

FULL PAPER

Consolidated recommendations to change GST patterns for managing the impact of Covid-19: A case in India

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The Finance Commission of India stated that FY 2020-21 was full of uncertainties and the pandemic led to the creation of an uncertain economic environment of the SME sector in India. However, the implications of COVID-19 have been relatively more devastating for small and medium-sized business enterprises in India. The literature review based on the analysis of the secondary journals showed that the filing of GST returns led to a constraint of working capital faced by business owners of SMEs. Moreover, it was also inferred that the denial of credit on input taxes on GST resulted in a further deterioration of business for SMEs, which were a part of the food sector. However, results from secondary research signified that the financial situation of rural SMEs has become volatile due to job losses, weak financial quarterly income, salary cuts and lower volume of sales. A majority of 61% of business owners of SMEs in India decided to lower their respective scale of business operations during the pandemic. The feasible recommendation will be to exempt the business owners from paying penalties. Also, GST charges would be levied after the deduction of ITC charges. It can be concluded that the optimal way for managing the way entrepreneurs of SMEs manage business operations is to file GST returns in a quarterly manner, rather than per month. Besides, additional recommendations such as computing ITC and GST charges via the auto-generated system and re-setting the rate of interest subvention were proposed by the researcher.

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KEYWORDS

GST; SMEs; interest subvention; ITC charges.

Introduction

GST, also known as “Goods and services tax” was a form of value-added taxation that was levied on services and goods sold for local consumption. This study aimed at presenting a critical review of literature that is related to the research topic. However, the study also emphasizes key findings and discusses the correlation of results with corresponding research objectives. The section of methodology focuses on key methods of data collection used by the researcher. Besides, some additional recommendations are also

offered for managing the adverse implications of the COVID-19 pandemic.

The share of SMEs in the manufacturing, trade and retail sectors is 31%, 36% and 33%, respectively [1]. The Finance Commission of India stated that the FY 2020-21 was full of uncertainties and the pandemic led to the creation of an uncertain economic environment of the SME sector in India. The Commission announced that the COVID-19 pandemic will generate long term repercussions upon consolidation plans and deficits of SMEs operating in India [2]. Therefore, the need for amending changes in

the already existing GST regime was felt. The existing GST regime was putting huge pressure upon SMEs, which was a part of the informal sector in India [3].

However, the implications of COVID-19 have been relatively more devastating for small and medium-sized business enterprises in India. For example, *non-performing assets* of small-scale enterprises grew from 10.4% in June 2018 to 10.8% in September 2019. Besides, *non-performing assets* of medium scale enterprises grew from 17.1% in June 2018 to 18.1% in September 2019 [3]. This signified that the business environment and the taxation regime did not favour the SME sector before the pandemic. (See the appendix for further information).

The primary aim of this research was to propose probable recommendations for tackling the negative implications of COVID-19 on the Indian economy, especially in the SME sector. However, the secondary aim was to critically analyze amendments carried out in the existing GST regime and find alternative solutions.

The research objectives in particular were as follows:

- To identify the impact of the COVID-19 pandemic on the SME sector in India;
 - To determine existing gaps in the existing GST tax regime that is considered to be an inhibitor to the growth of the SME sector in India during the pandemic; and,
- To propose consolidated recommendations for changing patterns of the GST tax regime for managing negative implications of COVID-19 on the SME sector in India

Literature review

Failure of the GST regime in managing adverse consequences of COVID-19 pandemic

The introduction of the GST regime was considered to be a logical step that directed the Indian economy towards economic perfection. It was viewed as a path breaker in

the history of the Indian tax regime that would revolutionize the taxation system. The GST regime was attributed as “*Dual GST*” because both the State and the Central authorities had the power to levy taxes on services and goods sold by business units in India [4]. On the other hand, a majority of business entrepreneurs who are running SMEs are pessimistic about the duty threshold of the GST bill [5].

