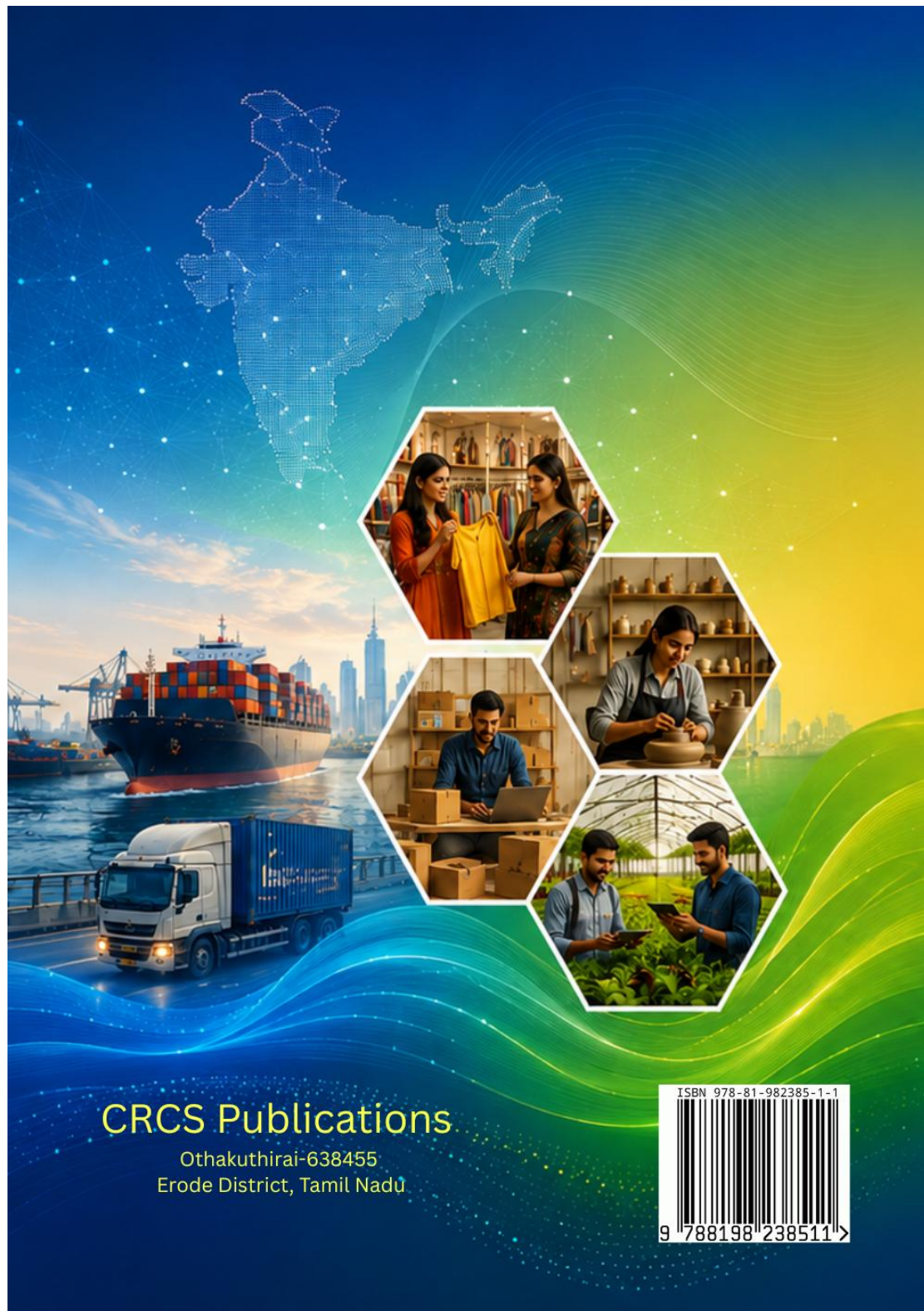




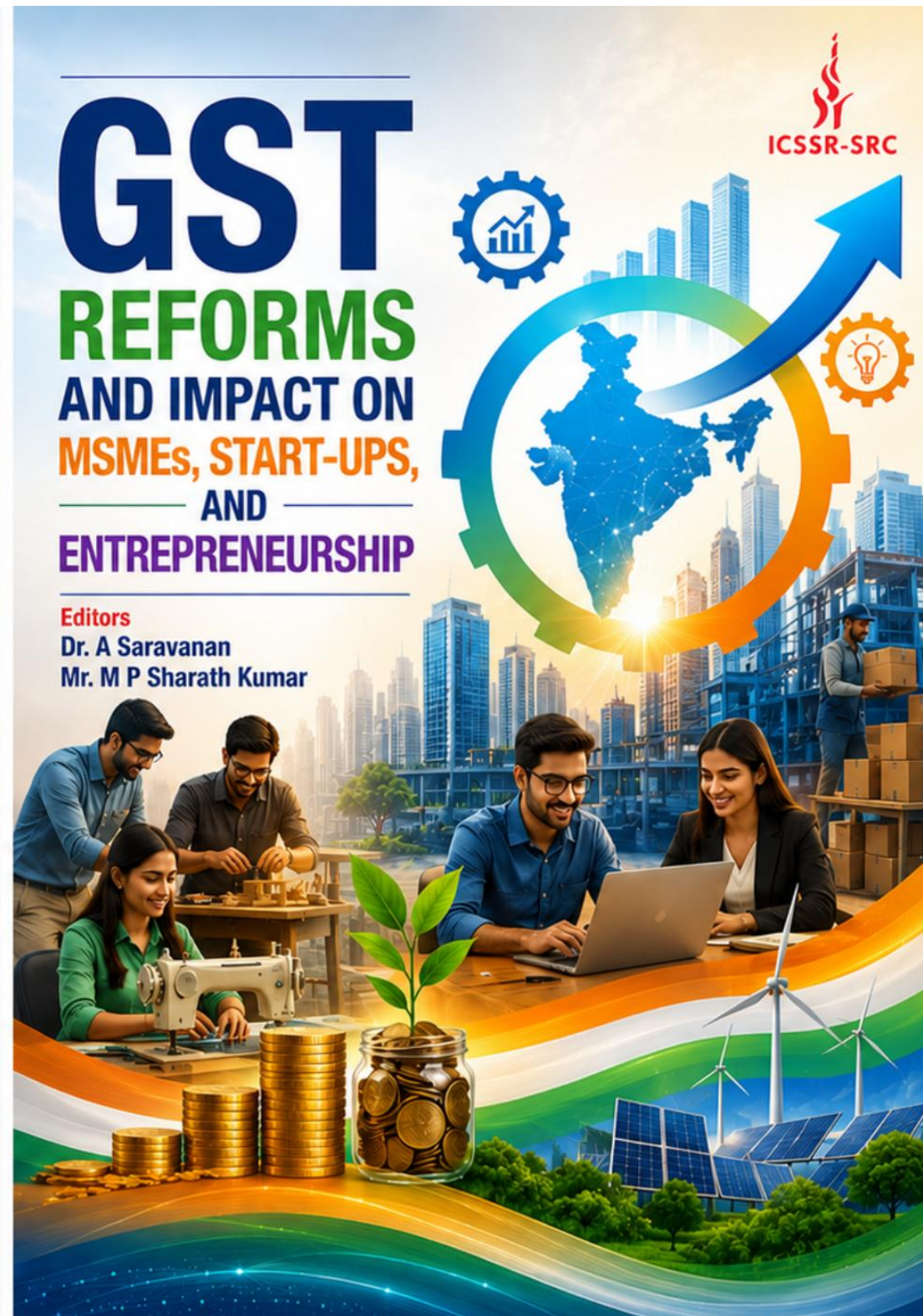
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GST REFORMS AND IMPACT ON MSMEs, START-UPS, AND ENTREPRENEURSHIP

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Exploring the Differential Effects of GST on Manufacturing and Service Sector MSMEs in India

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Abstract

The introduction of the Goods and Services Tax (GST) marked a significant reform in India's indirect taxation system by subsuming multiple central and state taxes into a unified structure. This study examines the differential impact of GST on Manufacturing and Service msme (Micro, Small and Medium Enterprises). While GST aimed to simplify taxation, enhance transparency, and promote ease of doing business, its implications have varied across sectors. Manufacturing msme experienced changes in input tax credit availability, supply chain restructuring, and interstate trade facilitation. In contrast, Service msme faced challenges related to place-of-supply rules, compliance frequency, and digital filing requirements. The study analyzes cost structures, compliance burden, working capital management, and overall business performance in both sectors. The research seeks to evaluate whether GST has created a level playing field or imposed disproportionate challenges on either manufacturing or service-based enterprises. The findings will contribute to policy recommendations aimed at improving tax administration and supporting MSME growth and entrepreneurship in India.

