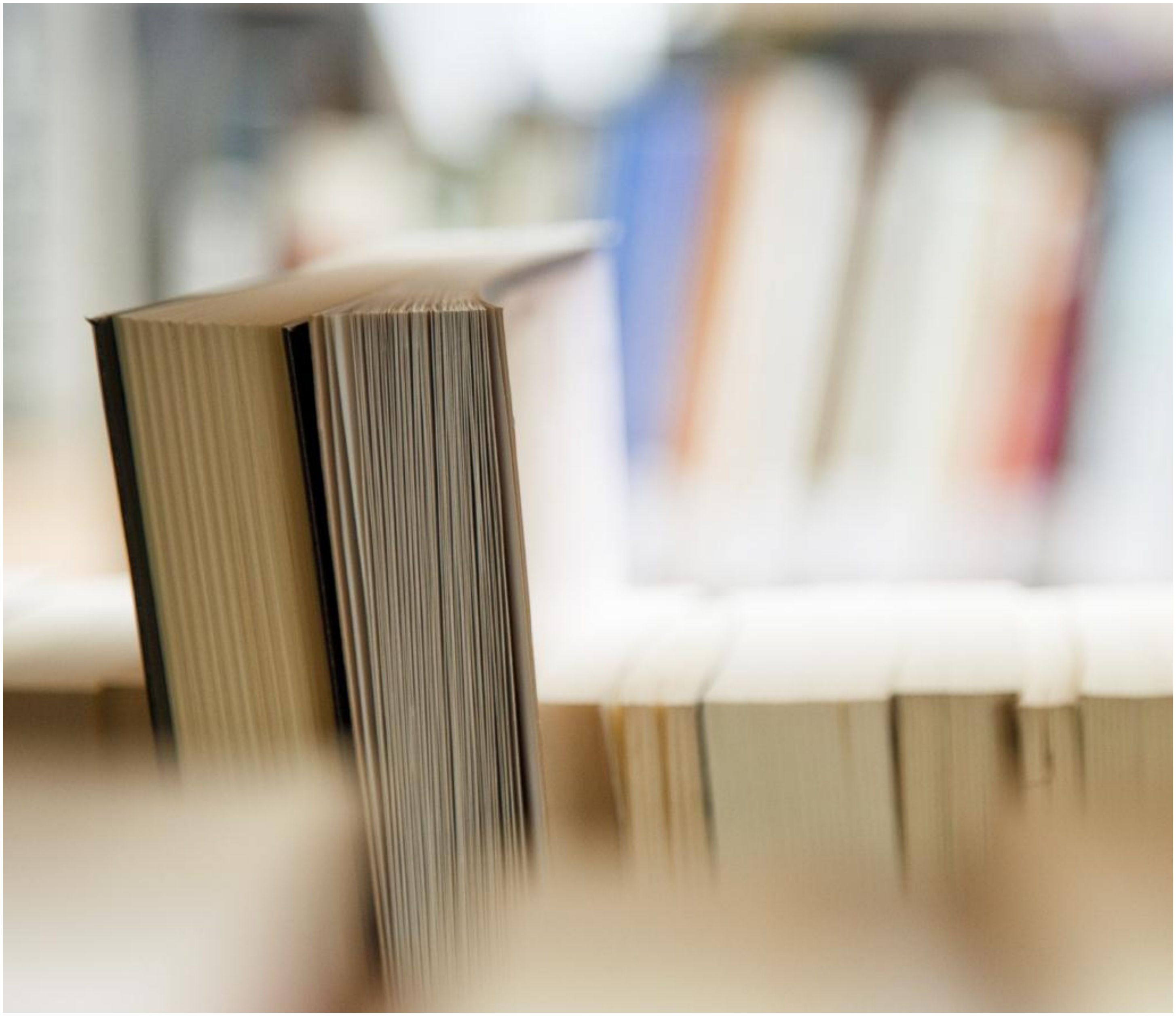

Impact of GST on SMEs

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INTRODUCTION

Small scale industry will be one of the largest affected sectors once GST comes into effect. With the Government being committed to roll out the GST by 1 July, 2017, it is critical that the small and medium enterprises analyze the impact and prepare themselves for the India's largest indirect tax reform since independence.

Let us analyze a few provisions as per the Proposed GST law which are set to have a significant impact on SMEs:

Stock Transfer

As per the current tax regime, large enterprises make a stock transfer to other states due to availability of multiple warehouses, godown or other infrastructural resources. After making this stock transfer, they sell the goods locally on payment of VAT. The buyer upon buying from these enterprises are eligible to avail input tax credit. The stock transfer described above is made solely for avoidance of Central Sales Tax which is not available as an Input Tax Credit to the buyer.