Besides, the GST pattern was designed in such a way that business owners of SMEs were required to file corresponding GST returns when goods were passed from one production stage to the other [6]. However, the inherent problem with the tax regime was that it impeded collections of credit coupled with delays of claim refund created an adverse impact on the Indian SME sector. The filing of GST returns led to a constraint of working capital faced by business owners of SMEs. The situation further worsened during the ongoing pandemic crisis because the cycle of cash conversion extended beyond a threshold level. Therefore, the already GST regime failed because the entrepreneurs of SMEs had to depend on sources of external credit for fulfilling the short-run requirements of working capital. There was an acute shortage of external credit from external sources and thus SMEs failed to clear GST liabilities during the pandemic

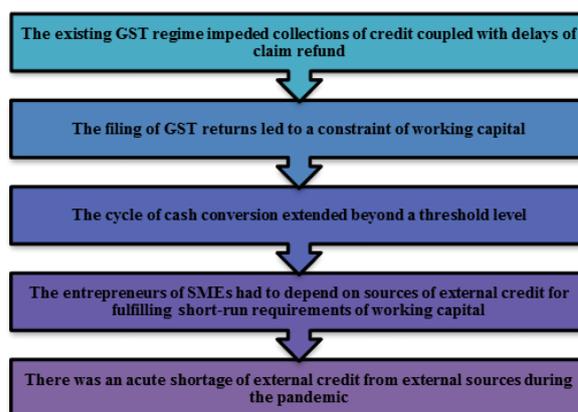


FIGURE 1 Course of actions that led to the failure of the existing GST regime for Indian SMEs [6]

Alternatives solutions for limiting the adverse repercussions of the COVID-19 pandemic in India

The GST regime has not yielded feasible outcomes for the SME sector in India since its genesis. The already existing GST regime increased the compliance cost for SMEs and led to the emergence of associated teething problems. There were no electronic systems of compliance that would help business owners of SMEs to file and register online returns of GST in an optimal manner [5]. The SME food sector was badly hit due to sub-optimal changes in GST patterns and corresponding changes in the consumption patterns of consumers. The denial of credit on input taxes on GST resulted in further deterioration of business for SMEs, which were a part of the food sector. The advent of the COVID-19 pandemic further worsened the situation because revenue income was affected to a large extent [7].

Henceforth, the *Indian Tax Council* members decided that changes be applied in GST patterns to manage adverse implications of COVID-19. As a result, Nirmala Sitharaman declared tax relief features for SMEs in India. The rate of interest levied on delayed GST filings was reduced only for those business entrepreneurs running SMEs with an annual turnover of Rs. 5 crores and less. The amendment in the GST regime was required because the business owners of SMEs were unable to maintain compliance with the GST regulations. Furthermore, they reached close to bankruptcy when they were charged with high penalties and interest rates against late GST filings [8].

Scope of the SME sector to benefit from proposed changes in the GST tax regime

There was less scope for the SMEs so that they could flourish under the presence of the GST regime of taxation. The extension of the date for filing returns of GST bills did not contribute

to a reduction of financial trouble for SMEs that were operating in India. The manufacturing, as well as the retail SME sector suffered a financial blow because consumption demand reduced drastically and investment expenditure fell. The financial crisis hindered business owners of SMEs to manage compensation for covering up average production cost. As a result, they were on the verge of collapse that was triggered by the liability of pending GST returns between April and June 2020. For example, the worth of GST collection was Rs. 43,000 crores in April 2020 as compared with a collection worth Rs. 97,000 crores in March 2020 [9]. These figures reflected that the already existing GST was putting high pressure on business owners of SMEs, during the ongoing financial crisis.

The scope of managing the adverse consequences of the COVID-19 pandemic by SMEs was further affected when the Finance Minister announced that business owners would have to pay GST on the supply of services and commodities. However, the striking feature of the GST regime was that GST returns were required to be paid by business owners even if they did not receive any payments for supplied services and commodities [10]. This magnified the intensity of the negative pressure that was borne by the business owners of SMEs in India.

