



A critical study of GST implementation and its effects on MSMEs in the Indian Economy

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Abstract: The Goods and Services Tax (GST), introduced in India in July 2017, represents one of the most significant indirect tax reforms aimed at simplifying the country's complex tax structure and creating a unified national market. While the reform was expected to improve transparency and efficiency in the taxation system, its implementation has generated several challenges for Micro, Small, and Medium Enterprises (MSMEs). MSMEs play a vital role in the Indian economy by contributing significantly to employment generation, industrial production, and exports. However, due to limited financial resources, technological capabilities, and managerial expertise, these enterprises often struggle to adapt to large regulatory changes such as GST. The present study examines the challenges and negative impact of GST on MSMEs in India. The study is based on secondary data collected from government reports, research journals, official publications, and other credible sources. The findings indicate that GST has increased compliance requirements, created working capital constraints, and imposed technological and administrative burdens on small enterprises. Mandatory digital filing systems, multiple return submissions, input tax credit dependencies, and procedural complexities have increased operational costs and administrative workload for MSMEs. Furthermore, the intensified market competition with large firms has placed additional pressure on small businesses struggling to meet compliance standards. The study concludes that although GST aims to improve tax transparency and economic integration, the transition has created several operational and financial difficulties for MSMEs, highlighting the need for simplified compliance procedures and supportive policy measures to protect the sustainability of small enterprises.

Keywords: MSMEs, Goods and Services Tax, SMEs, Tax, Economy, Supply Chain

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INTRODUCTION

On July 1, 2017, GST Act went into force and was applicable throughout India, marking a massive indirect tax reform in the country. Central and state governments no longer collect taxes like VAT, EDD, etc., thanks to this statute.¹ However, several scholars and industry experts have also highlighted the operational and compliance challenges faced by small businesses after the implementation of GST. In order to solve the long-standing issue of national market integration, it has been adopted with the goals of simplifying business operations, increasing financial resources, and reducing the fiscal deficit, all of which will stimulate economic growth.²

According to "Public Finance System Overview: Indian States" by S&P Global Ratings credit analyst YeeFarn Phua, a significant reform of the tax system was ushered in by the 2017 GST bill's approval, which would aid in expanding the tax base and enhancing state governments' income. Although GST was introduced to strengthen the taxation framework, its implementation has created several operational and financial challenges for small businesses, particularly MSMEs.³ The transition to the GST regime has required businesses, especially MSMEs, to adapt to new compliance systems, digital procedures, and

regulatory requirements.⁴ Businesses, farmers, and shoppers will all feel a huge weight lifted off their shoulders as a result of the simplified use of input tax credits, the consolidation of several levies into GST rates, and the gradual elimination of the CST.⁵

The Central Board of Indirect Taxes (CBIC) predicts that by expanding the tax base and encouraging better taxpayer compliance, GST would boost government revenue.⁶ Despite these expectations, several studies suggest that the transition to GST has created adjustment difficulties for MSMEs due to increased compliance costs and administrative procedures.⁷ In the short term, however, many MSMEs faced disruptions in their traditional business operations while adjusting to the new tax framework. It's possible that GST won't solve all of the problems with the indirect tax system, but it's also rather close.⁸ Some see benefits to the Indian tax system while others see drawbacks to GST regime.⁹ As a result, the beneficial effects of the GST will not become apparent until much later. ¹⁰

OBJECTIVES OF THE STUDY

- To learn what the Goods and Services Tax is and how it works.
- To examine the challenges and adverse impact of GST on MSMEs.
- To analyze the GST system as it pertains to micro, small, and medium-sized enterprises

RESEARCH METHODOLOGY

The descriptive character of this work makes it stand out. The information is culled from secondary sources, which include records and yearly reports from the Ministry of MSME and the Ministry of Finance, as well as reports on MSME from the GST Council, publications from the RBI, newspapers, journals worldwide, and online journals.

