

Impact of GST on Unorganized Manufacturing Sector with reference to MSMEs in Ulhasnagar City, Thane District

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Abstract

Tax being the major source of revenue contributes highly to the economic development of any nation. It is essential to have good taxation system in a country. India started its journey towards tax system in the year 1980. However, the proposal of GST was initiated in the year 2000 by Vajpayee Government. The constitutional amendment is passed by Lok Sabha in May, 2015. GST would be a major move towards Indian economy as it is assumed that the complexity of indirect tax system will be resolved by replacing all state and central indirect taxes into one simple tax.

Economists say that the informal or unorganized sector accounts for nearly 50% of India's gross domestic product and is responsible for more than 80% of total job creation in the country.

Manufacturing sector in India is one of the highly taxed sectors in the world. A complex and high taxation structure has the tendency to render products uncompetitive in the international market. GST in India is expected to lead to optimum allocation of factors of production leading to rise in GDP, exports and economic welfare.

Since unorganized manufacturing sector plays a pivotal role in employment generation and poverty reduction, it is necessary to measure the impact of GST on this sector. This article focuses on the concept of Goods and Services Tax and the impact of GST on unorganized manufacturing sector in Ulhasnagar City, Thane District.

Keywords: Goods and Service Tax, SMEs

Paper Type: Survey

Introduction

The Micro, Small and Medium Enterprises have been considered as the backbone of the Indian economy and have become primary growth driver of economic growth in India. It is estimated that we have around 3 million MSMEs in India, out of which 80% are micro enterprises, that account for almost 90% of the industrial units in India, contributing almost 50% of industrial output and 42% of total exports and 40% of value addition is in the manufacturing sector. It is increasingly recognized that the MSMEs play a vital role in employment creation and income generation in the world. SMEs are the largest employer after agriculture sector in India. This sector provides support for competitiveness and employs about 75 million people in India.

Government has recognized the solemnity of providing a fast stridden growth to MSME sector and therefore, in 2017 introduced the most awaited reform – Implementation of GST bill. GST is expected to benefit MSMEs with easy tax structure and digitalization in order to comply with GST system. The 'One Nation, One tax' approach will make India an open market helping SMEs explore new markets with no or low entry barriers and experience massive expansion of business. Hence GST will provide MSMEs an equal footing as compared to other big established counterparts.

The unorganized manufacturing sector which enjoys the cost advantage equal to the taxation rate has been brought under the GST bill. This had brought a lot of unorganized players under the tax bracket. It had taken a lot of meticulous planning in the implementation of the GST reform for capturing the unorganized sector under its realm. It had widened the tax reach and will benefit the organized manufacturers who lose out revenue to the unorganized manufacturing sector at present. The unorganized sectors are now forced to register and get GST registration no. in order to avail advantage of input tax credit. This will bring sanctity to the taxation system without hurting any of the sectors adversely. Most of the large companies are somewhat geared up to face the new tax regime but the same is not true for small and medium enterprises, especially in case of the unorganized sector. SMEs are expected to face teething issues in the initial period but such issues are likely to fade in subsequent months.

Objectives of the study

- To understand the concept of Goods and Service Tax
- To highlight the impact of GST on unorganized MSMEs in Ulhasnagar city, Thane District

Research Methodology

For the purpose of the present study, both primary and secondary data has been used.

Primary Data

Primary data is collected from the 20 MSMEs engaged in manufacturing sector in the city of Ulhasnagar, Thane District. Data was collected through structured questionnaire. Direct personal Interview method was followed by adopting Simple Random Sampling Method.

Secondary Data

The study focuses on extensive study of Secondary data collected from various books, National & International Journals, government reports, publications from various websites which focused on various aspects of Goods and Service tax.

Review of Literature

In an exclusive interview with Economics Times, Tanvir Gill and Ayesha Faridi, Rakesh Jhunjhunwala, Partner, Rare Enterprises, say that the biggest gain from GST is a digitized economy, along with efficiencies in logistics leading to efficient supply chains. Though there will be initial hiccups, the changes that the new tax regime will unleash and it will lead to a 'forced morality and a willingness to pay taxes', he said.

Sanjay Pant, Commissioner Service Tax, Bangalore viewed that "A well-designed GST is the most graceful method to get rid of distortions of the existing process of multiple taxation."