Methodology

Methods

The current research relied on positivist philosophy as using its scientific approach can help the researchers to gather in-depth knowledge [11]. On the other hand, the deductive approach was selected since it goes well with the positivist philosophy and can properly help in gaining numerical data. Also, the descriptive design was applied to research since it can contribute to deeply describe the topic and can provide accuracy during data collection. Moreover, in the research,

secondary research data were gathered which further made the research more flexible and could effectively provide authentic data on the topic of the research [12]. We relied on journals, articles, books and websites. The qualitative and quantitative data were considered for the research.

PRISMA framework was selected and based on that 15 journals were considered after collecting them from reliable databases such as EBSCO, ProQuest and Google Scholar along with official government websites. The journals selected were published after 2016 and had full pdfs available and no duplicate journals were considered while initially collecting 60 journals

Boolean table

Sampling

Prisma framework

TABLE 1 Boolean Table

Theme	Keywords	Boolean operators used	Article found
Implications of the COVID-19 pandemic on the SME sector in India	MSME, GST, COVID-19, Problems	(GST and MSME) or (MSME and Covid-19) or (Problems and MSME)	<i>"Explained: Why are Medium, Small, Micro Enterprises worst hit by Covid-19 lockdown?"</i>
Identification of defects in the prevalent GST tax regime that inhibit the growth of the SME sector	Relaxation, GST, CBIC, CGST Act	(CBIC and GST) or (Relaxation and GST) or (CGST Act and Relaxation)	<i>"GST relief 2.0: Govt can provide relaxations for certain measures under GST"</i>
Consolidated recommendations for amending the GST tax regime in India for the betterment of the SME sector	GST, COVID-19, Compensation, Revenue	(GST and Compensation) or (Revenue and COVID-19) or (GST and CVOVID-19)	<i>"GST compensate due to States is Rs. 1.51 lakh cr"</i>