RESULTS

GST represents an integrated framework of indirect taxation that encompasses nearly all indirect taxes levied by both the central and state governments on goods and services. The primary objective behind the implementation of GST is to streamline the indirect tax regime by eliminating the multiplicity of taxes such as excise duty, value-added tax (VAT), service tax, sales tax, entry tax, luxury tax, and various customs duties and replacing them with a unified, consumption-oriented tax system. The adoption of GST is expected to lead to greater consolidation within the Indian market by reducing tax-related inefficiencies and fragmentation.

The GST structure is grounded in a set of core principles formulated by the GST Council. First, GST functions as a consumption-based value-added tax, wherein tax is imposed only on the incremental value added at each stage of the supply chain. This mechanism allows businesses to claim input tax credit for the GST paid on their purchases, thereby preventing the cascading effect of taxation. Second, GST operates as a destination-based consumption tax, meaning that tax revenue accrues to the state in which the final consumption of goods or services takes place rather than the state of origin or production. 'Third, the unified compliance system under GST provides a single digital platform through the GST portal, enabling taxpayers to complete registration, return filing, and tax payments seamlessly for both Central GST (CGST) and State GST (SGST).

The implementation of GST has significantly altered the economic and operational environment for MSMEs, which are widely acknowledged as a foundational component of the Indian economy. MSMEs constitute one of the most dynamic and rapidly growing sectors, playing a critical role in driving economic development. Their importance stems from their strong capacity to generate employment, minimal capital and technological requirements, reliance on traditional and inherited skills, effective utilization of local resources, and ability to contribute to exports. Collectively, these characteristics enable MSMEs to support national economic growth objectives while fostering inclusive and equitable development. Under the revised framework, MSMEs are now classified based on updated investment and turnover thresholds.

Table 1: Enterprise Categorization according to Investment and Revenue

Types of Enterprise	Micro	Small	Medium
Capital Expenditure on Fixed Assets	≤ ₹10 million	≤ ₹100 million	≤ ₹500 million
Annual Turnover	≤ ₹50 million	≤ ₹500 million	≤ ₹2.5 billion

Requirements for Compliance with GST

Despite the fact that the GST system has made tax matters easier to understand, small businesses now have more compliance responsibilities due to new processes and digital filings.

Suppliers of services are exempt from GST if their total income does not exceed ₹2 million (₹1 million for the states of Manipur, Mizoram, Nagaland, and Tripura) for the threshold exemption. If a supplier's yearly sales are less than ₹4 million (or ₹2 million in certain states: Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Puducherry, Sikkim, Telangana, Tripura, and Uttarakhand), then they are exempt from registering for or paying GST. But it limits their ability to claim input tax credits.

The composition plan, which offers a GST rate between 1% and 5%, is available to entities with a revenue below ₹15 million. It is my regret that input tax credits are not an option at this time.' The states that fall under the special category—Arunachal Pradesh, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, and Uttarakhand—receive a separate allocation of ₹7.5 million. But they miss out on input tax credit benefits.

The GST system exempts registered individuals with an annual revenue up to ₹20 million from the need to have a cost accountant or chartered accountant audit their books. The purpose of implementing this exception is to facilitate faster transaction.

Electronic submission of sales returns (Form GSTR-1) and summary reports (Form GSTR-3B) is mandatory for all registered MSMEs. The sales returns are due monthly, while the summary reports are due quarterly. This will increase due to the reporting obligations.

To begin with, there is the Reverse Charge Mechanism (RCM), which states that instead of the provider

being liable for paying the tax, it is the recipient's obligation to do so. This system is applicable in some cases, or to particular notified goods and services.

E-way Bill It is mandatory for MSMEs to create electronic way invoices when transporting items across state borders with a value above fifty thousand rupees. Extended wait times and increased costs are consequences of inspections conducted at border crossings.

