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October 05th, 2016

Mr. Surendra Nath Tripathi
AS & DC
Ministry of MSME
Government of India

Dear Mr. Tripathi,

Subject: FICCI-CMSME: A brief note on impact of GST on MSMEs

Greetings from FICCI-Confederation of MSMEs (FICCI-CMSME)

This is with reference to our brief discussion at Secretary, MoMSME office and your request to us for sharing a note on impact of GST on MSMEs.

As desired, I am pleased to enclose a brief note on the subject for your kind reference & use. I hope you may find it useful.

Also as discussed, we would be happy to partner with your office to conduct sessions on GST to create awareness among MSMEs. We would be happy to come to your office at a mutually convenient date and time to discuss this further.

Looking forward to hearing from you.

Yours sincerely,

(Sanjay Bhatia)

Enclosures: Note on impact of GST on MSMEs

A brief note on impact of GST on MSMEs

The Government of India is working towards rolling out GST which will simplify and harmonize the indirect tax regime in the country as introduction of GST will do away with multiplicity of taxes at the State and Central levels which has resulted in a complex indirect tax structure. GST will foster a common or seamless Indian market due to seamless transfer of input tax credit from one stage to another in the chain of value addition. Hence, GST will open up the market for all the units irrespective of the State where they operate from.

Though MSMEs welcomes and are looking forward to the rollout of GST regime, there are certain positive and negative aspects within the GST Model Law that the MSMEs have brought to our notice during our interaction with them. The same are being highlighted below:

1) Exemptions provided to MSMEs under the current regime are exemption from Vat registration upto 20 lakh turnover; 1.5 crore Excise duty exemption, 10 lakh Service tax exemption, etc.All these exemptions will not be available as all these taxes will be subsumed under GST and the threshold limit for exemption proposed under the GST is upto 20 lakhs in general and 10 lakhs only for North East (Replace with the figures as now agreed by GST Council). This will definitely impact those MSMEs who were availing these exemptions as they would now have to pay taxes and their competitiveness may get affected. Besides, small and marginal traders will have to face hardship on account of the rigorous record-keeping and compliance requirements anticipated under the GST.

2) Clarity on the current exemption schemes (area based exemptions, incentives under State policies) is required because the transition provisions prescribed under the draft law do not provide for the treatment of the said Exemptions/ Incentives. Companies' long term business plans are based on Government incentives. To maintain continuity, incentive also should be continued in GST scenario.

   The existing model of tax exemption and other fiscal and financial incentives allow such units to compete with the other units situated in developed areas. Under the proposed GST if such units are obligated to pay taxes on inputs/capital goods this would impact their working capital severely and would add to financial burden.

3) Under the proposed legislation (GST), a service provider operating in various states will have to obtain registration in each state. This will not only increase the burden of obtaining so many registrations but will also increase the compliance burden manifold. On a rough estimate, service provider operating in many states will have to file 4.5 times more returns than being currently filed under service tax and VAT taken together. This is because, 3 returns per month (and an annual return) are proposed to be filed under GST regime for every registration whereas currently much lesser number of returns are required to be filed under centralized service tax registration and VAT taken together for Service tax the return has to be filed half yearly; for Excise it is monthly and for VAT it is to be filed quarterly. Hence, the compliance cost for MSMEs will increase manifolds.

   Also under the GST legislation the returns have to be submitted online. Currently, it can be submitted manually in hard copies. Hence, the clause specifying online submission of returns in GST would mean that MSMEs has to upgrade his knowledge, he has to be computer literate and should know how to file the return online or he would be compelled to engage some service provider for which he would have to shell out from his limited resources.

4) It is understood that there will be two separate authorities for administration of the GST laws (separately for CGST and SGST). There is, therefore, a possibility that assessments, audit scrutiny, enforcement and other related functions would be carried out independently by the Central and State authorities. It also remains unclear whether show cause notices would be issued separately by the Central and State agencies for the same assessment / offence and whether there will be separate adjudication and appellate authorities.

