost domestic demand, create more opportunities for domestic business and drive job creation. GST might not be the panacea for all the ills of indirect tax system but is also not far from that.

It is believed that GST regime has both the positive and negative effects on the Indian tax system. Thus the real effect of the GST can only be seen and realised over a period of time. (**Dash, 2017**)

Now with lapse of more than 3 years it is the time to make the independent evaluation of GST's impact on various sectors in the Indian economy which if taken in one go will be herculean task. In the present paper attempt has been made to evaluate the GST impact on the MSME sector of Punjab.

## MSME Importance and Classification

MSME industries are the backbone for any developing economy like India. India being labour intensive and capital deficit economy and its dependence on MSMEs for the economy's growth and employment generation is significant. One of the major concerns at the time of goods and services tax (GST) introduction was its probable strong impact on micro, small and medium-sized enterprises (MSMEs).

The MSME sector contributes to 45% of India's Total Industrial Employment, 50% of India's Total Exports and 95% of all industrial units of the country and more than 6000 types of products are manufactured in these industries ([www.msme.gov.in](http://www.msme.gov.in)).

Given the significant contribution of MSMEs in an Indian economy, it is critical to understand GST impact on these industries, especially in the wake of revised criteria of classification of MSMEs, resulting in large no. of units which hitherto were outside the scope of MSME now falling within it.

The previous MSME classification was based on the criteria of investment in plant and machinery or equipment. Consequently in order to qualify for MSME benefits, the MSMEs were required to restrict their investment to a specified threshold limit.

These lower limits were stifling the urge to grow as they were unable to scale their businesses further. There had been a long-standing demand for the revision of MSME classification so that they can further expand their operations while continuing to avail the MSME benefits.

In June 2020, the government revised the MSME classification by inserting composite criteria of both investment and annual turnover. Also, the revised MSME framework no longer distinguishes between the manufacturing and service industries. Elimination of this difference would bring the sectors closer together. The following is the revised MSME classification, which takes into account both investment and annual turnover when assessing MSME status.

Revised MSME Classification			
Criteria	Micro	Small	Medium*
Investment & Annual Turnover	< Rs.1 crore & < Rs.5 crore	< Rs.10 crore & < Rs.50 crore	< Rs.50 crore & < Rs.250 crore

## Implications of change in the definition

Change in MSME definition has been demanded by the sector's key players since a long time. One main reason/rationale behind such a revision is to enable the MSMEs grow in size and also to continue the benefits that MSMEs get as compared to large corporates. Supporting MSMEs will cater to the project "Make In India" and incentivising foreigners to collaborate with these MSMEs will cater to the project "Assemble in India".

Nearly a year after the FM announced changes in the definition of MSMEs, entrepreneurs and industry stakeholders say the classification has been a game-changer of sorts for the ecosystem. In fact, the Udyam

Registration portal, which came into effect in July 2020, saw over 80 lakh MSMEs being registered by April 2022. As per data shared by the MSME Ministry, the maximum number of registrations are from micro-enterprises.

Factsheet of Classified MSME (Udyam) Registration as on April 2022

Micro	76,55,993
Small	3,53,627
Medium	35,924
Total Registration	80,45,544

<https://udyamregistration.gov.in/Government-India/Ministry-MSME-registration>

## Gst Registration not Required now for Udyam (Msme) Registration

The government issued a notification dated 26.06.2020, which specified that GSTIN is mandatory for registering MSME on the Udyam registration portal. It suggested that, with effect from January 1, 2021, the PAN and GST of the enterprises be made compulsory.

However, the government has received multiple complaints from MSME groups claiming that the GSTIN requirement is causing delays in the registration process. In response to a request from the various MSME association. The Ministry of MSME issued a another notification dated 5th march.,2021, thus aligning the essential requirements for filing GST returns with those enterprises that are exempted from filing returns on the Udyam registration system,

Consequent to this notification, the MSME proprietor can now use only his/her PAN card for registering the enterprise.