Mr. Adi Godrej, Chairman of the Godrej Group expressed that "GST will be the biggest reform after 1991 and its implementation alone would add 1.5% -2% to India's GDP growth. It will provide tremendous stimulus and can solve several issues like inflation and fiscal deficit."

Impact of GST on Unorganized Manufacturing Sector

For a developing country like India and its demographic diversity, SMEs have emerged as the leading employment-generating sector. Amongst SMEs, it has been widely recognized that unorganized manufacturing sector is the largest employment provider of the nation. Low utilization of capital and large absorption of labour are the significant features of unorganized sector. However, manufacturing sector in India generally faces a problem of higher cost of production, declining exports, and high infrastructure. Multiple indirect taxes increase the administrative costs for manufacturers. Now, with GST in place, the compliance burden is expected to get ease resulting in better growth of this sector. The impact of GST on unorganized manufacturing sector is as follows:

Lesser Tax Evasion

After the passage of GST, the business which was not under the tax bracket previously will now have to register. Earlier, any manufacturer with a turnover of Rs. 1.5 crores or less was not required to comply with the rules of excise duty. However, with the merging of all State and Central level taxes into the ambit of GST, any manufacturer with a turnover of Rs. 20 lakh (others) / 10Lakh (Special category states) or more will have to comply with GST and its procedures. This will lead to lesser tax evasion.

Digitalization

The effect of GST is going to be far deeper than the tax itself. It will lead to digitalization. Anybody who has a business with a turnover of more than 20 lakh will have to digitalize their business and that will lead to tremendous efficiency in the way they work. All the compliance procedures under GST – Registration, Payments, Refunds and Returns will now be carried out through online portals only. Thus, SMEs need not worry about interacting with department officers for carrying out compliance procedures, which were considered as a headache in the past tax regime.

Burdensome Compliance Procedure

As per Chapter IX of CGST Act, 2017, read with CGST Rules, 2017 a normal taxpayer is required to furnish three returns monthly by the 10th of each month with one annual return. A registered person under the GST Composition Scheme will have to file the returns on quarterly basis with annual return. Generally they will have to file the GSTR-1, GSTR-2 and GSTR-3 Return. In total they are required to file 37 returns. Moreover, state-wise accounts would need to be maintained and various returns must match. Overall, the compliance burden would increase to an extent, which may be particularly burdensome for the SME sector.

Effect on Working Capital Requirement

According to an India Ratings report, introduction of GST will hurt working capital cycle for companies; hence availability of easy liquidity is necessary for up to 3-4 months. Under the new GST rules, the tax is levied when the stock is transferred. As a result, businesses are not able to claim tax credits till the time of sale, which is resulting in a huge time lag. Working capital levels are experiencing a drop during this time which is increasing the working capital requirements of the business.

Earlier input tax credit was not available on business overheads / expenses and thus these expenses were debited directly to the profit & loss account of the business. Input tax credits were eligible only for being availed on input services that were linked directly to the taxable output.

Under the GST, a business is eligible for availing of input tax credit on a business expense or overhead,

provided such overheads are used for the furtherance of a business or in the course of a business. Thus, under the GST regime the only expenses that are debited to the profit & loss account are the actual expenses that a business incurs (not inclusive of taxes). Additionally, a lower tax burden under GST will reduce the cost of raw materials, freight cost and logistics. All this has lowered the stress on working capital.

Tickings-off for suppliers' non-compliance

Managing suppliers and vendors on part of the business is extremely important under the GST because even if a business is running fine, any conflict on the part of the supplier in filing returns can land the business in big trouble in terms of claiming input tax credit. The input tax credit levels will depend on whether the suppliers comply with taxation and financial norms. This will make it imperative for suppliers to declare their outward supplies along with their tax payment. Manufacturer will be held accountable if his supplier fails to furnish valid returns. This is an unfavourable practice for the business since in the event of suppliers' non-compliance, manufacturer input credit tax claims can be reversed and he may have to pay interest. It is, therefore, important that manufacturer assesses his vendor base from a compliance perspective to avoid impacting his working capital.

Lack of technology

Compliance cost will be daunting for unorganized manufacturer. The Confederation of All India Traders (CAIT) has said that GST is a technology driven taxation system which requires mandatory compliance through digital technology only. Nearly 70% of small businesses in the country have not yet adopted computerization in their existing business format as most of the tax compliance was done through paper format. Now, the traders fail to comply with the procedures under GST due to lack of technology and technical expertise.

