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The Impact of GST Bill on SMEs' Bottom Line

The MSME sector which contributes to 40% of Indian exports is about to go bigger with the recent spate of reforms. Today, through various government and RBI led initiatives the financing for SMEs have progressed. A recent Credit Suisse report states that the SME Loan Market is estimated to grow $3,020 billion over the next decade. This brings good tidings to the existing and seedling SMEs in India. RBI reforms like guidelines on purchase and sale of priority sector lending certificates (PSLC) helps promote efficient lending practices for SME sector.

Upcoming government plan of rating MSMEs on 50 parameters will enable the sector to improve quality of manufacturing and gain a foothold in the international market. Other government led initiatives such as setting up of Bankruptcy Bill will enhance the ease of doing business for SMEs. All these reforms paired with the government pushing for passing the GST bill this monsoon session of Parliament, ensures a strong backing to the SMEs in India.

WHAT IS GST?

Goods and Services Tax (GST) is expected to revolutionise the Indian tax system and is the biggest tax reform since Independence. It will integrate and simplify the process of indirect taxation and will replace the complicated taxes such as State Value-Added Tax (VAT), Central Excise, Service Tax, Entry Tax or Octroi and other indirect taxes.

GST is levied on supply of goods and services and it combines other taxes such as state/local tax, entertainment tax, excise duty, surcharges, octroi, etc. It will be applicable on transaction value which includes packaging, commission and other expenses incurred during sales.

It will bring uniform taxation across country and will allow full tax credit from inputs and capital goods on procurement which can later be set off against GST output liability. The reform gives equal footing to the big enterprises and SME alike and removes the tax differentiation on stock transfer

On the other hand, under the current system, VAT is levied partially at state and central level and at multiple points which creates a cascading effect. Due to which the manufacturer has to shell out towards huge tax aggregates that is not sustainable in the long run. GST is aimed to simplify such tax hurdles and will be ultimately borne by the customer.

Salient Features of GST

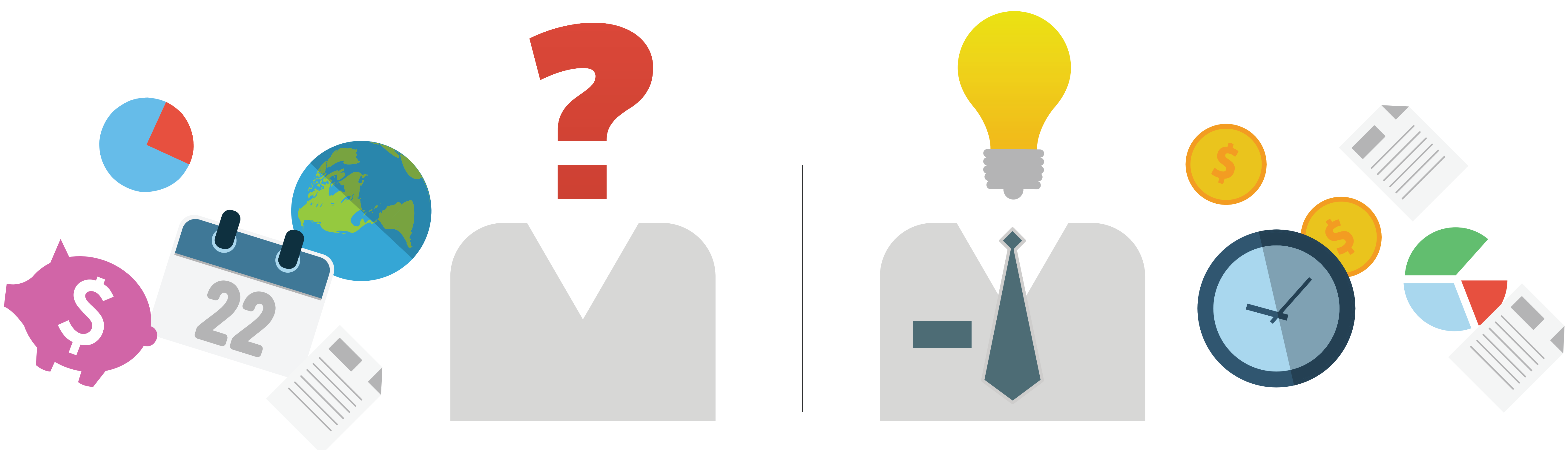
1. Applicable to both intra-state and inter-state transactions
2. Applicable at the time of supply
3. Administration at Central and State level
4. Follows a two-rate structure
5. Levied on import of goods and services into India

VAT vs GST

The following illustration will give a gist of calculation under the VAT and GST and the flow of tax burden.