Online filing and payment are mandatory for GST taxpayers. Companies who want to grow their business and go into new markets need to register on a regular basis.

Registering for and Complying with GST for MSMEs

MSME sector is a key engine of India's economic development, and its implementation has been hailed as a crucial step toward more economic transparency and expansion. There are many advantages for MSMEs to register under the GST system. Some of these benefits include an easier tax system, more market prospects in India, and the opportunity to claim input tax credits more easily. The GST system imposes compliance duties, but many small businesses need help satisfying these obligations. For MSMEs to be eligible for the GST, they need to fulfill certain criteria. Among these are the following: adhering to anti-profiteering provisions, responding quickly to notices, paying taxes on time, keeping accurate records, issuing invoices that comply with GST regulations, paying taxes on time, reconciling input tax credits, following E-way bill regulations, registering for GST promptly, and filing accurate GST returns like GSTR-1, GSTR-3B, and GSTR-9. MSMEs must comply with these regulations to avoid fines, maintain good relations with tax authorities, and ensure smooth operations under GST.

Challenges and Negative Impact Of GST On MSMEs

The introduction of the Goods and Services Tax (GST) in India was intended to simplify the indirect tax system and create a unified national market. However, despite its long-term objectives, the implementation of GST has posed several challenges for Micro, Small, and Medium Enterprises (MSMEs). MSMEs form the backbone of the Indian economy by contributing significantly to employment generation, industrial output, and exports. Due to their limited financial, technological, and managerial resources, these enterprises are more vulnerable to policy changes and regulatory complexities. The transition to the GST regime has therefore created multiple operational, financial, and compliance-related difficulties for MSMEs, which have affected their overall performance and sustainability.

1. Increased Compliance Burden

One of the most significant challenges faced by MSMEs under the GST regime is the increased compliance burden. Under the previous tax system, many small businesses had relatively simple tax procedures and fewer reporting requirements. However, GST requires businesses to maintain detailed digital records, generate GST-compliant invoices, and file multiple returns such as GSTR-1, GSTR-3B, and annual returns. These procedures must be completed within strict deadlines to avoid penalties.

For many MSMEs, especially those operating with limited administrative staff, these requirements create additional workload and complexity. Small businesses often lack in-house accounting expertise and therefore need to hire tax consultants or chartered accountants to ensure compliance. This increases

operational costs and reduces profit margins. In addition, frequent updates and changes in GST rules make it difficult for MSMEs to stay informed and compliant, creating uncertainty in business operations.

2. Financial Pressure and Working Capital Issues

Another major negative impact of GST on MSMEs is the pressure on working capital. Under the GST system, businesses are required to pay tax at the time of supply and later claim input tax credit on eligible purchases. However, delays in receiving input tax credits or refunds can block a significant portion of working capital for small enterprises. Since MSMEs typically operate with limited financial reserves, such delays can disrupt their day-to-day operations.

Furthermore, the dependence on supplier compliance for claiming input tax credit creates additional financial uncertainty. If suppliers fail to upload invoices or file returns on time, MSMEs may not be able to claim the credit even if they have already paid the tax. This situation can lead to increased tax liability and cash flow difficulties. For small businesses that rely on continuous liquidity to manage production and inventory, such financial constraints can significantly affect their operational efficiency.

3. Technological and Digital Infrastructure Challenges

GST is largely a technology-driven tax system that requires businesses to perform most compliance activities online through the GST portal. While digitalization improves transparency and efficiency in the long run, it has created several challenges for MSMEs, particularly those operating in rural and semi-urban regions. Many small businesses lack access to adequate digital infrastructure, reliable internet connectivity, and trained personnel capable of managing online tax compliance.

The requirement to use accounting software, maintain digital transaction records, and upload invoices regularly requires a level of technological capability that many MSMEs do not possess. As a result, businesses often need to invest in new software systems and employee training, which increases their financial burden. For very small enterprises and traditional family-run businesses, adapting to these technological requirements has been particularly difficult.