On the other hand, SMEs do not have the adequate infrastructure to be able to carry out stock transfers. In turn they have to make inter-state sales which are liable to CST. Since, this is not available as a credit to the buyer, it becomes a cost to them. So, a buyer would prefer to buy from a large enterprise even if it offers the same price of a product as compared to small and medium enterprise. It can be inferred that the existing tax structure renders the goods of SMEs uncompetitive when compared to large enterprises.

GST proposes to treat stock transfer at par with other inter-state supplies. Under GST, the buyer is eligible for the complete Input tax credit whether he buys the goods locally or from another state. So, it will neutralize the cascading impact of input taxes which is prevalent under the current regime. As a result, the SMEs will finally be able to enjoy a level playing field in pricing. This will allow a much fairer competition with respect to pricing within the industry.

Threshold limit

As per the Current Excise law, no duty is required to be paid by a manufacturer in the small-scale industry having a turnover of less than Rs. 150 lakhs. This allows the dealer to buy from the small-scale industry at a far competitive rate when compared to the large-scale manufacturers. It results in a saving of tax cost for the small-scale industry as a whole. Also, the working capital requirements are lowered due to lower outflow of the taxes. The compliance requirements are easier with regard to the filing of returns under Central Excise Law.

As per the GST law, it is proposed that the threshold limit of turnover for exemption will be lowered to Rs. 20 lakhs for Non-special category states and Rs. 10 lakhs for Special Category states. The lowering of this threshold will result in a huge chunk of SMEs now getting covered within the tax net. They will additionally have higher compliance requirements with regard to registration, filing of returns, maintenance of proper records etc. It would cause an addition in the working capital requirements in the hands of SMEs since they may be now required to discharge GST pending realization of the invoice. Since the value addition made by the SMEs at every stage will be liable to GST which otherwise was not liable to Central Excise earlier, the same would result in an increase in the tax cost in the hand of the consumer. Of course, the final increase / decrease in tax cost are dependent on other factors like the rate structure.

Composition Scheme

The SMEs have an alternative avenue of opting for composition scheme under GST if the aggregate turnover of the registered taxable person is below Rs. 50 lakhs in a financial year. However, this scheme will not be applicable for service providers and manufacturers of notified goods.

Under this scheme, the tax can be at a specified percentage of the aggregate turnover. The cumbersome compliances required for a registered taxpayer paying under normal scheme will be comparatively lower and simpler for a person opting for the composition scheme. So, the cost of maintaining records and making compliances will be lower under the composition scheme.

However, there are a few restrictions within which one can be covered within the composition scheme. The primary condition is that one will not be able to avail the benefit of input tax credit while making payment of output taxes. Also, one will not be able to charge GST from their customers for the purpose of making the payment. So, the entire payment of taxes under Composition Scheme is a cost for the taxpayer. Thereby, one should make a proper cost benefit analysis based on the expected turnover if one wants to incur a higher compliance cost by opting for normal scheme but at the same time be eligible to avail input tax credit and realize taxes from the customers. On the other hand, they can lower their compliance cost but pay taxes from their own pocket under composition scheme.

Technological burden of returns

Whether the compliance burden will ease out under GST can certainly not be answered in the affirmative for small scale industry. Usually, the taxpayers under this industry are exempt from Central Excise and are paying taxes under VAT in case of goods. They usually have operations in select states only rather multiple states. So, integration of multiple forms under different laws today to certain standardized forms under GST may not be that big an advantage for these kinds of taxpayers.

In case of services, they are paying service tax for which returns are being filed on a half yearly basis. Also, one registration is sufficient to cover all places of business and all kinds of services being provided throughout the country.

Under GST, state wise registration and higher frequency of returns with increase in data requirements may only adversely affect this industry in the short run. This is because most of the small taxpayers may not have the sufficient infrastructure and technology to cope up with these compliance requirements. Moreover, the repercussions of not being able to timely comply under GST may be mammoth. The availment of input tax credit of the recipient depends on the compliances made by the supplier. So, if the taxpayers do not make proper compliances, they stand a chance of losing out on orders from customers in the short run and eventually being eradicated from the market completely in case of sustained failure. Thereby, improper compliances due to inadequate infrastructural resources under GST can cripple the industry if they fail to adhere to the technological advancements that may be required in the proposed scheme.

Availability of Input Tax Credit in certain situations

For persons registered under the earlier law, the input tax credit can be carried forward as per the last return furnished for the period ending with the date preceding the date of applicability of GST. With respect to persons who were not registered under the earlier law or were part of the composition scheme or were suppliers of exempted goods/services or first stage/second stage dealer, it has been stated that they can take the input tax credit with respect to tax paid on inputs, inputs contained in semi-finished goods and finished goods held in stock as on the appointed date. One of the conditions under this is the possession of tax invoice evidencing payment of duty. So, these persons will be eligible to take Central Excise duty or Service Tax paid in the form of CGST and VAT/Entry tax paid in the form of SGST. Input tax credit for a specified percentage of tax paid on capital goods will also be available in case of persons registered under the composition scheme as per the erstwhile law.