   All the perceived advantages of the proposed indirect Tax reform would be lost and the new tax regime will be a nightmare if the taxpayers are required to deal with two sets of assessment/audit/enforcement agencies.

5) Under GST all along the Chain Credit will be available ascurrently it is available only in excise. MSMEs generally tend to operate in the same State because they not only have to comply with the tax requirement within the State but also have to deal with tax compliance of the other State like first CST and thentax deposit with that State. Thereby increasing their burden of filling forms, etc.

   Now under GST, MSMEs will be able to reach out to the whole country in the sense that MSMEs will find it as easy or as difficult to sell their products across the States Vis a Vis their own State. There will not be much difference in compliance and only IGST component will be added where in MSMEs seamlessly will be able to sell their products and also avail credit. Hence, because of this one nation one market the restrictive area of operation of MSMEs due to various compliances, etc will open and they will be encouraged to sell their products across borders, the hassle of filling forms will be minimized as the documentation which will be required within the State the same would be required outside the State and also the tax quantum will also be almost the same.

6) The implementation of GST would discourage Companies/units to procure from MSMEs who are not registered under GST as credit will be universally available because under GST scope of input tax credit will increase. Currently, input tax credit availability is limited as it has to be related to the particular line of business/unit. But after GST this provision of credit has been expanded so, large scale units will prefer to buy from someone from whom they could claim credit for the tax paid by him. Person who is not paying tax (exempted category) they may not prefer to buy from them.

7) Power to arrest [Section 62]: Currently, the monetary threshold for tax authorities to carry out arrest for any offence under the provisions of the Central Excise Act, 1944, is Rs. 1 crore, and Rs 2 crore under the Finance Act, 1994, (dealing with the service tax law). The threshold was raised from Rs 50 lakh for service tax to Rs 2 crore in the Finance Act, 2016. However, it is proposed to revert to the Rs 50-lakh threshold to trigger arrest in the model GST law. This will lead to undue harassment for smaller players as 50 lakhs threshold is not much

8) PERSONS AUTHORISED TO ORDER ARRESTS [Power to arrest [Section 62]: Stringent provisions of arrest and prosecution including imprisonment up to five years have been envisaged in the proposed GST law. There are apprehensions based on current experience that authorities may

abuse the power and harass the genuine tax payers. There is high possibility that authorities may adopt arm twisting tactics to extract undue advantage.

9) As per the GST model law Cenvat Credit shall not be allowed after 30th September of next year. However it is recommended that Full credit of all Input Taxes should be available without any time limit. It is the taxpayer's right to claim credit of taxes paid on inputs and it should not be subject to any time limit especially when there is no scope for any abuse or misuse.

10) SUPPLY OF GOODS WITHOUT CONSIDERATION (Meaning and Scope of Supply [Section 3] read with Schedule I): Supply of goods between persons without a consideration is deemed to be a 'supply' under the proposed GST legislation.

    Under the present regime, free supplies are not subject to VAT. These may take the form of free samples for medicines, sale promotion schemes such as 'Buy two, get one free', free supply of the sample of a new product with purchase of an established item, etc. The proposal to tax supplies without consideration will discourage companies from providing free samples which would deny the opportunity for any consumer to test the product and also the retailers to demonstrate the product quality. Consequently, the sales promotion expenses of companies will increase under the GST regime.

11) TREATMENT OF SUBSIDIES/OTHER TAXES FOR DETERMINATION OF VALUE(Value of Taxable Supply [Section 15(2)]): Various State Governments provide incentives to units through different schemes. Some States allow part of the sales tax amount collected to be retained by the manufacturer, some others by way of deferment of collection or otherwise. Section 15(2) of the proposed Model legislation provides that "subsidies provided in any form or manner, linked to the supply" is includable in 'value' for the purpose of the levy. Thus, subsidies received from Government under various Schemes, may be subject to GST levy. No yardstick to ascertain whether such linkage of subsidy to the supplies under assessment is provided.

    Subsidies are given to encourage and incentivize business for the purpose of augmenting industrialization. Charging tax on subsidies is against the basic principle of giving subsidies. Further Govt. Subsidies / incentive may not be related to supply.

