

Impact of GST on Small & Medium Enterprises (SME's)

Goods & Services Tax in India is proposed to be implemented from fiscal 2017-18; it will subsume 17 indirect taxes including excise duty sales tax, service tax, octroi, entry tax etc.

It will be comprehensive GST regime, based on value added principle, both centre & state government will levy tax (CGST/SGST) on a common base with seamless input tax credit across Goods & Services.

To analyse the impact of GST on SME's it is important to understand & compare both the taxing systems; currently both goods & services are treated differently in terms of taxing principles & legal framework. Due to this differential treatment by the governments, consumer ends up paying huge taxes in terms of **cascading effect** (tax on tax) or **double taxation** (taxing the transaction value twice), if I have illustrate these 2 terms here it is :

If you manufacture a product, you are liable to pay excise duty obviously, if you are not eligible for threshold exemption (technically called SSI exemption) i.e no excise duty if value of clearance is **upto INR 1.5 Cr.** in the first year of business & subsequently, if the previous financial year value of clearances is upto INR 4 Cr.

In GST Regime, the threshold limits are kept at **INR 20 lakhs** for business establishments registered in **all states except** north east states & **INR 10 lakhs for north east states**, as per the recent decision of GST Council, It simply shows the intention of governments to increase the tax base, and impacting lot of SME's operating below 1.5 Cr, in terms of legal liabilities to comply with GST laws.

In present system, It does not end's with excise duty, you need to pay Value added Tax (**traditionally known as Sales Tax**) also on sale of goods to respective state governments in which sale took place, interestingly on the value including excise duty (i.e the % of VAT is also charged on excise duty paid). This is just an illustration; consumer ultimately bears cascading effect of various cesses etc.

Further, when I say double taxation (i.e taxing a value more than once) as an illustration; I would like to remind you, your recent family dinner in an AC Restaurant, where your pocket was charged @ 20% approx. as taxes on account of central & state governments. (You may not have observed, it's a tax @13.125% on full value on account of VAT & (15% on 40% value) i.e 6% again on account of Service Tax, so you end up paying taxes on 140% value)

GST is set to protect the ultimate consumer from cascading effect & double taxation due to seamless input credit, however lower threshold will bring lot of SME's into tax net, adding compliance burden on their shoulders. GST compliance will be the major challenge for SME's as to effectively administer GST and tax credits, Government will ask for invoice wise details of supplies from both the supplier & consumer to match the tax credits with the taxes paid. The idea is to curb the malpractices leading to tax evasions. The Government is investing huge funds in developing the IT backbone (known as GSTN) to effectively process the invoice wise details & monitor the credit chain. So the SME's coming under GST net would require adding on to their accounting capabilities by modifying or building their IT Infrastructure.

Compliance Ratings under GST & its Impact

Government is also planning to introduce GST compliance rating as evident from Section 116 of model GST law; under this section government will rate each registered supplier for compliance with GST laws as per the prescribed parameters, this rating will be available in public domain & will be periodically updated. The purpose of this rating is to compel the compliance, it is obvious that the system will not allow credit unless the information of supplies & receipts would match (If you are trader registered with Delhi VAT, I would say it's similar to Form 2A & 2B, but now it's going to be invoice wise not trader wise). You may soon witness the large scale businesses incorporating expectable GST compliance ratings in their business policies.

It would be challenging for SME's to maintain their compliance ratings to qualify for business opportunities with such large scale enterprises.

Cash flows

Managing liquidity is the major challenge for SME's, sometimes good business opportunities go away due to shortage of funds; Tax payments considerably impact the liquidity of the business, factually taxes should be paid to government account on the same day when collected, however this seems impossible on account of compliance cost. So either government has to bear this opportunity cost or the assessee, therefore generally government bears it by providing the due dates in tax laws which is generally set post collection by the assessee and government discourage the withholding of taxes by levying huge interest & penalties for delayed payments. From last few years we are witnessing the shift in this principle i.e government being the administrator has incorporated accrual system in tax disbursement system, starting from service tax in 2011, Point of taxation rules mandates assessee to pay service tax within 30 days of invoicing, irrespective of receipt at his part. However cash basis disbursements are provided for small assessee below Taxable Turnover 50 Lakh. GST law is based on similar lines.

For assessee in Service Sector, they would continue to bear this finance cost on additional working capital, for manufacturers & traders, this reduction in threshold (1.5 cr. to 20 Lakhs) would result in additional working capital requirement since they may be required to discharge the GST liability pending realisation of the invoice.

GST on stock transfer to maintain the credit chain

Under the present taxing regime, large business units 'stock transfer' goods to other states to be sold thereafter in that state, due to availability of warehouses and thereby managing the impact of central sales tax (CST) on interstate movement i.e stock transfer on Form F in Delhi, Post-stock transfer, goods are sold locally on payment of applicable value added tax (VAT) to the buyer, who is eligible to avail of credit against output VAT liability, In this manner large enterprises avoid the cascading effect.

However, SMEs, owing to lack of infrastructure, effect inter-state sales (instead of stock transfers) and bear the burden of CST on them. The CST paid is currently not available as input credit to the buyer against his output VAT liability. The non-availability of input credit increases the cost of the product, thereby, rendering SMEs uncompetitive versus large enterprises.

Under GST, Inter-state self-supplies such as stock transfers will be taxable (IGST would be applicable on Stock Transfers), as a taxable person has to take state wise registration in terms of Schedule 1(5). Such transactions have been made taxable even if there is no consideration, to maintain the unbroken credit chain.

Intra- state stock transfer would not be taxable under GST. **So it is in benefit of SME's that they need not be required to bear that CST cost anymore & can sell their products competitively throughout the nation.**

Conclusion

SME's can enjoy the real fruits of GST, by realigning their business processes in line with compliances as required under this law, as it would not be feasible for an SME's to operate out of credit chain. Overall this tax will be reduce, logistic cost, storage cost & as expected standard rate around 20%, so tax on goods which is currently around 30% would go down by 10%, adding to the spending power of the consumer. With technology & robust IT infrastructure, compliance can be made simple. What is required is just the courage to be compliant to tax laws & ultimately contributing towards the growth of the nation.



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