Mandatory registration

In India, almost half of the six crore small businesses fall under the threshold limit of Rs. 20 lakh and hence do not require registration under GST. Another about one crore traders may opt for 'Composite Scheme', and remaining about two crore small businesses do not fall under any indirect tax law and therefore not require any registration. But under GST, businesses are now required to procure their goods and services only from registered dealers and maintain regular accounts and invoices. Thus, it becomes mandatory on the part of all the manufacturers to get registration.

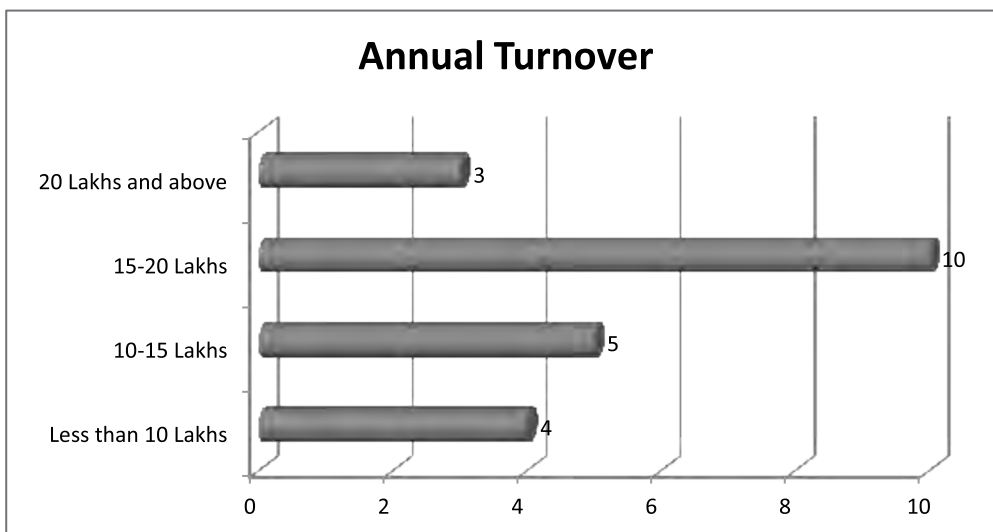
Lack of readiness

Big corporates or organized sectors are better primed for GST implementation with their IT systems in place. But smaller companies or unorganized sector are following the lead of larger companies and still in the process of implementing GST in their business with a time lag. Unorganized sectors putting on a wait-and-watch hat as they feel it will be very difficult to operate business in the GST era.

Data Analysis, Interpretation and Findings

The respondents for the research are unorganized manufacturing sector in Ulhasnagar city, Thane District. Respondents are mainly engaged in manufacturing jeans (05), plastic goods (05), furniture (05), chocolates and biscuits (05).

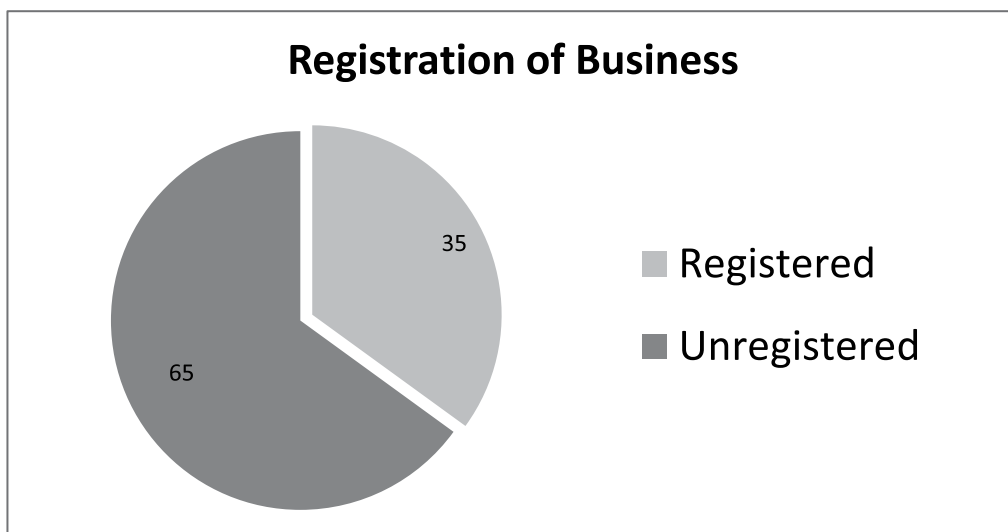
● **Annual Turnover**



Source: Compiled by Researcher

From the above chart, it is clear that 17 out of 20 respondents' annual turnover is less than 20Lakhs. Only 3 respondents' annual turnover crossed above Rs. 20 Lakhs. This shows that majority of the businessmen in Ulhasnagar falls under the category of Micro Enterprise. Hence they are not required to register under GST.