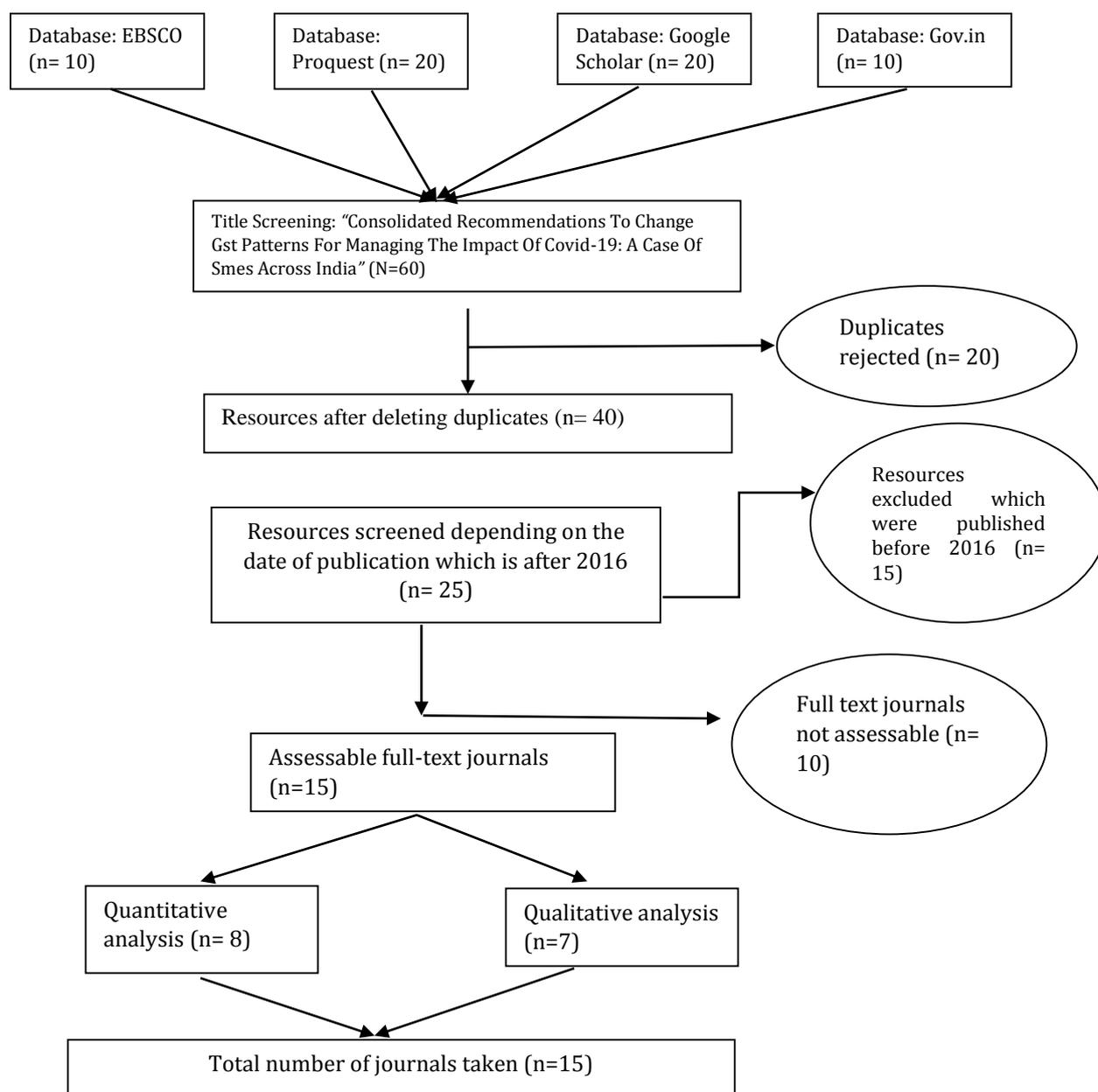


FIGURE 2 Systematic review

Ethical consideration

The researchers observed ethical considerations and attempts were made to preserve the confidentiality of the data. Privacy and authenticity were maintained throughout the research and before collecting data, higher authority was informed and following their consent, the research was conducted. Also, the collected data were protected based on the Information Technology Act 2000 under section 43A and 72A.

Results

Implications of the COVID-19 pandemic on the SME sector in India

The COVID-19 pandemic has led to a permanent pause in a major fraction of SMEs such as manufacturing and retail business enterprises in India, especially in metropolitan cities. The business entrepreneurs of SMEs believe that they are expecting normalcy in business conditions within a span of the coming six months.

However, the majority hope to receive support from the Federal Government of India to tackle the crisis. The business entrepreneurs of roughly 50 SMEs hope to enjoy either exemptions or discounts from paying GST. The

remaining, nearly 36% of SME business entrepreneurs are expecting to receive credit at cheap interest rates such that they can finance GST claims [13].

