THE IMPACT OF GST ON MICRO, SMALL AND MEDIUM ENTERPRISES IN UTTARAKHAND: A CASE STUDY OF SELAQUI INDUSTRIAL ESTATE, DEHRADUN

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ABSTRACT

Uttarakhand , in north India ,was created on 9 November 2000, as the 27th state of the Republic of India, out of the Himalayan and adjoining north western districts of Uttar Pradesh. According to the 2011 Census of India, Uttarakhand has a population of 10,086,292, making it the 19th most populous state in India. 86 percent of this state is mountainous and this geographical inequality between the hills and the plains divides the state critically. With limited scope for agriculture, 48.1 percent population living in the hills (Mamgain & Reddy D.N.2015), nearly 70 percent population in the rural areas (Census 2011), lack of economic and industrial infrastructure, absence of large scale industries in the ten hill districts of the state, widespread unemployment in the hills and the persistent problem of out migration, there is a need to encourage entrepreneurial activity through market encouragement and financial support to entrepreneurs particularly in the micro, small and medium enterprises (MSME) sector. This will not only create employment opportunities but will also help to remove economic backwardness in the state.

The State Infrastructure & Industrial Development Corporation of Uttarakhand Limited (SIDCUL), a government of Uttarakhand enterprise, was set up in the year 2002 to promote industrial development in the state. An Integrated Industrial Development Policy 2008 was launched for the industrial development of hilly and remote areas in the state. As MSMEs are generally labour-intensive, they have the capability to create employment. Further, in view of the continuing implications of climate change, it is necessary that the MSME sector is prepared to absorb millions who may be rendered unemployed in the agriculture sector. The absence of MSMEs in low income countries is known as 'The Missing Middle'. This demonstrates their significance in the overall process of development.

India's paradigm shift to the Goods and Services Tax (GST) regime in July 2017 will increase the compliance costs and snare a majority of Micro, Small and Medium Enterprises (MSMEs) of this state into the indirect tax net for the first time. The Goods and Services Tax bill, touted to be India's biggest tax reform, will simplify the current system of taxation. It seeks to convert the country into a unified market by replacing regional and local taxes with a single and uniform system of taxation by bringing all taxes under a single umbrella. With five different rate slabs, the proposed GST structure intends to widen the tax base and eliminate exemptions.. This present study seeks to assess the impact of GST on MSMEs of Uttarakhand with the Selaqui Industrial estate in Dehradun as a case study.

Key Words: *Goods and Services Tax (GST), Micro, Small and Medium Enterprises (MSMEs), State Infrastructure & Industrial Development Corporation of Uttarakhand Limited (SIDCUL),*

INTRODUCTION

Micro, small and medium enterprises (MSMEs) have been accepted as an engine of economic growth and play a vital role in equitable economic development of the country. The Indian_MSME sector is the backbone of the national economic structure and has unremittingly acted as a bulwark for the Indian economy, providing it resilience to ward off global economic shocks and adversities. With around 36.1 million units throughout the geographical expanse of the country, MSMEs contribute around 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities as well as 33.4% of India's manufacturing output. They have been able to provide employment to around 120 million persons and contribute around 45% of the overall exports from India. The sector has consistently maintained a growth rate of over 10%. About 20% of the MSMEs are based out of rural areas, which indicates the deployment of a significant rural workforce in the MSME sector and the importance of these enterprises in promoting sustainable and inclusive development as well as generating large scale employment in rural areas.

The **economy of India** is a developing mixed economy. It is the world's sixth-largest economy by nominal GDP and the third-largest by purchasing power parity (PPP). India is the sixth largest economy in the world with a nominal GDP of $2.45 trillion The economy's strength lies in a limited dependence on exports, high saving rates, favourable demographics, and a rising middle class. According to the World Bank, India's industrial manufacturing GDP output in 2015 was 6th largest in the world on current US dollar basis ($559 billion), and 9th largest on inflation-adjusted constant 2005 US dollar basis ($197.1 billion). The industrial sector underwent significant changes due to the 1991 economic reforms, which removed import restrictions, brought in foreign competition, led to the privatisation of certain government-owned public-sector industries, liberalised the foreign direct investment (FDI) regime, improved infrastructure and led to an expansion in the production of fast-moving consumer goods. Post liberalization, the Indian private sector was faced with increasing domestic and foreign competition, including the threat of cheaper Chinese imports. It has since handled the change by squeezing costs, revamping management, and relying on cheap labour and new technology.

