

Impact of GST on Small and Medium Enterprises (SMES) in India

K. Maithili^{1*} and N. Gayathiri¹

¹III B.Com (CA), Velumanoharan Arts and Science College for Women

*Corresponding Author Email: maithilikaleswaran@gmail.com

Abstract

The introduction of the Goods and Services Tax (GST) in India on July 1, 2017, marked one of the most significant indirect tax reforms since independence. GST replaced a complex structure of central and state taxes with a unified and comprehensive tax regime aimed at simplifying tax administration, reducing cascading effects, and broadening the tax base. Small and Medium Enterprises (SMEs), which form a vital pillar of India's economy in terms of employment generation, industrial output, and contribution to GDP, have experienced both positive and challenging outcomes under the new tax system. This paper evaluates the multifaceted impact of GST on SMEs by examining compliance requirements, cost structures, competitiveness, integration of the informal sector, profitability, and growth prospects. It further explores operational challenges such as increased compliance burden, working capital constraints, and technological adaptation, while also highlighting benefits including input tax credit (ITC), improved transparency, and enhanced market access. The study concludes with policy recommendations aimed at strengthening GST implementation and maximizing its effectiveness for sustainable SME development.

Keywords: Goods and Services Tax (GST), Small and Medium Enterprises (SMEs), Tax Reform in India, Input Tax Credit (ITC), Compliance Cost, Formalization of Economy, Ease of Doing Business, Indian Taxation System.

Introduction

Small and Medium Enterprises (SMEs) constitute a crucial segment of the Indian economy, significantly contributing to employment generation, industrial production, exports, and overall economic growth. The implementation of the Goods and Services Tax (GST) on 1 July 2017 represented a transformative reform in India's indirect taxation system, replacing multiple central and state taxes such as VAT, service tax, excise duty, and entry tax with a

unified tax structure. The primary objectives of GST were to simplify tax compliance, eliminate the cascading effect of taxes, promote transparency, and establish a common national market. While GST has introduced greater transparency, enabled seamless input tax credit, and encouraged the formalization of businesses, it has also imposed new compliance requirements and increased dependence on digital systems. For many small enterprises, adapting to online return filing, understanding tax classifications, and managing working capital under the ITC mechanism posed significant challenges. This study examines the overall impact of GST on SMEs in India, focusing on compliance burden, cost structure, competitiveness, and growth opportunities, to assess how effectively GST supports the sustainability and long-term development of the SME sector.

Objectives of the Study

The primary objectives of this study are to analyze the direct and indirect impact of GST on SMEs, to assess the benefits and challenges associated with GST implementation in SME operations, and to provide policy insights that can enhance tax outcomes and promote sustainable growth within the sector.

Literature Review

The theoretical foundation of this study is based on tax reform theories and the relationship between tax compliance and business behavior. Tax reform theories emphasize simplification, neutrality, and efficiency, while compliance theories explore how businesses respond to regulatory changes. Globally, countries implementing GST or Value Added Tax (VAT) have experienced similar transitions, offering valuable lessons in SME competitiveness, compliance management, and formalization. Empirical studies conducted in India before and after GST implementation reveal trends in increased formalization, variations in compliance costs, and mixed effects on revenue growth and profitability among SMEs.

Methodology

The study adopts a descriptive and analytical research design, utilizing both primary and secondary data sources. Primary data may include structured surveys conducted among SME owners and managers to capture firsthand insights into GST-related experiences. Secondary data are collected from government publications, GST Council reports, MSME annual reports, and industry association findings. The analysis framework includes a

comparative evaluation of pre-GST and post-GST performance indicators, incorporating both quantitative measures such as revenue and profitability and qualitative assessments of compliance and operational challenges.

GST Framework and SME Provisions

The GST framework comprises Central GST (CGST), State GST (SGST), and Integrated GST (IGST), ensuring tax uniformity across intra-state and inter-state transactions. Registration threshold limits provide exemptions for smaller enterprises, while the Composition Scheme offers simplified compliance with lower tax rates but restricted input tax credit benefits. The Input Tax Credit (ITC) mechanism, designed to eliminate tax-on-tax effects, plays a crucial role in reducing cascading taxes; however, eligibility conditions and timing differences can impact SME working capital management.