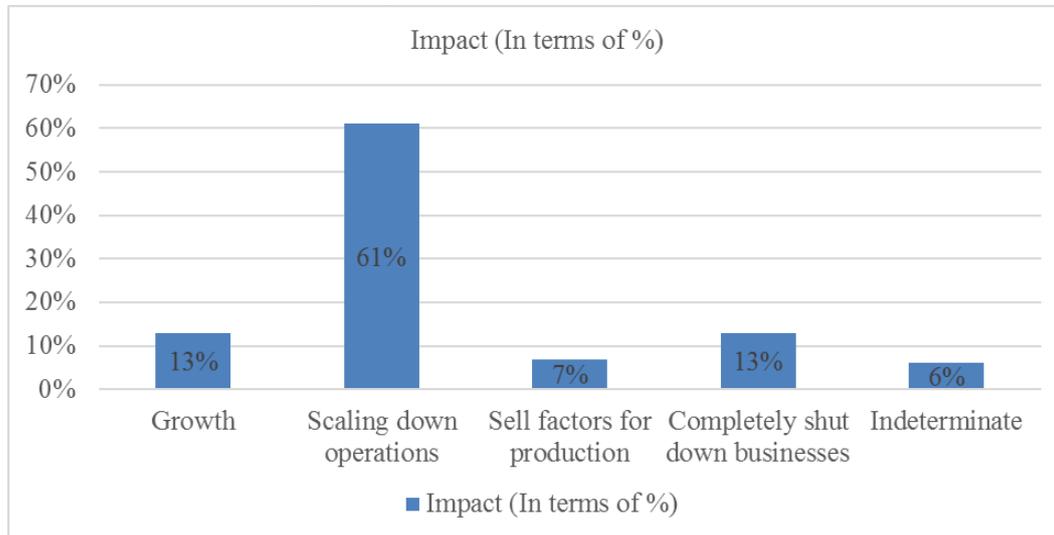


FIGURE 3 Impact of COVID-19 on SMEs in India [1]

Figure 3 demonstrates that a majority of 61% of SMEs (a combination of both rural and urban SMEs) decided to lower their scale of business operations. Alternatively, 13% of businesses were forced to shut down business operations and 7% of business owners of SMEs encountered problems such as laying off

workers, selling capital and leasing out land. A handful of nearly 13% of SMEs experienced growth only by a marginal amount. Besides, business owners of registered SMEs faced hardships in clearing off GST obligations due to poor financing facilities [1].

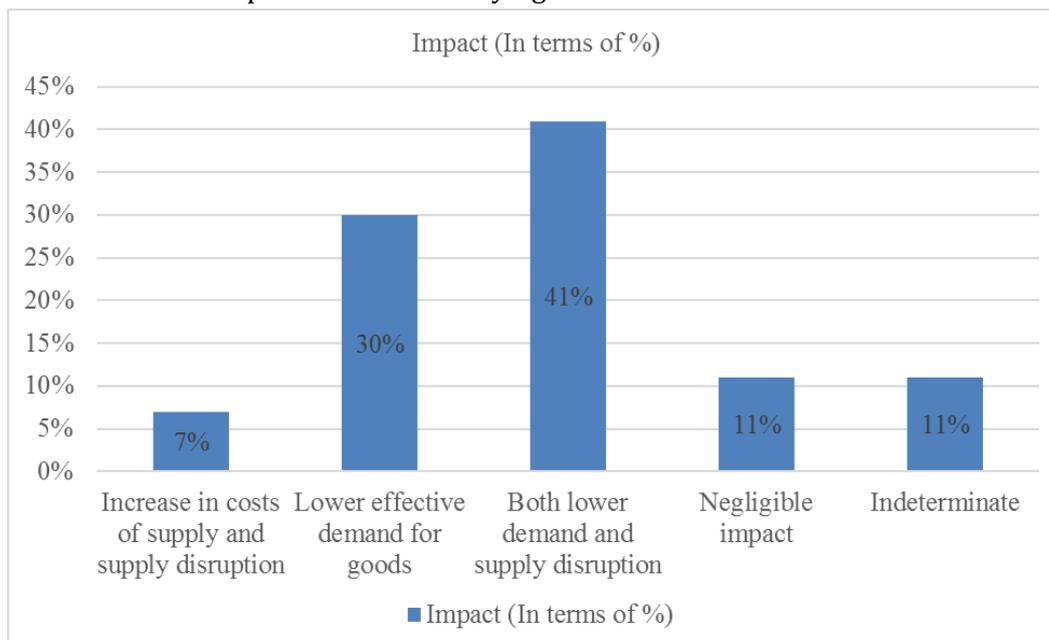


FIGURE 4 Impacts of COVID-19 on the rural SME sector in India [14]

Figure 4 depicted that a major proportion comprising 41% of rural SMEs experienced both supply disruption and a fall in effective demand. However, nearly 30% of rural SMEs incurred losses due to poor effective demand, whereas there were 7% of SMEs that were victims of supply distortion. Due to a lack of demand, the export business for rural SMEs was badly hit. The financial situation of rural SMEs has become volatile due to job losses, weak financial quarterly income, salary cuts and lower volume of sales [14].