Uttarakhand , in north India ,was created on ***9 November 2000***, as the 27th state of the Republic of India, out of the Himalayan and adjoining north western districts of Uttar Pradesh. According to the 2011 Census of India, Uttarakhand has a population of 10,086,292, making it the 19th most populous state in India. 86 percent of this state is mountainous and this geographical inequality between the hills and the plains divides the state critically. With limited scope for agriculture, 48.1 percent population living in the hills (Mamgain & Reddy D.N.2015), nearly 70 percent population in the rural areas (Census 2011), lack of economic and industrial infrastructure, absence of large scale industries in the ten hill districts of the state, widespread unemployment in the hills and the persistent problem of out migration, there is a need to encourage entrepreneurial activity through market encouragement and financial support to entrepreneurs particularly in the **micro, small and medium enterprises (MSME)** sector. This will not only create employment opportunities but will also help to remove economic backwardness in the state. The State Infrastructure & Industrial Development Corporation of Uttarakhand Limited (SIDCUL), a government of Uttarakhand enterprise, was set up in the year 2002 to promote industrial development in the state. An Integrated Industrial Development Policy 2008 was launched for the industrial development of hilly and remote areas in the state. As MSMEs are generally labour-intensive, they have the capability to create employment. Further, in view of the continuing implications of climate change, it is necessary that the MSME sector is prepared to absorb millions who may be rendered unemployed in the agriculture sector. The absence of MSMEs in low income countries is known as 'The

Missing Middle'. This demonstrates their significance in the overall process of development.

GOODS AND SERVICES TAX (GST)

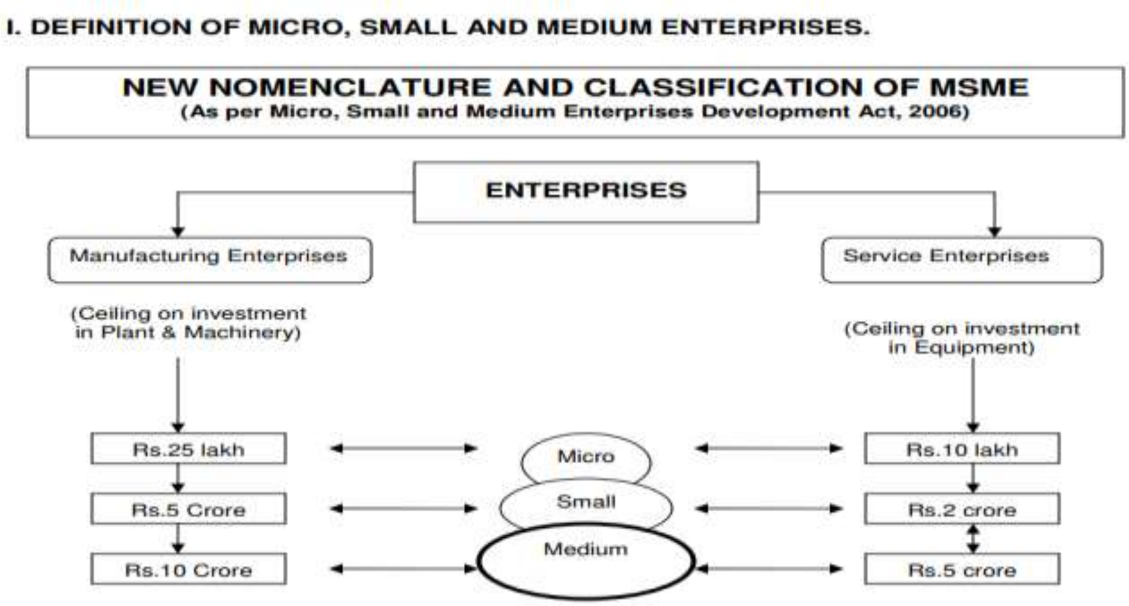
India's paradigm shift to the Goods and Services Tax (GST) regime in July 2017 will increase the compliance costs and snare a majority of Micro, Small and Medium Enterprises (MSMEs) in this state into the indirect tax net for the first time. The Goods and Services Tax bill, touted to be India's biggest tax reform, will simplify the current system of taxation. It seeks to convert the country into a unified market by replacing regional and local taxes with a single and uniform system of taxation by bringing all taxes under a single umbrella. Various taxes like Excise Duty, Value Added Tax (VAT), Central Sales Tax, Luxury Tax and Entry Tax, etc. will all be included under a single roof by GST.A very important feature of the GST bill is that instead of collecting taxes at several steps, it will be collected in one step. One-Country-One-Tax GST, will reduce the cascading effect of taxes on taxes, increase productivity, transparency, and tax-GDP ratio as well as reduce tax evasion and corruption.

