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A Deep Study of the Impact of Goods and Service Tax (GST) on Small Scale Business with New Tax Rates

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Abstract: *The Goods and Service Tax (GST) introduced in India on 1st July 2017, represented one of the most significant indirect tax reforms in the nation's history. It aimed to replace multiple indirect taxes with a single unified tax structure, simplifying compliance and fostering a common national market. While the reform presented the opportunities such as elimination of cascading taxes, Input Tax Credit (ITC) benefits, and enhanced interstate commerce, its full impact particularly on small scale businesses- remain mixed. This paper explores the effects of GST on micro, small and medium enterprises (MSMEs) with emphasis on the latest GST rate reforms introduced from September 2025 onwards, which rationalized GST slabs into simpler tiers (primarily 0%, 5%,18% and special 40% for luxury goods.) aiming to further ease compliance and tax burdens.*

Keywords: Input Tax Credit, Tax structure, cascading taxes, MSMEs

I. INTRODUCTION

1.1 Background

India's Indirect Tax system prior to 2017 was a mosaic of central and state taxes such as excise duty, service tax, value added tax (VAT), octroi, entry taxes and more resulting in a cascading effect where taxes were levied on top of taxes, burdening businesses, especially smaller ones with limited resources. GST was conceptualized as a "One Nation, One Tax" system to address this fragmentation and create a harmonized tax system.

Under the original GST regime, taxes were levied at multiple rates- 5%, 12%,18% and 28% depending on the type of goods and services. The new reforms effective from late 2025 restructured this into primary slabs of 5% and 18% (For most goods and services), with 0% for essential items and a 40% slab for specific luxury and sin goods, simplifying the structure and aiming to boost competitiveness for MSMEs.

II. LITERATURE REVIEW

2.1 GST and Compliance Trends

Riya Goel and V.N.Sharma characterized GST as a transformation reform with both positive and negative outcomes for small and medium enterprises (SMEs). They argue that while GST reduced tax cascading and encouraged transparency, the compliance burden disproportionately affected micro enterprises due to complex filings and digital requirements. A study on MSMEs using advanced data analysis techniques found that GST influenced operational costs, compliance, revenue Patterns, and long term sustainability positively but required adaptation to digital systems and paperwork.

2.2 Secretarial and Case Study Perspectives

Multiple empirical works highlight that smaller firms initially struggled with adaptation due to compliance costs, lack of awareness, and IT infrastructure deficits. On the other hand, medium enterprises were often able to leverage GST's interstate ease of doing business to expand market reach.

Case studies show that GST's effectiveness varied significantly by sector. In some manufacturing clusters and organized retail, operational efficiency improved post GST. However in agriculture linked and unorganized sectors, subjective compliance and rate mismatches posed challenges.

2.3 GST adoption & Business Performance Metrics

Quantitative research employing Partial Least Squares Structural Equation Modeling (PLS-SEM) indicates that relative advantage, complexity and compatibility of GST adoption significantly influenced business performance, with employee trust acting as a moderating factor. Findings reveal a positive impact on financial performance when adoption is aligned with internal organizational support.

A cross-sectional survey reported that determinants such as technology adaptation and tax awareness significantly enhanced operational efficiency and profitability for MSMEs, while reducing working capital blockage.

III. METHODOLOGY

3.1 Scope and Objectives:

This paper adopts a descriptive analytical approach using secondary research, policy documents, peer reviewed journals Government Of India publications, GST council announcements and relevant economic analyses. The primary objectives are:

* To critically evaluate the effects of GST on small scale businesses.
* To assess the role of new GST rate reforms (Post 2025) on MSME performance.
* To examine compliance challenges, cost implications and strategic responses.
* To provide policy recommendations for optimizing GST's impact on small enterprise.

3.2 Data Sources

This research utilizes:

* Peer reviewed articles on GST and MSMEs.
* Government reports and GST Council notifications.
* Industry analyses on GST reform impacts.
* News citations capturing evolving GST enforcement and reforms.

IV. GST STRUCTURE AND REFORMS

4.1 GST Tax Slabs (Pre-2025)

Originally, GST in India operated under a four-tier system- 5%,12%, 18%, and 28%. Essential goods and services largely attracted 5%, middle range goods/utilities attracted 12-18%, and luxury items attracted 28% or higher with cess.

4.2 Major Rate Rationalizations (2025-26)

Reforms effective from September 22, 2025 simplified GST into:

* 0% GST for basic essentials. (e.g. bread, staple groceries.)
* 5% GST for merit goods and daily use items.
* 18% GST as a standard rate for most goods and services.
* 40% GST for designated sin and luxury goods.