Identification of defects in the prevalent GST tax regime that inhibit the growth of the SME sector

The Government of India has been seeking to bring about changes in the GST regime so that SMEs in India are better-off during the pandemic. The Government liberalized the filing of returns of GST along with provisions of depositing penalties against delayed tax payments [15]. However, a suitable recommendation will be the provision for a facility of deferring without consequences of penalties. The strategy will be beneficial for individual and self-employed taxpayers who are actively linked with the SME sector in India. The Government of India could offer tax supports by providing rebates in headline rates of GST. The Government failed to provide sector-wise tax support such as hospitality, retail and manufacturing sector in the form of GST rebates [15].

The Finance Minister of India, Nirmala Sitharaman, issued GST guidelines for SMEs and stated that relaxation was being provided to default taxpayers. The Finance Minister announced that taxpayers could pay their GST filings between March and April till 30th June 2020 [16]. However, the alternative recommendation will be to exempt SMEs from GST filings, with an annual turnover worth Rs. 5 crores and less till October 2020. The strategy would help business entrepreneurs of SMEs to maximize their sales volume, incur higher revenue and compensate for losses.

The aspect of the pandemic has been included in GST regulations levied in India. For example, according to **Section 80 of the CGST Act**, business owners of SMEs in India are allowed to pay their GST payments in 24 installments. Multiple sectors of SMEs such as pharma packaging, hospitality, manufacture, retail and e-commerce are expected to be benefitted from the newly issued tax regime [17]. However, there is a lack of proper supervision that may limit the scope of the newly introduced GST regime. The recommendation will be to form a regulatory authority that would monitor and critically inspect the business turnover of the particular enterprise. Only those businesses would be offered the opportunity that were on the verge of financial collapse, bankruptcy and was planning to shut down during the pandemic

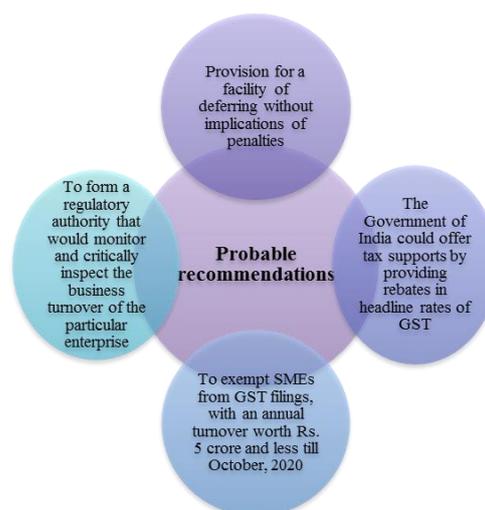


FIGURE 5 Probable recommendations for changing existing GST patterns

Consolidated recommendations for amending the GST tax regime in India for the betterment of the SME sector

The states in India have incurred a shortfall in GST revenue income worth Rs. 2.35 lakh crore in Q2 of 2020. As a regulatory step for managing the business operations amidst the pandemic, the Federal Government has announced changes in the GST regime. The

Joint Council of SMEs could request the respective State authorities to borrow either Rs. 2.35 lakh crore from open market operations or borrow Rs. 97,000 crores lent by special windows [18]. However, the feasible recommendation will be to extend the margin of borrowings from special windows and open market operations. A higher amount of borrowing would enable business entrepreneurs to maximise production activities and make timely filings for returns of GST. The GST collection was dipped by a drastic amount between April and July 2020. The worth of GST collection was Rs. 1.81 lakh crore that was 26.2% of the annual target of Rs. 6,90,500 crores [4]. This is a piece of evidence illustrating that the present changes in the GST regime were unsatisfactory and inefficient to match the targeted GST returns from each state.

There are more than 1.20 crore SMEs in India that fall under the segment responsible for filing returns of GST per month. However, 17 lakh SME owners have requested the Indian Government to grant them an opportunity to file returns of GST in a quarterly manner. They have opted to be a part of the "*Compensation Scheme*" for levying the opportunity [19]. The feasible recommendation will be to levy GST taxes from SMEs after deducting charges of credit of input tax (ITC). The exemption from ITC charges that were earlier included in GST would provide an opportunity for reducing future liability claims for SMEs in India.

