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GST and its Impact on MSMEs in India— A Post-Implementation Analysis

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ABSTRACT: The Goods and Services Tax (GST), implemented in India on July 1, 2017, represents one of the most significant fiscal reforms in the country's economic history. By replacing a complex web of central and state taxes with a unified tax regime, GST aimed to create a seamless national market, reduce tax cascading, and enhance ease of doing business. However, its impact on Micro, Small, and Medium Enterprises (MSMEs)—which form the backbone of India's economy, contributing approximately 30% of GDP and employing over 110 million people—has been a subject of intense debate.

This research paper conducts a comprehensive post-implementation analysis of GST's effects on MSMEs, evaluating both intended benefits and unintended challenges. The study examines multiple dimensions, including compliance burdens, operational efficiency, cost structures, profitability, and working capital management. Using a mixed-methods approach, the paper analyzes secondary data from government reports (GST Council, Ministry of MSME), RBI bulletins, and industry surveys (FICCI, CII), alongside case studies of affected enterprises in key sectors such as textiles, handicrafts, and food processing.

The paper concludes with actionable policy recommendations to optimize GST for MSMEs, including simplified return filing processes, an increased Composition Scheme threshold, faster ITC refund mechanisms, and targeted digital training programs.

KEYWORDS: GST, MSMEs, tax reform, compliance burden, Input Tax Credit, working capital, Indian economy, ease of doing business

I. INTRODUCTION

The Goods and Services Tax (GST) marked a watershed moment in the country's economic reforms. Designed to replace a convoluted system of multiple indirect taxes (including VAT, excise duty, and service tax) with a unified, destination-based tax regime, GST promised to transform India into a "one nation, one market" economy. By eliminating cascading taxes and reducing inter-state trade barriers, the reform aimed to boost economic efficiency, enhance tax compliance, and attract foreign investment. However, its implementation presented unique challenges for Micro, Small, and Medium Enterprises (MSMEs), which form the backbone of India's economy.

MSMEs contribute nearly 30% of India's GDP, account for 45% of manufacturing output, and employ over 110 million people, making them critical to employment generation and inclusive growth. Unlike large corporations with dedicated compliance teams, most MSMEs operate with limited resources and financial literacy. While GST simplified taxation for formalized businesses, its complex structure—featuring multiple tax slabs, frequent regulatory updates, and digital compliance requirements—created significant operational hurdles for small enterprises. Many MSMEs, particularly in the informal sector, struggled with the transition, facing liquidity crunches due to delayed Input Tax Credit (ITC) refunds and working capital shortages under the Reverse Charge Mechanism (RCM). Sector-specific analyses highlight disproportionate impacts on manufacturing MSMEs, which face higher input costs, versus service-sector MSMEs that benefit from the Composition Scheme but face market restrictions.

Objectives of the Study:

- To understand the structural changes introduced by GST in the indirect taxation system.
- To assess the impact of GST implementation on MSME operations.
- To analyze the compliance and cost burden on MSMEs post-GST.
- To evaluate government initiatives and policy support post-GST for MSMEs.
- To suggest measures for improving the effectiveness of GST for MSMEs.



II. METHODOLOGY

This research paper adopts a descriptive and analytical research methodology to examine the post-implementation impact of the Goods and Services Tax (GST) on Micro, Small and Medium Enterprises (MSMEs) in India. The study is based entirely on secondary data sources, which include reports and publications from the Ministry of MSME, the Central Board of Indirect Taxes and Customs (CBIC), and other relevant government departments. It also draws insights from research studies conducted by reputed industry associations such as FICCI, CII, and ASSOCHAM. In addition, scholarly articles published in journals, working papers by economists, media reports, and data available from GST portals have been reviewed to understand the broader implications of GST on MSMEs. A comparative analysis has been done to evaluate the scenario before and after the implementation of GST, with a focus on key parameters such as compliance burden, cost of doing business, access to markets, and financial health of MSMEs. This method allows for a holistic and objective assessment of the GST regime's effect on the sector, while also highlighting the policy gaps and providing actionable recommendations.

GST Framework and MSMEs:

The Goods and Services Tax (GST) in India was conceptualized as a unified indirect tax system to streamline the country's fragmented tax structure. It replaced a host of central and state-level taxes with a single, destination-based tax levied on the consumption of goods and services. GST operates through a multi-tier structure comprising Central GST (CGST), State GST (SGST), and Integrated GST (IGST), depending on whether the transaction is intra-state or inter-state. Its legal framework mandates periodic return filings, digital invoicing, and input tax credit (ITC) compliance, significantly altering how businesses operate, especially in the MSME sector.