Introduction

Micro, Small and Medium Enterprises (msme) play a vital role in India's economic development by contributing significantly to GDP, exports, and employment generation. These enterprises operate across diverse sectors, primarily manufacturing and services, each with distinct operational and cost structures. The implementation of the Goods and Services Tax (GST) in July 2017 transformed the indirect tax landscape by replacing taxes such as excise duty, service tax, VAT, and entry tax with a single comprehensive tax system. The primary objectives of GST were to eliminate cascading taxes, ensure uniform tax rates across states, promote transparency, and enhance the ease of doing business. For Manufacturing msme, GST reduced the burden of multiple state-level taxes and improved input tax credit mechanisms, thereby streamlining supply chains and encouraging interstate trade. However, compliance requirements, including monthly return filings and digital documentation, increased administrative responsibilities. On the other hand, Service msme encountered specific challenges under GST. Unlike the previous service tax regime, GST introduced complex place-of-supply provisions and state-wise registration requirements for businesses operating in multiple states. This led to increased compliance costs and

procedural complexities. At the same time, GST also expanded market access and improved credit availability for service providers. The comparative analysis of GST's impact on manufacturing versus service msme is essential to understand sector-specific outcomes and policy gaps. By examining operational efficiency, tax burden, compliance costs, and financial performance, this study aims to provide insights into how GST reforms have influenced entrepreneurial growth and sustainability in both sectors.

Statement of the Problem

The implementation of the Goods and Services Tax (GST) was introduced to simplify India's indirect tax system, eliminate cascading taxes, and promote ease of doing business. While GST was expected to create a uniform and transparent tax structure, its impact has not been uniform across sectors, particularly among Manufacturing and Service msme. Manufacturing msme have experienced changes in input tax credit mechanisms, supply chain operations, and interstate trade procedures. Although GST reduced multiple indirect taxes, compliance requirements such as frequent return filing, e-invoicing, and digital documentation have increased administrative burdens and working capital pressure. At the same time, Service msme face distinct challenges related to place-of-supply rules, multi-state registration requirements, and tax rate variations, which may increase compliance complexity and operational costs. Despite several reforms and amendments in GST provisions, there is limited comparative research analyzing how these changes have differently affected manufacturing and service msme in terms of cost structure, profitability, liquidity, compliance burden, and overall business performance. It remains unclear whether GST has created a level playing field for both sectors and whether one sector has faced greater structural disadvantages.

Review of Literature

The introduction of the Goods and Services Tax (GST) has generated extensive academic and policy discussions regarding its impact on Micro, Small and Medium Enterprises (msme). Several studies have examined GST from the perspectives of tax reform, compliance burden, sectoral performance, and entrepreneurial development. Early research on GST highlighted its potential to eliminate the cascading effect of taxes and create a unified national market. Scholars argued that the "one nation, one tax" framework would enhance supply chain efficiency, reduce tax evasion, and improve transparency. Studies focusing on manufacturing msme found that GST improved the availability of input tax credit (ITC), reduced logistics costs due to the removal of interstate check posts, and encouraged formalization of business operations. However, some researchers observed that frequent return filing, e-invoicing requirements, and digital compliance increased administrative costs for small manufacturers, especially those with limited technological capabilities. On the other hand, literature examining service msme presents mixed findings. Under the previous service tax regime, service providers operated with centralized registration, but GST introduced state-wise registration requirements and complex place-of-supply rules. Researchers have noted that this increased compliance complexity for service enterprises operating across multiple states. At the same time, GST broadened the tax

base and improved credit flow, which benefited organized service firms. Comparative studies between manufacturing and service sectors indicate that the impact of GST varies due to differences in cost structures and operational models. Manufacturing msme's often deal with tangible goods, inventory management, and multiple suppliers, making input tax credit a significant advantage. In contrast, service msme's rely heavily on human capital and may have fewer input credits to offset output tax liability, potentially increasing their effective tax burden. Several empirical studies also highlight working capital challenges faced by msme's due to delayed GST refunds and the requirement to pay tax before receiving payments from customers. This issue has been particularly significant for export-oriented manufacturing units and small service providers. Furthermore, research emphasizes that digital literacy and awareness levels play a crucial role in determining the ease of GST compliance among entrepreneurs. Recent literature suggests that continuous amendments in GST rates and procedures have gradually reduced compliance difficulties. Government initiatives such as simplified return filing systems and composition schemes have attempted to ease the burden on small businesses. However, gaps remain in understanding the long-term comparative impact of GST on manufacturing versus service msme's, particularly in terms of profitability, sustainability, and entrepreneurial growth. Overall, the existing literature provides valuable insights into the sector-specific implications of GST but indicates the need for more focused comparative studies. This research aims to bridge that gap by systematically analyzing the differential impact of GST on Manufacturing and Service msme's.