Discussion

The first research objective stressed upon the identification of the negative impact of the pandemic on the Indian SME sector. The objective was addressed by highlighting the proportion of SMEs, as a whole that either lowered their scale of business operations, sold factors for production, or shut down their businesses. It was evident that a majority of 61% of business owners of SMEs in India

decided to lower their respective scale of business operations during the pandemic [1]. Furthermore, owners of SMEs suffered distress in terms of a drop in real wages, lower sales volume, accentuating job losses and deterioration in the trend of revenue income [14].

The second research objective focused on the determination of prevalent gaps that hindered the ability of business managers of SMEs to manage the COVID-19 pandemic. Owing to the volatility of the economic status of SMEs in India, the Indian Government brought about changes in the GST regime by allowing the scope to SME owners deposit penalties for delayed tax payments [15]. However, the feasible recommendation will be to exempt the business owners from paying penalties. This would help self-employed and individual payers of GST optimally. Furthermore, the recommendation for tax support in a sector-wise manner was considered to provide a scope to SMEs in managing financial distress due to the COVID-19 pandemic.

The third research objective focused on the proposal of consolidated recommendations for bringing about changes in the GST pattern. The researcher found that the margin of borrowing credit by business owners of SMEs could be extended beyond special windows and open market operations. Furthermore, this would provide scope to the owners of SMEs to file monthly GST returns without default and maximize the income generated from higher sales. Moreover, the researcher also recommended that GST charges would be levied after the deduction of ITC charges.

Conclusion

It can be concluded that a majority of 41% of SMEs in rural India faced problems in filing GST return per month due to the dual effects of supply disruption and lower effective demand. Furthermore, the existing GST regime was considered as a sub-optimal one

because it did not favour SMEs in manufacturing, retail and the hospitality sector. Therefore, amendments were required to be made by adjusting the exiting GST pattern. A tax support scheme for each sector was needed to be developed. Additionally, it was deduced that a complete exemption of SMEs that had incurred annual turnover worth Rs. 5 crores and below from filing GST returns would enable them to manage their business operations during the COVID-19 pandemic.

It can be concluded that the optimal way for managing the way entrepreneurs of SMEs manage business operations is to file GST returns in a quarterly manner, rather than per month. Therefore, business owners would enjoy an extended period for depositing their GST returns without default. However, the present tax regime did not contribute much in terms of allowing a scope to entrepreneurs of SMEs to tackle adverse impacts of the COVID-19 pandemic.

Some additional recommendations for bringing about changes in GST patterns are suggested below. The underlying recommendations will help business owners of SMEs tackle the adverse implications of the COVID-19 pandemic.

- Initially, taxpayers need to compute values of ITC charges and GST liabilities before paying GST taxes. However, it is recommended to ease the process of computation of GST for financial managers of SMEs. For example, a document generated via system automatically would enlist ITC charges and GST liabilities for each SME per month. Therefore, the financial managers of SMEs would find it easier to upgrade linking outward return of supply and summary of GST returns.
- Changes are required in terms of extending the date of filing GST compliances to be paid by SMEs in India. Therefore, there is a need for rationalising the pattern of GST so that entrepreneurs of SMEs in India could enjoy the scope of the simplified process of tax filings.

- The transparency in the process of filing GST returns is required to be brought about so that entrepreneurs of SMEs do not end up landing GST returns in the hands of non-compliant vendors.

- There is a need for setting the interest subvention to 2% for all SMEs that are registered with the State and liable to make monthly GST filings. The interest rate that is charged on incremental loans and fresh loans are subject to amendment under the proposed new regime.

- The Central Government should consider lowering GST on the procurement of raw materials that are used for production purposes. The GST levied upon raw materials should be adjusted to 4% so that business owners associated with manufacturing SMEs could minimize the cost of procurement of raw materials and improve business prospects. For example, the GST on natural fibre should be reduced to 5%, whereas GST levied on artificial fibre should be adjusted to 12%.

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