## Status of MSME Units and GST in Punjab

Punjab has a wide presence of MSME units across the state truly reflecting the enterprising spirit of the State (**Industrial and Business Development Policy 2017**). There are 2.59 lakh MSME units with a total

workforce of 20.29 lakhs in Punjab. The pandemic has revealed several shortcomings in the GST regime that have adversely impacted MSMEs' operations in the past and will continue to do so in the future if problems are not addressed.

Recognizing the need for a coordinated effort to support them, the Punjab government has signed an agreement with the Global Alliance for Mass Entrepreneurship (GAME) to boost 'ease of doing business' for MSME units in the state as part of Omidyar Network India's 'ReSolve Initiative.' The ReSolve Initiative focuses on providing funding to lighthouse ventures that are developing solutions to empower migrant workers and micro, small, and medium enterprises (MSMEs).

Again, timely ITC refund is vital for MSME units because they rely on refunds for their working capital requirements, as they do not use formal working capital channels owing to the informal nature of their record keeping. Hence delays in refunds severely impact their ability to process customer orders in time.

M S Mani, partner, Deloitte India has lucidly explained the working capital cycle for MSMEs in export business when he said. "MSME don't have a strong balance-sheet. They are either a proprietorship or partnership firms and many of them may not even have a proper legal entity. In such a situation, when banks don't lend to them, they are dependent on refund to finance their next input purchase. If they don't get the refund in time, they can't buy their next inputs and if they can't buy the next input they can't do the next manufacturing. If they don't do the next manufacturing, they can't do the next exports. That's the kind of hand-to-mouth existence of many of the MSMEs,"

Moreover in June 2020, Micro, Small, and Medium Enterprises (MSMEs) in the state have requested the Punjab government to clear Value Added Tax (VAT) and Goods and Services Tax (GST) refunds promptly highlighting the liquidity crisis of the MSMEs in the state. Especially export units of Punjab facing a liquidity crunch due to their input tax credit (ITC) refund under the goods and services tax (GST) regime are being delayed and proving to be a major challenge.

Recently in a notification dated November 26, 2020, GSTIN (Goods and Service Tax Identification

Number) was made one of the mandatory conditions for registration on the MSME portal that was effective from April 1, 2021. However, several MSME associations raised concerns that the measure of making GSTIN mandatory is impacting the registration process as many enterprises are exempt from the mandatory requirement of filing GST returns as per the GST Act/notifications.

Responding to the concern as discussed, MSME ministry in a notification issued on 5<sup>th</sup> March 2021, declared that "For any proprietorship enterprise not registered under any Act or rules of the Central Government or the State Government, the proprietor may use his or her PAN for registration of the enterprise on the Udyam Registration portal, and for all other types of enterprises, PAN shall be mandatory now. The proprietor may use his or her PAN for registering the enterprise."

Thus now, entrepreneurs and proprietors who are exempted from filing GST returns can register their company on the Udyam Registration portal as an MSME with the help of a PAN card. This facilitation expected to help several micro-enterprises, including skilled craftsmen, artisans, and other enterprises in the informal sector and unorganised sector, to register easily.

No doubt, the GST is aimed to increase the taxpayer base and revenue augmentation for the government; government is also proactively paying heed to the various concerns raised by the MSMEs. Nevertheless, immediate effects are suggesting increasing burden of compliance and associated costs for MSME industries.

## Literature Review

**Saurabh Suman (2017)** conducted a study on GST implementation by SMEs and inquired into the problems associated with GST in this paper. The paper concluded that issues will be resolved over time and that GST will be favourable in long run to all business owners.

**Shalini Shukla & Ram Singh (2018)** In this paper, the author attempted to empirically assess the efficiency of businesses after one year of GST implementation. The results indicated that among all three financial parameters taken in this research (i.e., total

assets, profit, and market capitalization for FY2017 and FY 2018), only total assets were significantly different from the pre-GST time (FY2017). Further demographic variables (i.e. size and experience of companies) revealed that age and size of the company also affected the equation and was found significant in influencing the performance of companies after GST implementation. The research revealed new insight into the impact of the GST regime on company financial results.