With five different rate slabs, the proposed GST structure intends to widen the tax base and eliminate exemptions. The objective of the present study, based on the primary and secondary data is to assess the impact of GST on MSMEs of Uttarakhand with the Selaqui Industrial estate in Dehradun as a case study.

As per the provisional reports of Census India, in 2011, the population of Dehradun, the capital city was 578420 with 303,411 and 275,009 males and females respectively. The percentage of literates in Dehradun city is 89.32%.

DEFINITION OF MSMEs IN INDIA

In India, economic enterprises have been broadly classified into two categories: (i) Manufacturing and (ii) those engaged in providing/rendering services. Both categories of enterprises have been further classified into micro, small and medium enterprises based on their capital investment. The present ceiling on investment for classification as micro, small or medium enterprises is as under :



IMPACT OF GST ON THE MSME SECTOR: NEGATIVE IMPACT

• **The burden of lower threshold**: The GST proposed a reduction in the threshold to 20 lakh and 10 lakh for North Eastern states. In the earlier central excise law the threshold was Rs.1.5 crore. This reduction will significantly impact the MSMEs' working capital. For example, a manufacturer who traded at Rs. 25 lakhs without any tax levy will now be expected to pay GST. As the threshold is low, most MSMEs earlier exempted will now have to pay a chunk of their profit towards tax.

• **No tax differentiation for luxury items and services**: The tax neutrality will not differentiate between luxury goods and normal goods. Earlier, the state and central government levied higher taxes on luxury goods and services. Under GST implementation, all goods and services will be taxed at the same rate which will lead to the rich becoming richer and poor becoming poorer. It is not an ideal situation for MSMEs competing against large businesses.

• **Selective tax levying**: GST not being applicable to alcoholic beverages and petroleum based businesses creates disparities and does not support the 'unified market' ideology of GST.

• **The burden of a higher tax rate for service providers**: Earlier, the Service Tax rate was 15%. The GST rate is around 18%. The scenario in the services sector will further be impacted as the concept of centralised registration has been done away with and each unit in different states will have to be separately registered. Thus even if services are supplied by company's one unit in State A to another unit in State B , then also taxes will be payable.

• **Excess Working Capital requirement** - Taxation on stock transfer will primarily impact the working capital requirements. The quantum of impact will vary depending on stock turnaround time at warehouses, credit cycle to customer, quantum of stock transfer, etc. Higher amount of capital requirement will increase interest cost which will ultimately increase the price of finished goods.

• **Realignment of Purchase and Supply Chain** - Under GST credit is not available to a compliant company if the vendor from whom MSME is purchasing goods does not show the same in its return. Thus sourcing strategies will change on account of the GST credit mechanism.