    Further all taxes, duties, fees other than GST are proposed to be included in the transaction value. This provision is unreasonable and would result in cascading.

12) TIME LIMITS FOR RETURN OF GOODS (Time of Supply of Goods [Section 12(6)], Exempted goods returned to place of business [Section 148], Duty paid goods returned to place of business [Section 149]):In terms of Section 12(6) as well as the transitional provisions under Sections 148 and 149 of the proposed legislation, goods can be returned within a maximum time period of 6 months.

    In various industries like the ready-made garment industry, the norm is to send goods to Consignment Sales Agents (CSA) and customers on a "sale or return" basis. The norm in such industries is that the CSAs / customers return the goods after the season is over. Consequently, in numerous cases the return of goods happens well after a period of 6 months from date of original removal. Moreover, procedures for enabling such returns appear to be cumbersome.

13) Advances received against supply of goods and/or services are taxable on receipt basis. Levy of taxes on advances is questionable. Advances received if any, should not be liable to GST merely because some amount has been given against future supply of goods or services. Terms of payments should have no bearing on the point of taxation. Moreover, it is possible that advance may have been received for intra-state as well as inter-state supplies of goods and services. It may be difficult to determine at that point of time whether such an advance would be liable to CGST and SGST or IGST. It is also possible that the receipt of goods or services may be beyond the time limit prescribed for availment of ITC. If however, it is specifically provided in the proposed GST law that advance payment of any kind for whatsoever purpose shall be taxable, it should also be provided that credit of tax paid on advances will be eligible immediately on receipt of advances without subject to further condition of supply of goods/services. This will also minimize issues of additional funds requirement.

14) Manner of taking input tax credit in respect of inputs sent for job work [Section 16A(2)] : Section 16A(2) of the draft law provides the time limit of two years by which the principal has to receive back the capital goods on which he has taken credit and are sent to the job-worker. As per this clause the issue will arise where dies and moulds given by a manufacturer to another manufacturer for production of goods as per his specifications and also the dies are given by the principal manufacturer to the other manufacturer for the full term of its useful life. Thus the condition of receiving back of the dies after two years would be practically very difficult to implement.

15) RESTRICTIONS ON ISSUE OF CREDIT AND DEBIT NOTES[Section 24]: Sub-sections (1) and (2) of section 24 specify a time limit within which the credit notes or debit notes respectively can be issued for making adjustments in the taxable value or the tax charged vis-a vis the tax invoice issued earlier. Such adjustments can be made up to the 30th September following the end of the financial year in which such supply was made or the date of filing the annual return, whichever is earlier. The prescribed time limit is considered to be short particularly for adjustments in respect of tax invoices issued in the month of March. Apart from rectifying errors, in many cases such instruments have to be issued to reflect re-negotiated prices which can take time.

    Proviso to Section 24(1) provides that no credit note shall be issued by the said person if the incidence of tax and interest on such supply has been passed by him to any other person. The intention behind the proviso is fair in as much as it denies the adjustment of tax credit if the quantum of excess credit has already been passed on. It is however, against the basic principle of transactions. If issue of a credit note is a commercial requirement, it should not be denied though the adjustment of tax credit can be declined.

    Further, transactional errors can be rectified not necessarily by issue of credit/debit notes alone; some businesses resort to issue of revised invoices to rectify errors/reflect re-negotiated prices. Further adjustments in several invoices by issue of a single credit/debit note are also in vogue.

16) Matching, Reversal and Reclaim of input tax credit [Section 29]: Manner of resolving the mismatch between the details of outward and inward supplies uploaded on GST Network (GSTN) is unfair to the recipients. Shifting the onus on the buyer to check whether the seller has paid goods and service tax (GST) is the most onerous provisions in the draft Model GST Law. The draft provides that a buyer shall not be entitled to claim an input tax credit (ITC) unless the tax charged in respect of such supply has been paid by the seller. In simple terms, ITC is the amount of tax paid by the

buyer on purchases made by him for which the buyer is entitled to claim a credit against the sales subsequently carried out by him. It will be impossible for a buyer to ascertain whether the payment has actually been made by the seller.