**Dr. V. R. Nedunchezian and others (2018)** The report outlined the important issues that are widely discussed among the public. The survey was conducted with small and micro business traders for response on the overall impact of GST on their business. It was observed that the responses were neither too negative nor too positive and was in a balanced condition. If governments resolve teething problems quickly and efficiently, GST implementation would be a seamless.

**Dr. Ankita and others (2018)** examined into the challenges that MSMEs are facing, as well as their feedback on GST and how business owners are managing their companies one year after GST implementation.

In their article, **Vidit Mohan and Salman Ali (2018)** present a multi-dimensional understanding of the differences between the expected and current GST regime's effect on MSMEs and the related tax compliance. It explains the difficulties that come with implementing GST.

## Need of the study

The Goods and Services Tax (GST) law, which came into effect on July 1, 2017, established a unified indirect tax system in India, which was projected to have a long-term positive impact on the economy but has created short-term trade challenges.

Group of experts in their report on the Punjab's economic and industrial revival in post-COVID-19 period has suggested that the State government should pay close attention to Micro, Small and Medium Enterprises (MSMEs), as few studies indicate that as many as 20%-40% of MSMEs in the State could permanently shutdown.

The present study is an attempt to identify and analyze the major issues encountered by GST-registered MSMEs in Punjab, namely compliance cost, filing returns, claiming ITC & refunds electronically, and facing working capital issues etc. the study assumes even significant importance in view of fresh challenges posed by covid-19.

## Objectives of Study

1. To study and highlight the challenges and advantages that has accrued to MSME sector of Punjab on account of GST.
2. To suggest measures to make GST more MSME friendly and conducive to government's agenda of "ease of doing business."

## Research Methodology

The study focuses on MSME units operating in the state of Punjab. Total 150 MSME units operating in the region of Punjab have been selected for the purpose of study and GST related information about these units has been collected from the qualified CAs/CSs/CMAs who are in practice and handling GST related work of these units. A structured questionnaire was prepared to translate the objective of the study into a set of questions in a simple and plain language. The five point likert scales with pre-arranged response option were used for many questions. Also, few open ended questions were also included in the questionnaire.

Primary data has been collected using a stratified sampling process. To make the sample more representative, 50 micro, 50 small, and 50 medium enterprises were chosen from a total selected sample of 150 MSME units. The quantitative research is conducted and survey method based on the questionnaire was used to attain the objectives of the study and to address the research problem.

Secondary data related to MSME units required for this research has been gathered from the various research papers, articles, thesis, magazines and Government publications.



## Discussion and Analysis

The above stated objectives have been studied by analyzing and interpreting the empirical testing of various important factors related to the above objective by using chi square test. The perceptions of GST practitioners

like Chartered Accountants, Company Secretaries and Cost Accountants in practice who are handling outsourced work of MSME in Punjab were obtained on five point Likert's scale. These observations were then plotted on excel sheet to enable the application of chi square test on the data.

### Distribution of responses of GST practitioners towards various factors responsible to assessee the impact of GST on MSME units in Punjab