• **Dual Control** - In a recent GST Council meeting it was decided that those assesses having a turnover of less than 1.5 crores will be assessed by the State Government and existing Service Tax assesses, irrespective of turnover will be assessed by the Central Government as there is lack of expertise with the State Government in relation to Service Tax matters. As a result of this, small traders dealing in both goods and services will have dual administrative control both by Centre and State.

POSITIVE IMPACT

• **Starting a business becomes easier:** Earlier, the Sales Tax department had various turnover slabs which required VAT registration. A business with multi-state operation in this case had to follow varied tax rules applicable to different states. This not only created excess complication but also adds to procedural fees, due to which the price sensitive MSMEs got burdened. Uniform GST will standardize the process.

• **Improved MSME market expansion:** Earlier, big corporations procured goods based on an MSME's locality in order to reduce overheads. Thus MSMEs limited their customers within state to avoid the burden of tax on interstate sales, reducing their customer base. With implementation of GST, this will be nullified as tax credit will transfer irrespective of the location of buyer and seller. This allows MSME segment to expand their reach across borders.

• **Lower logistical overheads:** GST will eliminate time consuming border tax procedures and toll check posts and encourage supply of goods across borders. Accordingly the logistical cost for companies manufacturing bulk goods will be reduced. Such costs can be crucial for the survival of MSMEs.

• **Aids MSMEs dealing in services:** GST will not distinguish between goods and services. This is good news for the MSMEs that deal with the services model of business. For them the taxation will be simplified and calculated on the turnover.

• **Unified market:** GST will allow flexibility in transfer of goods across states and reduce the cost of doing business, as the reform has eliminated multiple taxes imposed by state and central government.

•**Purchase of Capital Goods:** In the earlier system, only 50% of the input tax credit against purchase of capital goods was available in the year of purchase and the balance amount in the subsequent years. Under GST regime, entire amount of input tax credit can be availed in the year of purchase itself. This will support "Make in India" campaign.

FINDINGS OF THE SURVEY (IMPACT IN THE STATE OF UTTARAKHAND)

The present study is based on an empirical study of small and medium enterprises in Selaquie Industrial estate based in the Dehradun district of Uttarakhand. The method used for the collection of the primary data in the present study is **the survey method with the use of questionnaires and schedules**. The sample includes the owners of the small and medium enterprises in the given area of study. A total of 50 respondents have been selected on the basis of **convenience sampling.** The respondents were selected from all over the study area. It being a prominent and one of the largest industrial estates in the capital city of Uttarakhand, has been useful to broadly understand, analyze and evaluate the impact of GST, July 2017 on this sector **in this young Himalayan state of Uttarakhand** .

There is a wide range of industries working in the Selaqui industrial estate. The industries covered are engaged in a variety of production lines such as manufacturing allopathic medicines, herbal medicines and cosmetics (ayurveda), seat covers, other car accessories and air conditioner parts.

Based on the investment in plant and machinery, all the industries surveyed fall in the categories of small and medium enterprises. Most of these industries are more than 5 to 10 years old in the business and therefore firmly placed in their respective lines. Majority respondents reported the turnover of more than Rs 50 lakhs per year with only 15% enterprises manufacturing car parts reporting turnovers between 20 to 30 lakhs per annum. 100% of the industries covered in the sample fall in the GST bracket and confirmed during the study that they have been paying indirect taxes such as excise duty even before July 2017.

COST STRUCTURE POST GST

Majority of industries which are manufacturing medicine and car parts and AC parts reported a significant increase in their overall cost structure since the introduction of GST in July 2017. However, 25 percent industries reported no increase in overall cost structure post July 2017. These industries are engaged in the manufacturing of herbal medicines and cosmetics.

EFFECT OF GST IN INPUT COST

A large number of industries reported an increase in the input and raw material cost following the implementation of GST (allopathic medicine and car parts). Industries that manufacture AC parts reported negligible effects on their input cost. Interestingly, 5 industries that are manufacturing herbal based cosmetics even reported a decrease in the input raw material cost. The variation in the impact on the input cost of the various industries can be attributed to the different sources of input and raw material.