The MSME sector—comprising micro, small, and medium enterprises—is diverse in scale and operational capacity, and was deeply impacted by the overhaul in taxation. A key structural feature of GST relevant to MSMEs is its turnover-based threshold for compulsory registration. Many small businesses, previously unregistered under the excise or service tax regimes, were brought under the tax net. This broadened the base but also introduced new regulatory responsibilities for businesses that had never before engaged in formal tax processes.

One of the most significant technical changes brought by GST was the shift to a completely digital tax platform. This digital-first approach requires businesses to register, file returns, maintain records, and reconcile invoices through an online portal. For MSMEs, especially those in rural or semi-urban regions with limited IT literacy or infrastructure, this transition posed challenges. Many had to invest in accounting software, hire professionals, or rely on third-party services to remain compliant.

Additionally, GST introduced the Composition Scheme, allowing eligible small taxpayers to pay taxes at a nominal rate with fewer compliance requirements. Though beneficial in terms of reducing procedural burdens, the scheme's limitations—such as restriction on inter-state trade and ineligibility for input tax credit—meant it was not suitable for all MSMEs. Businesses involved in manufacturing or trade across state lines often found themselves excluded from these simplified provisions.

From a logistical perspective, GST eliminated several bottlenecks by dismantling interstate checkpoints and creating a common national market. This particularly benefited medium-scale enterprises seeking to scale operations across regions. The removal of border taxes and harmonization of tax rates simplified supply chains and reduced transit times for goods, leading to increased operational efficiency.

The evolution of GST also introduced audit obligations, e-way bill compliance, and tax reconciliation challenges, particularly for growing MSMEs. While larger corporations often possess dedicated compliance teams, smaller units have had to bear additional costs to meet these obligations. This created a disparity in administrative load and raised concerns about the sector's ability to remain agile under the new framework.

Post-Implementation Analysis of GST on MSMEs:

- **Compliance Burden** - GST requires digital filing of monthly/quarterly returns, which is a challenge for micro and small enterprises lacking IT infrastructure and accounting support. Initial issues with GST portal downtime and technical glitches added to the difficulties.
- **Working Capital and Liquidity** - Due to input tax credit (ITC) mechanisms, delays in refunds and invoice matching impacted the liquidity of small firms. Businesses involved in exports faced significant delays in GST refunds, thereby increasing their working capital needs.
- **Cost of Doing Business** - Increased compliance costs (hiring consultants, purchasing software, etc.) The reverse charge mechanism (RCM) created confusion and deterred transactions with unregistered suppliers.



- **Formalization and Market Access** - GST has encouraged formalization of MSMEs, enabling them to access new markets and become part of organized supply chains. Registration has also made it easier for MSMEs to avail credit from financial institutions.
- **Technology and Digitalization** - GST has accelerated digital adoption among MSMEs. It has improved transparency and accountability in business transactions.

III. GOVERNMENT MEASURES AND POLICY RESPONSES

The impact of Government Measures and Policy Responses can be analyze by the following points-

Composition Scheme for Small Taxpayers-

To reduce the compliance burden on small businesses, the government introduced the Composition Scheme under GST. This scheme is specifically designed for businesses with an annual turnover of up to ₹1.5 crore, allowing them to pay tax at a fixed rate (ranging from 1% to 6%, depending on the business category) without engaging in detailed record-keeping or filing multiple returns. Under this scheme, the taxpayer is exempted from maintaining elaborate invoices and availing input tax credit (ITC), which significantly simplifies the overall tax process. However, businesses registered under this scheme are restricted from making inter-state supplies, and they cannot pass on the input credit to buyers. Despite these limitations, the Composition Scheme remains an important measure to support micro and small enterprises by offering administrative simplicity and cost-effective compliance.

Simplification of Return Filing for Small Enterprises-

Understanding the capacity limitations of MSMEs in managing frequent and complex return filings, the GST Council has made several reforms to simplify the process for small taxpayers. One notable step was the introduction of the Quarterly Return Monthly Payment (QRMP) scheme for businesses with turnover up to ₹5 crore. This allows eligible MSMEs to file only four returns annually instead of twelve, while continuing to make monthly tax payments. Additionally, the introduction of simplified return forms such as GSTR-3B has helped in reducing paperwork and technical errors. The government has also attempted to auto-populate return data based on e-invoices and GSTR-1 filings, thus making compliance more user-friendly and efficient for small businesses with limited staff or digital skills.