The draft law prescribes for a GST compliance rating score, which would be given to all taxpayers (including sellers). The parameters of such rating are yet to be defined. The rating would be available in public domain, so to this extent a buyer could avoid dealing those having a poor rating. However, the rating has little or no value, as it doesn't absolve the buyer from ascertaining that the payment has been made by the supplier.
If the mismatch between the details of outward and inward supplies uploaded on the GSTN is not rectified by the vendor in the month of communication of the same to the recipient, the recipient will be liable to pay the differential GST along with interest in the subsequent month.

As per the provisions of the proposed law, ITC itself would become a cumbersome process altogether considering the fact that there would be a large number of small suppliers who may not be such techno friendly to file the return accurately etc. and because of their non-compliance, buyer would have to suffer.

These kind of provisions would completely erode the business of small dealers because nobody would like to deal with small scale businesses due to the inherent fear of non- compliance by them and in turn this would lead to more dependency on large players and therefore, could create a situation of monopoly in the market.

Large tax payers will have voluminous data in the return. Quantum of mismatch may also be high.

17) Matching, reversal and reclaim of reduction in output tax liability [Section 29A]: Registered person may issue credit notes to the unregistered person or dealer (URD) under composition scheme. Since URD/ composition dealer are not required to either upload any return or upload invoice wise details, the online matching will not be possible for such credit notes and tax benefit of credit note will be lost.

18) Annual Return [Section 42(4)]: Every taxable person who is required to get his accounts audited under sub-section (4) of section 42 shall furnish, electronically, the annual return along with the audited copy of the annual accounts and a reconciliation statement, reconciling the value of supplies declared in the return furnished for the year with the audited annual financial statement, and such other particulars as may be prescribed.

Reconciliation of Annual Return with the audited Annual Financial Statement is not possible since the annual GST Return will be drawn up for the operations of a Business in the particular State whilst the Annual Financial Statement is drawn up for the entire entity, i.e., Business – spanning all operations within and outside the country.

Also it would become mandatory for MSEs to get their accounts audited whereas in the Union budget the 2016-17 threshold limit of the turnover for calculating presumptive tax was increased from 1.5 crore to 2 crore. Hence, this benefit may also go away.

19) COLLECTION OF TAX AT SOURCE BY E-COMMERCE COMPANIES: Sections 43B and 43C Section 43C of the draft Model GST Law requires every electronic commerce operator to collect an amount out of the amount payable to a supplier representing consideration towards the supply of goods or service at such rates as may be notified and deposit the said amount to the credit of the appropriate government in the prescribed manner (a sort of Tax Collected at Source – TCS provision).

The entire draft of GST law is sector/industry agnostic and same law is prescribed for all industries uniformly except for e-commerce sector. Model GST law prescribes stringent and more onerous compliance requirements for e-commerce players.
TCS provision is discriminatory in nature, as the obligation of tax collection at source is cast in respect of supplies made through e-commerce market place model only, while the retailers supplying goods and services from a brick and mortar structure or e-commerce operators selling their own inventory are not saddled with such encumbrances.

Registration: As is evident from section 19 read with Schedule III para 5 (viii) and (ix), any supplier who supplies goods / services through an e-commerce operator is required to obtain registration under the GST Act irrespective of the threshold prescribed in para 1 to Schedule III. In this regard, it is pertinent to note that the e-commerce marketplace caters to thousands of small and medium enterprises ('SME') and several of which may be way below the prescribed threshold for obtaining registration. Such a requirement of seeking registration is discriminatory and unreasonable.

Excess input tax credit: As the amount of TCS paid is credited to the account of the seller, this could lead to refund situation and blockage of working capital for thousands of sellers who conduct business on very low margins. The refund of GST credits is only provided in situations of export or inverted tax structure and therefore the sellers could be saddled with additional costs in the form of non-refundable tax credits and which itself is against the very spirit of GST.
In the current Model GST Law, there are no provisions relating to refund of the credit accumulated on account of TCS.