Manufacturer to Customer	VAT	GST
(A) Cost of Production	100000	100000
(B) + Profit Margin	50000	50000
(C) Producers Basic Price (A+B)	150000	150000
(D) +Central Excise Duty @ 12% of C	18000	N/A
(E) C+D	168000	150000
(F) VAT @ 12.5% of E	21000	N/A
(G) +Central GST @ 12% of E	N/A	18000
(H) State GST @ 8% of E	N/A	12000
Total Sale Price	**189000 (C+D+F)**	**180000 (E+G+H)**

*The calculation above is only an illustration, GST rates are yet to be finalised.



THE IMPACT OF GST ON SMES

The Good

GST boosts competitiveness of SMEs. They will benefit as follows:

Starting business becomes easier:

Currently, the Sales Tax department has various turnover slabs which require VAT registration. A business with multi-state operation in this case has to follow varied tax rules applicable to different states. This not only creates excess complication but also adds to procedural fees, due to which the price sensitive SMEs will be burdened. Uniform GST will standardise the process.

Improved SME market expansion:

In the current system, big corporations procured goods based on SME locality in order to reduce overheads. Thus SMEs limit their customers within state as they will bear the ultimate burden of tax on interstate sales, reducing their customer base. With implementation of GST, this will be nullified as tax credit will transfer irrespective of location of buyer and seller. This allows SME segment to expand their reach across borders.

Lower logistical overheads:

As GST is tax neutral it will eliminate time consuming border tax procedures and toll check posts and encourage supply of goods across borders. According to a CRISIL Analysis, the logistical cost for companies manufacturing bulk good will be reduced by around 20%. Such costs can be crucial for the survival of SMEs.

Aids SMEs dealing in sales and services:

GST will not distinguish between sales and services. This is good news for the SMEs that deal with sales and services model of business, for them the taxation is simplified and will be calculated on total.

Unified market:

GST will allow flexibility in transfer of goods across states and reduce the cost of doing business, as the reform will cut down multiple taxes imposed by state and central government.

The Not So Good

While the SMEs will enjoy the tax neutrality, reduction in duty threshold is one of their main concerns in warming up to the GST bill.

The burden of lower threshold:

The GST bill proposes a reduction in threshold to be around Rs. 10 lakhs to increase the tax net, Rs. 5 lakh for North Eastern states. Under the reform, any service provider or retailer will be subject to tax levy. In the current central excise law threshold is Rs.1.5 crore. This reduction will significantly impact the SMEs' working capital.

For example, a manufacturer who trades today at Rs. 25 lakhs without any tax levy will be expected to pay GST post implementation. As the threshold is low, most MSMEs are now exempted and will have to pay a chunk of their capital towards tax in future.

No tax differentiation for luxury items and services:

The tax neutrality won't differentiate luxury goods and normal goods. Currently the state and central government levy higher taxes on luxury goods and services. Under GST implementation, all goods and services will have to pay the same tax. Which will lead to rich becoming richer and poor becoming poorer. It is not an ideal situation for SMEs competing against large businesses.

Increase in cost of product:

SMEs that supply to the end customer will be the ones to suffer. GST which will ultimately be levied on supply, will not be available for input credit. This will increase the cost of the product.

Selective tax levying:

The industry rumours suggest that GST will not be applicable to alcohol and petroleum based businesses, which creates further gap and does not support the 'unified market' ideology of GST.

Industries That Will Be Affected

- Online Retail
- Dealers
- FMCG
- Imports & Exports
- Logistics
- Manufacturing
- Pharmaceuticals
- Textiles
- Services
- Infrastructure
- Supply Chain
- Telecom
- IT & IT components
- Hospitality
- Warehousing
- Energy
- Transportation
- Retail

THE WAY AHEAD

Every major reform is faced with certain hurdles, and arguments from various stakeholders. However, from an SME perspective, GST will bring in many positives compared to the current systems such as easy process of availing input credit, single point tax, elimination of cascading tax system, and simpler taxation. These pros offset the negatives.

While hopes rests with GST to boost the GDP growth and reduce the fiscal deficit. The extent of such impact will depend on a favourable consensus on GST rates for all business segments and integrated implementation of the same.

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About Kotak Mahindra Bank Limited

Kotak Mahindra Bank Limited (KMBL) is a foremost banking and financial services company. It was established in 1985 as Kotak Mahindra Finance Limited and in 2003, became the first non-banking financial company (NBFC) in Indian corporate history to be converted into a bank.

Our professionals leverage the financial scenarios of the world and aid our customers and clients with extensive banking services. The Kotak Group offers comprehensive personal finance solutions from commercial banking, to stock broking, mutual funds, general and life insurance. The bank offers transaction banking, operates lending verticals, manages IPOs and provides working capital loans.

Kotak's footprint across the country consists of 684 branches, 1273 ATMs, covering 379 locations. With a vision to be the most preferred employer, and the most trusted financial services company, KMBL professionals reflect the ethos of the organization to deliver award-winning services. The KMBL symbol is representative of the infinite number of ways we meet our clients' needs, while maintaining a uniquely global Indian personality.