Factors	Strongly Disagree n (%)	Disagree n (%)	Neutral n (%)	Agree n (%)	Strongly Agree n (%)	Chi-square value	df	p-value
Majority of MSMEs outsources GST related work to practicing firms of CA/CS/CMA instead of in house handling the GST work	3 (2.0%)	20 (13.33%)	40 (26.67%)	67 (44.67%)	20 (13.33%)	79.93	4	0.00**
Whether the implementation cost has increased due to introduction of GST	4 (2.67%)	32 (21.33%)	31 (20.67%)	69 (46.00%)	14 (9.33%)	81.93	4	0.00**
Whether the compliance cost has increased due to introduction of GST	3 (2.0%)	37 (24.67%)	37 (24.67%)	70 (46.67%)	3 (2.0%)	105.2	4	0.00**
Whether the recruitment and training cost has increased due to introduction of GST	5 (3.33%)	28 (18.67%)	49 (32.67%)	61 (40.67%)	7 (4.67%)	82.67	4	0.00**
Whether the IT cost (including GST software) has increased due to introduction of GST	3 (2.0%)	25 (16.67%)	32 (21.33%)	75 (50%)	15 (10.0%)	100.27	4	0.00**
Whether there is an increase in Professional payments due to introduction of GST	5 (3.33%)	23 (15.33%)	44 (29.33%)	70 (46.67%)	8 (5.33%)	98.47	4	0.00**
Whether GST regulations are beneficial to MSMEs in general	1 (2.0%)	37 (24.67%)	28 (18.67%)	48 (32.0%)	36 (24.0%)	41.8	4	0.00**
Whether all the compliance procedures under GST such as registration, payments, refunds and returns being done online, is a big relief for MSMEs	8 (5.33%)	5 (3.33%)	32 (21.33%)	79 (52.67%)	26 (17.33%)	117.67	4	0.00**
MSMEs are facing adversity in working capital requirement due to change in GST regime	5 (3.33%)	20 (13.33%)	32 (21.33%)	75 (50%)	18 (12.0%)	107.27	4	0.00**
GST has impacted various business processes (such as Purchase process, Sales process, Supplier chain process, Customer claim process etc) of MSME units	3 (2%)	8 (5.33%)	14 (9.33%)	84 (56.0%)	41 (27.33%)	150.2	4	0.00**

(Table continued)

(Table continued)

Factors	Strongly Disagree n (%)	Disagree n (%)	Neutral n (%)	Agree n (%)	Strongly Agree n (%)	Chi-square value	df	p-value
Whether MSME units encounter any challenges while interfacing with GSTN portal	4 (2.67%)	20 (13.33%)	36 (24.00%)	50 (33.33%)	40 (26.67%)	43.73	4	0.00**
Filing GST returns has become complicated, time consuming and burdensome for MSME units	5 (3.33%)	5 (3.33%)	17 (11.5%)	53 (35.33%)	70 (46.2%)	118.27	4	0.00**
Whether claiming of ITC refund is difficult for MSME units and their funds often get blocked	7 (4.67%)	4 (2.67%)	33 (22.00%)	87 (58.0%)	19 (12.67%)	152.8	4	0.00**

The table presents the details of distribution of responses about the impact of GST on ease of doing business for MSME units in the state of Punjab. The responses were analysed using percentage, mean and chi square test. 58% of respondents agreed that majority of MSMEs outsources GST related work to practicing firms of CA/CS/CMA instead of in-house handling the GST work due to lack of IT skills in handling online GST related work whereas 27% were neutral and 15% held opposite view. 55% of the respondents agreed that initial cost of GST implementation in MSMEs is very high whereas 21% were neutral and 24% were of opposite view.

Again 56% of the respondents agreed that GST implementation was a good step by the Government and is beneficial to MSMEs in general whereas 19% were neutral and 27% were of opposite view. 70% of the respondents agreed that the compliance procedures under GST such as registration, payments, refunds and returns being done online, is a big relief for MSMEs where as 21% were neutral in response and 9% were of opposite view. 82% of the respondents agreed that filing GST returns have become complicated, time consuming and burdensome whereas 11.5% were neutral and 6.5% were of opposite view. 84% of the respondents agreed that GST has impacted their clients various business processes such as Purchase process, Sales process, Supplier chain process, Customer claim process, etc. whereas 9.0% were neutral and 7.0% were of opposite view. 62% MSMEs are facing adversity in working

capital requirement due to change in GST regime as they have to pay GST without first recovering it from the customer. This has raised the requirement of working capital whereas as 21% were neutral and 17% were of opposite view.