Matching of data: The ecommerce operators are required to file monthly information returns; the seller-wise data contained therein shall automatically be populated in the sellers' returns. In case of any discrepancy or mistake arising out of this exercise, the supplier shall rectify the discrepancy in his return for the month in which the discrepancy is communicated to him [as per section 43C (7)]. However, there is no provision for rectification of statements furnished by an ecommerce operator. Hence, if discrepancy is at the Operator's end and cannot be rectified by the Operator, then the seller would be stuck with the additional liability and even for a transaction he may not have conducted.

As a consequence of the above, the proposed section will cause undue hardship not just for the ecommerce operator but also for thousands of small and medium sellers.
Additionally, this shall also lead to discrimination between other suppliers and suppliers selling through e-commerce operator vis-à-vis applicability of the GST Act merely basis mode of supply, which shall discourage suppliers to transact through ecommerce.

Impact on the SME sellers of ecommerce

- Massive impact on cash flow making it difficult to operate competitively for SMEs

- As the amount of TCS paid is to be credited to the account of the seller, this could lead to a situation of excess input GST credits available which may not be utilizable by the seller.
- Also, a lot of product/ services in which SMEs deal with could be exempt from GST. Even in such scenarios, the operators would be required to deduct TCS from payments made to seller. In such a case also, the sellers (SMEs) would have excess input GST credit
- The refund of GST credits is only provided in situations of export or inverted tax structure and therefore the seller could be left with excess credits that may be unutilized.

20) PROVISIONAL ATTACHMENT OF PROPERTIES DURING PENDENCY OF PROCEEDINGS
Provisional attachment to protect revenue [Section 58]: Where during the pendency of any proceedings, inter-alia under Section 51, the Commissioner is of the opinion that for the purpose of protecting the interest of the Government Revenue, it is necessary to do so, he may by order in writing attach provisionally any property belonging to the taxable person in such manner as may be prescribed which may be effective up to one year.

    Provisional attachment of property will cause undue hardship on the genuine assesse.

21) Presumption of culpable mental state [Section 75(1)]: As per Section 75(1), in any prosecution for an offence under the proposed law which requires a culpable mental state on the part of the accused, the Court shall presume the existence of such mental state but it shall be a defence for the accused to prove the fact that he had no such mental state with respect to the act charged as an offence in that prosecution. Such a provision assumes all the assessees to be of culpable mind and the entire burden to prove the contradictory comes on the assesse.

22) In the model law, imports of goods by STP/SEZ units are not zero rated which would imply paying of GST first and claiming refund later. This would lead to cash flow impact and accumulation of refund for such STP/SEZ units. Even if provisional refund is granted, the refunds could be disallowed during audit leading to litigation which we have in current regime.

    Under present indirect tax laws, supplies made to Special Economic Zone (SEZ)/EOU have been treated as Exports. To avoid similar issues in GST regime, supplies made to SEZs should be expressly defined as Exports and/or Zero-rated in the Law.

23) TRANSITION PROVISIONS-ITC ON CAPITAL GOODS-FACTORIES UNDER CONSTRUCTION:The Model GST law does not contain transition provision which has the effect that CENVAT credit cannot be availed by factories under construction. A factory can obtain registration under excise when it is close to completion, post which CENVAT credit can be availed on capital goods.

    Under current Model GST law, only credit which has been availed can be taken as credit in GST regime. Therefore, factories which have not obtained registration before GST regime will lose the CENVAT credit on capital goods

24) ITEMS SUBJECT TO PRINTING OF MAXIMUM RETAIL PRICE Chapter XXV (Transitional provisions): On date of implementation of GST most manufacturers are expected to have inventory of finished goods on hand which have been cleared from the factory – on payment of central excise duty – to depots for purposes of onward sale. Within this, most packaged goods would carry a declaration (as is required statutorily under the Packaged Commodity Rules of the Standards of Weights and

Measures Act) of the Maximum Retail Price (MRP) at which such goods may be sold to consumers. The MRP would have been set by the manufacturers after factoring in the cost of central taxes like Central Excise Duty and Service Tax and State Taxes like VAT that need to be recovered on sale of the goods.