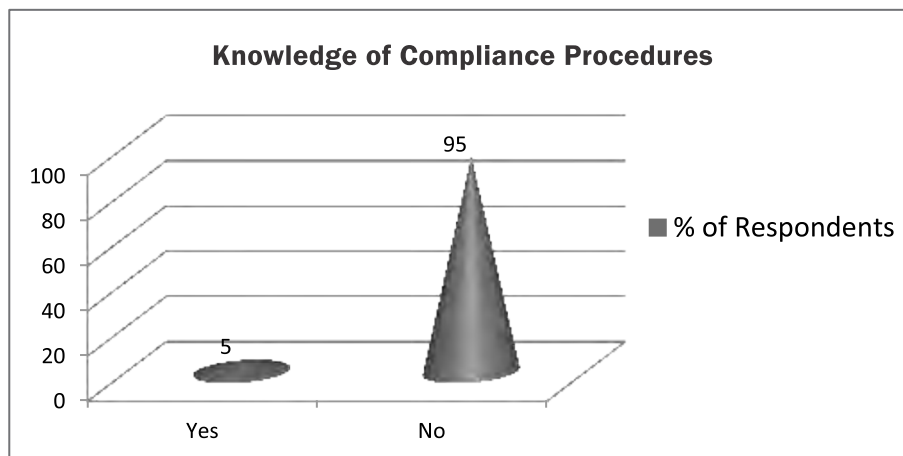
● **Registration of Business**



Source: Compiled by Researcher

Only 35% of the respondents i.e. 7 out of 20 respondents in Ulhasnagar are registered under GST as of now and have received registration number in order to continue their business hassle free. Remaining 65% of the respondents are unregistered as their annual turnover is less than 20Lakhs and also they are waiting for the next move of the government and regulatory agencies. They believe that the current hitches will get resolved after sometime and things will be smooth as before.

● Knowledge of Compliance Procedures



Source: Compiled by Researcher

Almost 95% of the respondents i.e. 19 out of 20 respondents do not possess any knowledge of GST and its compliance procedures and they are totally confused on how to fulfill GST requirements and whether they are required to register their business under GST or not. Whereas only 5% of the respondents (i.e. only 1 respondent out of 20) are aware of GST but they are dependent on external experts i.e. Chartered Accountants for filing returns and other compliance procedures.

● Technological Upgradation

Most of the businesses in Ulhasnagar still follow traditional method. All the accounts, invoices and vouchers are kept in paper format. Still single entry system of recording transactions is adopted by most of the manufacturers in Ulhasnagar. This shows that the unorganized sectors in Ulhasnagar are lacking adequate knowledge, technology and technical expertise to comply with GST procedures.

The unorganized manufacturers in Ulhasnagar have grown faster than organized players because of lower cost structures stemming from tax avoidance and by not providing any social security benefits to their employees such as provident fund and gratuity, and also by not paying excise duty as their turnover is less than Rs. 1.5 crores. Some of the manufacturers in Ulhasnagar also understate employee base or set up multiple ventures to avoid breaching tax thresholds. Such sharp practices helped them to price products and maintain profit margins competitively over the organized level.

Conclusion

Most of the firms operating in Ulhasnagar make profits largely due to tax evasion and non-compliance with regulatory norms, which allows them to offer products at comparatively lower prices than organized sectors. However, in the GST-era, for manufacturers, the reduction in the threshold for GST exemption from Rs. 1.5 crore to Rs. 20 lakh means many unorganized MSMEs will soon be cast into the tax bracket. It will be a struggle for survival for such firms because they will be faced with taxes, lower margins and a sharp spike in the cost of compliance. Some firms in the unorganized sector are finding their profits curtailed. Also digital transaction trails created by dual authentication of invoices under GST will strengthen the tax compliance.

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