Persons who are not in possession of tax invoice evidencing payment of duty in respect of inputs only will be eligible to avail input tax credit as per the prescribed rate subject to certain conditions, limitations and safeguards. However, such provision is not applicable in case of capital goods. This basically covers dealers who may not have an Excise paid invoice. It is being proposed that even under this situation, such dealers will be able to take the Input tax credit of Central Excise duty paid which they had treated as part of their cost in the erstwhile regime. Obviously, this provision has been made in order to ensure that if the output is liable to both CGST and SGST, then the input tax credit in respect of those goods should also be proportionately available for set off.

Perhaps the greatest omission here is that the provision of availability of credit for persons not in possession of tax invoice evidencing payment of duty has not been made applicable for small scale manufacturers. So, if any of the inputs are bought by small scale manufacturers from traders who do not issue invoice under Central Excise, then the input tax credit on the said invoice will not be available on the appointed date in respect of those inputs.

Pricing

Usually, an entity in the SME sector have only a few if not only one line of business. As a result, they are either registered with Central Excise/VAT or registered with the Service Tax Department. However, in order to run any business, one needs both goods and services in the form of inputs/input services. Usually, they are not completely available for set off for any business. So, generally input services results in an addition of cost for a dealer in VAT. Also, VAT/CST paid inputs are a cost for a small service provider. This results in cascading effect of taxes and an increase in cost for the small-scale sector.

With the advent of GST, what is expected is relatively seamless flow of input tax credit and set off allowed for GST paid on both goods and services received in the form of inward supply against outward supply of both goods and services. This will result in saving of tax cost and widening of the ambit of input tax credit. Based on this, there can be renegotiation of prices with the vendors based on the alternative sources of procurement. Eventually, this will cause improve the pricing for the consumers and allow the small-scale industry to sustain and compete in the market.

However, it must be carefully analyzed that not all the businesses within the SME sector will have the adequate infrastructure to understand the additional input tax credit available under GST and may not be able to avail any immediate benefit once GST comes in. So, they may not be able to factor this in the saving of their cost. But, the larger players in the industry who influence the price in the market may make this adjustment of cost and input tax credit sooner than the businesses in the small-scale industry. So, the small businesses may have to respond to the market forces and change their pricing though they may not be in a position to immediately reduce the cost at their end.

Supply chain management

The procurement and distribution of goods get restricted today because of distortion in the taxation and rate structure within different parts of the country. Unavailability of input tax credit on CST paid on inter-state purchase of goods further compounds this problem. As a result, any person prefers buying goods within the state and not inter-state.

With GST, the market throughout the country will be integrated. The tax structure is expected to be uniform. So, decisions regarding procurement and distribution of goods will be made on pure economic and business sense rather than the tax cost involved. With new avenues of procurement and distribution, logistics planning and selection of transporters also becomes crucial. With clauses like that of compliance rating and dependence of input tax credit on payment by the supplier, redrafting of contract terms (like credit policy) with the vendors and customers and dealing with tax compliant vendors are some of the areas that will require careful attention by these small businesses.

Time of Supply

Central Excise is paid on removal of goods and VAT is paid upon sale of goods. For the first time, taxes on goods are required to be paid on receipt of advance. This will prepone the liability of payment of taxes.

Small service providers have an option of paying on receipt basis under Service Tax. Under GST, there is no such option wherein the earliest of the date of invoice or payment is to be looked at if the invoice is issued within the prescribed period. If the invoice is not issued within the prescribed, then the earlier of last date of issue of invoice or payment becomes important. This may cause preponement of liability of payment of taxes.

So, there will be a requirement of additional working capital in respect of both goods and services due to the preponement of the tax payment.

Place of Supply

Today, the service providers are not excessively worried about the state wherein the place of provision of service lies as long as it can be determined that the said service have been provided in India or outside India. Since, the place of supply under GST determines which state the tax accrues to, the correct determination of place of supply becomes far more important under GST. Wrong determination of place of supply can result in payment of the tax again to the correct state and then claiming of refund from the state to whom the taxes were wrongly paid.

With respect to goods, the disputes in the CST regime today as to which state receives the taxes is quite a significant area of concern. Obviously under GST, the taxes will accrue to the destination state rather than the origin state. However, the dispute among states with regard to determining the correct place of supply under GST for goods may continue to cause ripples within the industry.

CONCLUSION

Based on the above analysis, it can be summarized that there will be widespread impact on the SSI sector once GST sets in. It is expected that the unorganized sector will have to organize themselves in order to sustain under GST. In the short run, this sector may have to face certain difficulties of compliance. Also, the realization of the true benefits of the new tax regime may take its own course of time. However, in the long run, once the sector gets used to this new regime, the overall impact is expected to be positive.

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