4. Increased Competition and Market Pressure

The implementation of GST has also intensified market competition for MSMEs. The unified tax structure has enabled large corporations to expand their operations more easily across multiple states. Large firms typically have better financial resources, advanced technological systems, and professional management teams, allowing them to comply with GST regulations more efficiently.

In contrast, MSMEs often struggle to meet the same compliance standards while maintaining competitive pricing. The increased formalization of the economy has also exposed many small businesses to competition from larger and more organized players in the market. As a result, some MSMEs face difficulties in sustaining their market share and profitability under the new tax environment.

5. Procedural Complexity and Administrative Difficulties

Despite efforts to simplify taxation, the GST system still involves several procedural complexities that create challenges for MSMEs. Requirements such as e-way bills for goods transportation, reconciliation of

purchase data, invoice matching, and periodic return filing add multiple layers of administrative responsibility. Errors in documentation or delays in filing returns can result in penalties and legal complications.

These administrative requirements divert time and attention away from core business activities such as production, marketing, and customer service. For small enterprises with limited manpower, managing these additional regulatory responsibilities can become a significant burden.

Problems in Fulfilling GST Compliances

The GST onboarding process for MSMEs is still impeded by procedural hurdles, even if digital compliances have been made to run more smoothly. In particular, problems with GST compliance systems have been identified, including an increased compliance burden and negative impacts on performance. The shift from informal to formal processes has disrupted existing systems, leading to severe implications for small enterprises and workers. Despite the good outcomes in terms of more tax revenue, a bigger tax base, and better compliance transparency, these effects have been mitigated.

Every state has its own unique registration requirements for different types of businesses. Also, you have to put in a lot of effort to do yearly consolidations. Invoices must be uploaded monthly and returns must be filed quarterly using the GSTR-3B form. To minimize fines, it is vital to execute accurately and on time.

Inconsistencies in reporting and reconciliation of GSTR-2A purchases may greatly impair the working capital cycles of MSMEs. Incomplete paperwork, late vendor bills, irregular supplier return filing, etc., make it difficult for MSMEs to get the input tax credit that is available under GST. It may be a significant financial and logistical burden for MSMEs to implement qualified personnel and accounting software in order to ensure compliance.

Operational and Financial Constraints of GST on MSMEs

The implementation of the Goods and Services Tax (GST) has created several indirect operational and financial constraints for Micro, Small, and Medium Enterprises (MSMEs) in India. While GST was introduced with the objective of simplifying the indirect tax structure and improving transparency, its transition has significantly affected the functioning of small businesses. MSMEs often operate with limited resources, informal management structures, and minimal technological infrastructure. The introduction of a complex digital tax framework has therefore generated several indirect pressures that influence their day-to-day operations and long-term sustainability.

One of the key operational constraints arising from GST is the shift from traditional manual accounting practices to a completely digital compliance system. Businesses are now required to upload invoices, reconcile transaction data, and file returns through the GST portal. This transformation has increased the administrative workload for MSMEs and forced many enterprises to adopt accounting software and professional tax services. For small firms that previously relied on simplified tax procedures, the transition to a digital environment has required additional financial investment in technology and employee training. Consequently, many MSMEs experience higher operational costs while trying to meet the compliance standards of the GST system.

Another significant indirect impact is the uncertainty associated with input tax credit reconciliation. Under GST, the ability of a business to claim input tax credit is dependent not only on its own compliance but also on the compliance behavior of suppliers. If suppliers delay filing their GST returns or fail to upload accurate invoice details, the purchasing MSME may face difficulties in claiming the eligible tax credit. This dependency creates financial uncertainty and complicates working capital planning. Since MSMEs generally operate with limited liquidity and rely on quick turnover of funds, any delay in credit reconciliation can disrupt production cycles and reduce operational efficiency.