One input cost that has gone down for all industries is the cost of transportation of raw material from their source to the manufacturing point. Because of the implementation of GST , the movement of goods has become faster , more efficient and cheaper . Due to the elimination of sale tax barriers at the borders of states 83.66% reported a fall in their transportation cost because they are purchasing their raw material from other states.

EFFECT OF GST ON THE VOLUME OF SALES

All the industries surveyed confirmed the absence of any adverse effects on their volume of sale following GST.

EFFECTS OF GST ON THE REVENUES OF FIRMS

The actual effects of this policy can be judged by the impact on the revenue of the industries. Half of the respondents report that there has been a considerable increase in their revenues . Very few of the industries show adverse or neutral effects on their revenues.

FILING OF RETURNS BY SMALL AND MEDIUM FIRMS

Nearly all the firms file GST returns thrice a month as per the prevailing norms under GST. As the entire process is detailed, time consuming and elaborate, nearly 90% of the firms reported that they have hired professional help for filing these returns which entails an extra cost for them. However, over the last four months, the system of filing returns has become absolutely clear to 94% of the firms with only 6 % of the firms reporting lack of clarity on certain aspects.

Nearly 85% of the firms reported difficulties pertaining to the online filing system with issues such as software crash, no immediate uploading of data, many technical errors associated with the GST portal etc. The glitches in the GST portal and the absence of offline support systems make the whole process cumbersome and tardy.

The following major **conclusions** emerge from the present study:

- GST can have huge implications on the MSME sector where more than 90% of the businesses consist of partnership and proprietorship firms. The objective of plugging the informal economy into formal setup will have some benefits but it may have a heavy cost as well if done forcefully and not properly implemented.

- The current rate structure is too complicated and may lead to confusions , corruption, and litigation .

- Presently, the lower exemption threshold of Rs 20 lakhs coupled with cumbersome compliance can prove to be counter- productive and push small businesses towards new ways of tax evasion.

- The removal of taxes on the interstate movement of goods such as sales tax , octroi, etc. under this single tax system has made transportation efficient, cheap and quick, thereby vastly reducing freight and transportation costs for the sector under study.

- GST provides an option to an assesse to approach the Authority for Advances Ruling (AAR) in case of any confusion with respect to the determination of taxation liabilities to help them in planning activities with certainty. However, AAR is yet be constituted by the state government.

- One major problem under GST system is the cumbersome and complicated procedure for filing returns under this system, such as too many returns to be filed, complicated and detailed form, lot of technical issues associated with the working of GST online portal and the absence of offline support system.

- The basis of the creation of taxation slab is not very clear or rational.

SUGGESTIONS

- Constant monitoring and course correction in the implementation of GST is absolutely essential in the infancy of this new taxation regime , especially with reference to the small scale sector which hitherto has been mainly a part of the unorganized and informal economy.
- The existing GST slabs need to be simplified and rationalized. They should be more relevant to the ground reality of India.
- The threshold limit of Rs 20 lakh is low and needs to be suitably revised upward.
- The benefits arising from the efficient and low cost transportation should be maximized.
- The state government should be more proactive in dealing with problems arising from the system. For instance, Authority of Advance Ruling (AAR) should be immediately set up in Uttarakhand . Also the State Revenue department needs to interact more with the local businesses and entrepreneurs to solve the teething troubles.
- Filing of the GST returns should be made simple and user friendly .For small businesses, the requirement of filling forms should be made simpler. For example -: there is a huge traffic of "NIL" returns .This should have nothing more than a single page form like the one for Income Tax Returns.
- Certain relaxations should be given to micro and small enterprises under GST regime in the less developed states like Uttarakhand.
- Under the ambit of Corporate Social Responsibility (CSR), it could be made statutory(legal) for big business houses to provide all necessary support to the micro, small and medium enterprises for the GST compliance.

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