Impact on SME Compliance

GST has significantly altered compliance practices for SMEs. The requirement to file multiple returns, including GSTR-1, GSTR-3B, and annual returns, increased administrative responsibilities. The shift to digital filing necessitated investment in accounting software, professional consultancy services, and employee training. Frequent changes in GST rules, complexities in determining HSN and SAC codes, and transitional issues from pre-GST stock further intensified compliance challenges, particularly for micro and informal enterprises.

Impact on Cost Structure and Pricing

One of the major benefits of GST is the elimination of cascading taxes, which positively influences pricing strategies and reduces hidden tax burdens. However, ITC timing issues and refund delays often extend working capital requirements, especially for SMEs with limited access to credit. Sector-specific impacts vary, with manufacturing SMEs experiencing changes in input taxation and service SMEs adapting to unified service tax integration. Informal sector enterprises faced relatively higher compliance costs compared to their revenue levels.

Market Competitiveness and Growth

GST has accelerated the formalization of SMEs, enabling better access to organized markets and participation in larger contracts. The removal of interstate barriers and entry taxes reduced logistics and distribution costs, facilitating smoother regional trade. Zero-rated exports

under GST enhanced export competitiveness, although refund delays sometimes constrained liquidity. Overall, GST improved the ease of doing business by creating a more transparent and uniform tax environment.

Challenges Faced by SMEs

Technological barriers, including limited digital infrastructure and low digital literacy, posed difficulties for many SMEs, particularly in rural areas. Knowledge gaps regarding tax slabs, exemptions, and compliance procedures necessitated continuous training and awareness programs. Delays in GST refunds affected cash flow management, especially for export-oriented businesses. Micro and informal enterprises experienced disproportionate compliance costs and transitional migration issues during GST implementation.

Positive Outcomes for SMEs

Despite challenges, GST has resulted in a simplified tax structure with unified rates and the elimination of multiple state-level taxes. Reduced logistics barriers and real-time tax reporting have enhanced transparency and minimized tax evasion. The structured documentation process has strengthened financial discipline and improved creditworthiness among SMEs.

Comparative Analysis and Policy Recommendations

Comparative analysis of pre- and post-GST periods indicates improvements in formalization and transparency, though profitability trends vary across sectors. Larger corporates with advanced compliance systems were better positioned to absorb technological and professional costs compared to SMEs. Policy recommendations include simplifying return filing through a single-return mechanism, revising threshold limits, upgrading GST portal infrastructure, implementing faster refund systems, and expanding awareness and training programs through government-industry collaboration.

Future Outlook

The future of SMEs under GST is closely linked to digital transformation, including the adoption of cloud accounting systems and integrated financial software. Enhanced export prospects and adaptive tax reforms based on stakeholder feedback can further strengthen SME

competitiveness in global markets. Continuous policy evolution and technological support will be essential in ensuring that GST contributes positively to sustainable SME development.

Conclusion

GST has had a significant and multidimensional impact on SMEs in India. While it has reduced tax fragmentation, enhanced formalization, improved transparency, and facilitated interstate trade, it has also imposed compliance burdens and working capital pressures. The overall impact differs based on sector, enterprise size, and digital readiness. Focused policies emphasizing simplification, technological support, and capacity building can further maximize the benefits of GST for SMEs, fostering a more inclusive, resilient, and dynamic Indian economy.

References

1. *Government of India. (2017). Goods and Services Tax (GST): Concept and Status. Ministry of Finance.*
2. *Ministry of Micro, Small and Medium Enterprises (MSME). (2020). Annual Report. Government of India.*
3. *GST Council. (2019). GST Council Reports. Government of India.*
4. *World Bank. (2018). Ease of Doing Business Report: India. World Bank.*
5. *Kumar, R., & Singh, A. (2018). Impact of GST on SMEs in India. International Journal of Research in Economics and Social Sciences, 8(6), 45–52.*