This simplification eliminated the 12% and 28% slabs, aiming to reduce complexity and broaden the tax base.

4.3 Policy Goals of the GST Reforms:

The latest reforms aimed to:

* Simplify tax compliance by reducing multiple slabs.
* Lower tax burden on broad categories to stimulate consumption.
* Expand formalization and tax base by making compliance easier.
* Enhance MSME competitiveness by reducing cascading and rate mismatches.

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V. ANALYSIS: IMPACT ON SMALL SCALE BUSINESS

5.1 Positive Impacts

5.1.1 Unified Tax System

By replacing multiple indirect taxes with GST, small businesses benefits from a single, transparent system, reducing litigation and ambiguity in taxation, and improving clarity in pricing and accounting practices.

5.12 Input Tax Credit (ITC)

GST enables businesses to claim ITC on purchase taxes paid earlier in the supply chain, effectively reducing their net tax outlay and eliminating cascading tax effects. This has positively impacted working capital flows for compliant firms.

5.1.3 Interstate Trade Ease:

Under GST, small firms can sell interstate without multiple permits and checks, enhancing market reach beyond state borders- a significant driver of MSME growth.

5.1.4 Simplified Return Filing for Small Taxpayers:

The introduction of simplified returns for small taxpayers and composition schemes allow eligible small firms to pay tax at a flat rate on turnover and file fewer returns.

5.1.5 Rate Rationalization Benefits:

The recent GST restructuring- lowering slabs for essentials and smaller items- helps small retailers and manufacturers reduce operating costs and price products more competitively. Sectors like FMCG, clothing and parts Manufacturing particularly stand to benefit due to lower taxes.

5.2 Negative Impacts

5.2.1 Compliance Burden

Small businesses, often with limited administrative capacity, face significant compliance costs tied to monthly/quarterly tax filings, invoice matching, and digital bookkeeping requirements.
Many must hire accountants or purchase software, increasing operating expenses.

5.2.2 IT Infrastructure Constraints

GST Compliance is digitizes and dependant on the GST Network (GSTN). Small firms in rural or under-served areas face challenges adapting to e-filing, e-invoicing, and frequent portal updates, leading to errors, penalties, or delayed filings.

5.2.3 Cash Flow & Refund Delays

For businesses with high input costs, delays in GST refund processing can block significant working capital, more acutely affecting small printers and low-margin sectors.

5.2.4 Rate Mismatches and Sect-oral Problems

Despite rationalization, sector specificissues persists. Some raw materials may attract higher GST than finished goods, causing inverted duty structures and cash flow challenges for manufacturers and artisans.

VI. CASE EXAMPLES AND SECTOR INSIGHTS

6.1 Micro retailers and E-Commerce Sellers

Small online sellers often file returns for each state, even with low turnover, due to GST registration thresholds not uniformly applying, increasing administrative overheads.

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6.2 Artisanal and Craft MSMEs

While lower GST rates help pricing, many handicrafts units faced higher taxes on raw materials post rationalization, marginalizing profit margins.

6.3 Services and Startups.

Services oriented small firms find GST rates of 18% challenging, as pricing pressures remain high. However, clearer compliance coupled with improved documentation practices enhances credibility with large buyers.

VII. POLICY RECOMMENDATIONS

1. Increase Threshold for Mandatory GST Registration :

Raising the threshold (Currently Rs.40 Lakh for goods and Rs.20 Lakh for services in many states) could reduce compliance load on micro businesses.

2. Focus on Digital Literacy and Support:

Government assisted training and subsidized compliance software for small firms could help reduce reliance on expensive accountants.

3. Timely Refund Processing:

Streamlining refund protocols to ensure speedy ITC refunds prevents working capital blockages.

4. Sector-Specific Tax Shelters:

Design exemptions or concessional rates for industries with input-output mismatches. (e.g. printing, leather goods.)

5. Simplify Return Filings Further:

Introduce annual or consolidated return options for small tax payers to reduce frequent filings.

VIII. CONCLUSION

GST has fundamentally transformed India's indirect taxation landscape. For small scale businesses, it has brought clarity, unified taxation, ITC benefits, and an easier interstate marketplace. However, compliance costs, digital adaptation challenged, refund delays, and sectoral mismatches remain significant issues, particularly affecting micro enterprises and low margin sectors.

The latest GST reforms (2025) simplifying rate slabs and reducing tax burdens for essentials and many goods are promising developments that potentially improve competitiveness and consumption. Yet, to fully realize GST's promise for small businesses, successful adaption, supportive policy enhancements, and targeted capacity building initiatives are necessary.

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