60% of the respondents agreed that they encounter many challenges while interfacing with GSTN portal whereas 24% were neutral and 16% were of opposite views. 71% of the respondents were of the view that GST regime claiming of ITC refund is difficult and their client's funds often get blocked. Whereas 22% were neutral and 7% were of opposite view.

When asked for the recommendations to smoothen the implementation and working of GST, only 23 respondents came up with suggestions that frequent amendments in GST laws should be avoided as it has brought uncertainty in their businesses. Majority of the respondents suggested that flat rate of GST should be introduced for MSME without any ITC. Again majority of the respondents suggested that penalty for non compliance should be reduced.

Some of the respondents also reported that the novel corona virus situation has brought forward a GST anomaly, wherein small businesses who are finding it hard to sell in the traditional market, forced to switch to online mode of selling, find that GST threshold limits which were available to them in the offline transaction is not available in online sales and now are under compulsion to get themselves registered under GST.

## Findings and Suggestions and Conclusion

Based on the analysis above, one can assume that various costs such as the implementation, compliance, recruitment, and training cost, IT (GST software) cost, and Professional fees have gone up. The claiming of ITC refund by MSME units has become difficult under GST as funds often get blocked and there is an adverse effect on the working capital requirements of the MSME sector in Punjab.

Also, we can observe that the return filing has become more complicated, time consuming and burdensome for the respondent MSME units. These units are also encountering various challenges while interfacing with GSTN portal.

Nevertheless, despite the challenges discussed above, MSME units in Punjab find it much easier and advantageous to outsource the GST-related work to the professionals rather than managing it in-house. Again, all the compliance procedures under GST (such as registration, payments, refunds, and returns) being done online, is viewed as a huge relief. Even though MSMEs are encountering challenges that they never had to face before but with the right business atmosphere, required support from the government and there is no other alternative but to move forward, one can expect that with some challenges to stay for some more time, MSMEs will surely find enormous opportunities in the present GST regime and in time to come, MSMEs will emerge as a more robust and competitive form of business in Indian business environment.

Keeping in view the above findings, following suggestions are made to improve the competitiveness of the MSMEs in Punjab.

1. In view of the present covid-19 adversaries, government is expected to give more reliefs/relaxations to the MSMEs from GST related compliances such as filing of GST returns, payment of taxes, availing ITC, penalties for non compliances etc.
2. It is suggested that mechanism of ITC should be made friendlier to help MSMEs in regulating their cash flows and monitor their working capital requirements.

3. It is further suggested that government should take MSMEs representation more empathetically while making GST related laws and subsequent amendments therein.
4. MSMEs are expected to accept GST as the regular business feature instead of perceiving it as unnecessary burden of compliances.
5. Technological up gradation on the part of MSMEs is imminent; MSMEs should adept with technology at the earliest and be more efficient in handling the online GST mechanism.
6. Owners of the MSMEs should increase their awareness about GST and learn how GST works and keep themselves updated with changes in GST laws where ever possible.
7. GST suvidha centres are in place and MSME units should take benefits from the services of such centres. The role of GST Suvidha centre is very important and they must adhere to the guidelines issued by the government while providing assistance to the GST registered MSME units.
8. Just as importantly professionals practicing in the GST must provide correct and timely information to their MSME clients and motivate them to comply with GST law and help them understand the role of GST in the growth of their business.

To gauge the impact of GST more studies are needed and it is necessary that all the sectors and subsectors within those sectors in the economy be independently studied to draw a generally accepted inference.

In nutshell, it can be inferred that most of the respondents were of the view that the online interface with the department has made compliance procedures under GST such as registration, payments, refunds, and returns very uniform and transparent. Respondents expect that GST will be a game-changer and would boost sales and profit whereas respondents also cautioned that GST has hindered their business. A few others stated that after GST they were unable to purchase from the registered dealer if the purchaser is unregistered.

However, it also indicates that business owners were inadequately prepared at the time of the introduction of GST in India to accommodate the new tax system into their existing business; they are also