Capacity Building and Digital Awareness Initiatives-

Recognizing that many MSMEs lacked the necessary digital infrastructure or expertise to operate within the online GST system, the government launched several capacity-building programs to address this gap. These initiatives included nation-wide GST awareness campaigns, workshops, and training sessions in collaboration with state governments, industry associations, and professional bodies. The Ministry of MSME, in association with GSTN (Goods and Services Tax Network), also facilitated access to GST Suvidha Providers (GSPs) to offer digital filing support to small taxpayers. Moreover, toll-free helplines, online tutorials, and multilingual resources were created to ensure broader outreach and effective handholding for entrepreneurs unfamiliar with digital compliance processes.

Regular Policy Revisions Based on Feedback-

One of the critical responses by the government post-GST implementation has been its willingness to revise policies based on industry feedback, particularly from the MSME sector. The GST Council, which is the apex decision-making body, has regularly convened to address grievances and introduce changes such as revised tax slabs, exemption thresholds, and relaxation in filing deadlines. Several procedural relaxations have been granted in light of hardships faced by small businesses, especially during the initial phase and during the COVID-19 pandemic. Additionally, policies related to refund processing, invoice matching, and e-way bill generation have been simplified over time. This adaptive approach has helped in gradually aligning the GST system with the practical capabilities and limitations of MSMEs.

IV. KEY CHALLENGES STILL PERSIST:

These are the major challenges that need to be solved in this regard-

Digital and Technological Barriers-

Despite efforts by the government to promote digital compliance, a significant proportion of micro and small enterprises continue to struggle with the technological requirements of the GST system. Many MSMEs, particularly in rural and semi-urban areas, lack access to stable internet connectivity, updated hardware, or professional accounting software. Moreover, the owners and staff of these enterprises often lack adequate digital literacy, making it difficult to navigate online GST portals, understand filing schedules, or manage reconciliations. While some businesses have resorted to hiring tax professionals or consultants, this adds to their operational costs. For enterprises accustomed to



informal or paper-based record-keeping, the transition to a digital tax system remains a steep learning curve, affecting timely compliance and increasing their dependency on external support

Complexity and Cost of Compliance-

The GST framework, though streamlined in theory, remains complex in its implementation for small businesses. MSMEs are required to file multiple returns—monthly, quarterly, and annually—depending on their registration and business profile. Understanding the nuances of input tax credit (ITC), reverse charge mechanism (RCM), and HSN code classification involves a level of tax knowledge that many small entrepreneurs lack. Even minor mistakes in return filing or invoice matching can result in penalties, notices, or delays in ITC claims. Additionally, the need to hire accountants, purchase GST-compliant billing software, or subscribe to GST filing services adds a recurring cost burden that smaller units may find hard to absorb. For businesses with limited human resources, the time and effort spent on compliance takes away from their core operations and growth efforts.

Delays in Refunds and Input Tax Credit Processing-

Cash flow management remains a critical issue for MSMEs, and delays in the refund of GST and processing of input tax credits have worsened this challenge. Export-oriented units and businesses dealing with inverted duty structures are particularly affected, as they often accumulate credit which needs to be claimed as a refund. However, the refund mechanism is frequently marred by procedural delays, document mismatches, or manual verification, leading to funds being blocked for extended periods. This affects working capital availability and may force MSMEs to borrow at high interest rates to sustain operations. The lack of a fully automated, real-time refund system has become a bottleneck, especially for those businesses that operate on thin margins and rely on timely inflows to pay suppliers and meet payroll obligations.

V. SUGGESTIONS AND RECOMMENDATIONS

- **Simplified Tax Filing:** Introduce single-page returns or further simplified forms for micro-enterprises.
- **Refund Acceleration:** Streamline refund process, especially for exporters and seasonal businesses.
- **Capacity Building:** Regular training and support centers for GST compliance.
- **Subsidized Technology Tools:** Provide low-cost accounting software and mobile-based solutions.
- **Rationalization of Penalties:** Reduce penalties for first-time or genuine compliance errors.

VI. CONCLUSION

GST is a significant reform that has potential long-term benefits for the Indian economy. However, its implementation has brought considerable challenges for MSMEs, especially in terms of compliance and cash flow management. While larger enterprises have adjusted to the new system, micro and small businesses continue to face hurdles. To truly realize the benefits of GST, the government must take continuous feedback and evolve the system to make it more MSME-friendly. A balanced approach that combines formalization with support is essential to ensure inclusive growth in the post-GST era.

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