GST has also indirectly intensified competitive pressure within the market. Large corporations and well-organized firms possess stronger technological infrastructure, dedicated compliance teams, and greater financial capacity to manage GST procedures effectively. These organizations can take full advantage of interstate trade opportunities and input tax credit mechanisms provided under the GST regime. In contrast, many MSMEs struggle to maintain the same level of compliance efficiency due to limited resources. As a result, smaller enterprises may find it difficult to compete with larger companies that are better equipped to operate within the new tax environment.

In addition, regulatory requirements such as e-way bills, invoice matching, and periodic reconciliation processes have increased the documentation burden on MSMEs. These procedures require careful monitoring and timely submission of information to avoid penalties or disruptions in the movement of goods. For small enterprises that operate with minimal administrative staff, managing these additional regulatory tasks consumes valuable time and effort that could otherwise be devoted to business development activities.

FINDINGS

The analysis of secondary data indicates that the implementation of GST has created multiple structural and operational challenges for MSMEs in India. One of the key findings is the significant increase in compliance requirements under the GST regime. MSMEs are now required to maintain digital records, generate GST-compliant invoices, and file multiple returns within strict deadlines, which increases administrative workload and compliance costs. Many small enterprises lack the financial capacity to maintain dedicated accounting systems and therefore depend on external professionals, increasing their operational expenses.

Another important finding relates to working capital constraints faced by MSMEs due to delays in input tax credit adjustments and refund processes. Since MSMEs typically operate with limited financial reserves, any delay in claiming tax credits directly affects their cash flow and day-to-day operations. Additionally, the dependence on supplier compliance for input tax credit reconciliation creates financial uncertainty for small businesses.

The study also reveals that the technology-driven nature of GST has created adaptation challenges for many MSMEs, particularly those located in rural and semi-urban regions where digital infrastructure and technical expertise remain limited. The requirement to adopt accounting software, maintain online transaction records, and regularly interact with the GST portal has increased both financial and technical pressures on small enterprises.

Furthermore, GST has intensified competition in the market by enabling large corporations to operate more efficiently across multiple states. Larger firms possess better financial resources and technological infrastructure, allowing them to manage compliance procedures more effectively. As a result, many MSMEs face difficulties in sustaining their competitiveness within the new tax environment. Overall, the findings indicate that while GST has introduced a standardized tax structure, its implementation has created significant compliance, financial, and operational challenges for MSMEs.

CONCLUSION

The implementation of the Goods and Services Tax (GST) represents a major transformation in India's indirect taxation system, aimed at improving transparency and establishing a unified national market. However, the findings of this study highlight that the transition to the GST regime has created several challenges for Micro, Small, and Medium Enterprises (MSMEs). Due to their limited financial resources, technological capacity, and managerial infrastructure, MSMEs have faced considerable difficulties in adapting to the new tax framework.

The study demonstrates that GST has increased compliance responsibilities through mandatory digital filings, detailed documentation requirements, and multiple tax return submissions. These requirements have raised administrative costs and created operational complexities for small businesses. In addition, delays in input tax credit adjustments and refund processes have placed pressure on the working capital of MSMEs, affecting their liquidity and business continuity. The need for technological adaptation, including the use of accounting software and online compliance systems, has further increased the financial burden on small enterprises.

Moreover, the GST regime has intensified market competition by enabling large corporations to expand their operations more efficiently across different regions. Large firms are better equipped to manage compliance requirements and benefit from interstate trade opportunities, which places MSMEs at a competitive disadvantage. As a result, many small enterprises face difficulties in sustaining profitability and maintaining market presence under the new tax system.

In conclusion, although GST was introduced with the objective of simplifying taxation and strengthening economic integration, its implementation has created several operational and financial constraints for MSMEs. Therefore, policy measures aimed at simplifying compliance procedures, improving digital support systems, and providing financial assistance are essential to ensure that MSMEs can successfully adapt to the GST framework and continue contributing to economic development and employment generation.

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