Objectives of the Study

- To analyze the effect of GST on the cost structure and pricing strategies of Manufacturing and Service msme's.
- To compare the availability and utilization of Input Tax Credit (ITC) in both sectors.
- To examine the impact of GST compliance requirements on administrative costs and operational efficiency.
- To study the effect of GST on working capital management and cash flow position of msme's.
- To assess the level of awareness and adaptability of entrepreneurs toward GST provisions.
- To identify sector-specific challenges faced by Manufacturing and Service msme's under GST.

Comparison of Availability and Utilization of Input Tax Credit (ITC) in manufacturing vs Service msme's

Under the Goods and Services Tax (GST), the Input Tax Credit (ITC) mechanism allows businesses to reduce their tax liability by claiming credit for the tax paid on inputs used in the production of goods or services. However, the availability and utilization of ITC differ significantly between Manufacturing and Service msme's due to variations in their operational structure.

1. Availability of ITC

Aspect	Manufacturing msme's	Service msme's
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The compliance requirements under the Goods and Services Tax (GST) have a significant impact on both administrative costs and operational efficiency for businesses. Maintaining detailed records of sales, purchases, and input tax credits, along with regular return filings, increases administrative workload and often necessitates investment in GST-compliant accounting software, staff training, or professional tax services. These additional responsibilities can elevate operational costs, particularly for small and medium enterprises. At the same time, GST can initially slow operational efficiency due to the time and resources required for accurate reporting and process adjustments. However, over time, businesses can experience improvements in efficiency through streamlined tax procedures, better cash flow management via input tax credits, and reduced complexities in interstate transactions. By leveraging technology, automation, and process optimization, companies can mitigate compliance burdens and gradually realize the benefits of a more transparent and standardized tax system.

Sector-Specific Challenges Faced By Manufacturing and Service MSME under GST

Manufacturing msmes

- **Complex Input Tax Credit (ITC) Management:** Manufacturers often deal with multiple raw materials from different suppliers. Ensuring accurate ITC claims across various input goods can be cumbersome, especially if suppliers are non-compliant or delayed in filing returns.
- **Inventory Valuation and Stock Reconciliation:** Manufacturing units must maintain proper documentation for raw materials, semi-finished, and finished goods to comply with GST audits. Misclassification of goods or errors in stock valuation can result in penalties.
- **Multiple GST Rates:** Raw materials, intermediate goods, and finished products may attract different GST rates. Calculating tax liability accurately across these tiers increases complexity.
- **Refund Delays:** Export-oriented msmes often face delays in GST refund claims, affecting working capital and operational cash flow.
- **Technological Adaptation:** Smaller manufacturers may struggle with implementing ERP systems or accounting software that integrates GST compliance, increasing operational burden.

Service msmes

- **Reverse Charge Mechanism (RCM) Compliance:** Many service msmes are liable to pay GST under RCM for services received from unregistered suppliers. Tracking and paying these taxes adds complexity.
- **Classification of Services:** Ambiguity in service categorization can lead to disputes over applicable GST rates, resulting in potential penalties or interest.
- **High Compliance Frequency:** Services often involve frequent invoices with small transactions, which increases the effort required for accurate filing and reconciliation.

- **Input Tax Credit Limitations:** Unlike manufacturing, service msme may have limited capital goods and raw material purchases, restricting the ITC they can claim and increasing effective tax costs.
- **Cash Flow Pressure:** Service providers with delayed client payments may struggle to pay GST on time, creating liquidity issues.

Conclusion

The impact of GST on msme varies significantly between the manufacturing and service sectors. Manufacturing msme face challenges primarily related to input tax credit management, multiple GST rates across raw materials and finished goods, inventory reconciliation, and refund delays, which can increase administrative costs and strain working capital. In contrast, service msme are more affected by issues such as reverse charge compliance, service classification ambiguities, frequent invoicing requirements, and limited input tax credit opportunities, often leading to cash flow pressures. While GST standardizes taxation and can improve transparency and long-term efficiency, the immediate effect for both sectors involves higher compliance burdens. Ultimately, sector-specific strategies—like automation, proper bookkeeping, and timely reconciliation—are essential for msme to mitigate compliance costs and optimize operational efficiency under GST.

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