Sale of such goods under the Standard Rate of GST would result in cascading of taxes since the GST would also get levied on the embedded central taxes.

25) In certain States that levy Entry Tax, the tax so paid is allowed as a set-off against VAT payable on the goods at the time of their sale. On implementation of GST it is quite possible that manufacturers / trade may have stock of finished goods on which Entry Tax has been paid but no set-off is possible due to replacement of VAT with GST.

26) Currently the Model GST Law is silent as to how the various export promotion schemes would be planned further under the proposed GST regime. The process note released by the Government on refunds stipulates that all exemptions will be converted into post-tax refunds. In this scenario, the EOU/STP/SEZ schemes, the advance authorizations, EPCG licences, MEIS/SEIS scrips etc. become redundant under the GST regime as the same are as good as DTA exports. It is also not clear how such licences under operation will be treated during the transition period. In brief the entire import/export incentive policy would collapse under the proposed GST.

27) PENAL PROVISIONS UNDER THE MODEL GST LAW**:** As per Section 62 read with Section 73 of the proposed GST legislation, a Commissioner of CGST or SGST can authorize an arrest of a person if "has reason to believe" that the person has committed any offence punishable under the GST law. The person can be arrested even if such a person has not been issued a show cause notice intimating the alleged violation and even if the investigations are yet to be concluded. It also does not make a difference whether the alleged tax-liability is on account of deliberate tax-evasion or is simply a differential tax liability in a genuine and bonafide dispute.

The Model GST law further enumerates twenty other categories of offences under Section 66 to provide for imposition of penalty in such cases which can be equivalent to tax amount in dispute. A bare look at these categories reveals strikingly resemblance with the existing provisions under the central and state enactments. One does not need reminding the mechanical exercise of these powers to saddle the taxpayers with unwarranted penal consequences in the most deserving of cases. Continuing these provisions under the GST regime is clearly unwarranted.

The Model GST law does carry a stipulation on 'general disciplines related to penalty' in Section 68. A bare look at this provision is sufficient for it to be written-off in as being inherently deficient. It provides against imposition of substantial penalties for 'minor breaches of tax' where a minor breach is defined to mean a case involving tax dispute of less than five thousand. The other regulations under this provision are again directory and do not tie the hands of trigger-happy tax officers.

The Service Tax law carried a simple provision for almost two decades prohibiting imposition for penalty in cases with a reasonable cause for default. Even such a simple provision does not find place in the GST law.

Further, even though the judiciary has contributed significantly in developing tests to identify cases where penalty should not be imposed, those lessons have been ignored in casting the penal provisions. Even cases involving classification disputes, interpretation disputes, etc. where the judicial opinion is firmly settled against imposition of penalty do not find mention in the list where penalties cannot be imposed.

Compared to the penal provisions, the Model GST law only turns draconian when one reviews the provisions relating to criminal liability. Section 73 prescribes twelve categories of prohibited action which can lead a person to prison. Depending upon the amount of tax involved, the person can be sentenced to seven years in prison with a threshold as law as two and half crores of alleged tax-liability. Further, Section 75 of the Model GST law puts the onus upon the person accused of the offence to establish that the alleged offence was unintended. In short the tax officer can lodge a complaint leading to prosecution even in a case where the officer is not required to establish the intent of the accused.

The Model GST law also does not instill the safeguard that the criminal proceedings will be initiated only if it has been proved in the tax proceedings that indeed the claims / actions of the taxpayer were motivated or driven by malafide. In other words, even before the tax liability is crystalized, the taxpayer can be subjected to criminal prosecution under the Model GST law. What is worse in the fact that the law does not specify the officers who can initiate such action. In other words, the sanctity of the jurisdictional officer is also completely eroded under the Model GST law.

On an overall basis, thus, the Model GST law confers disproportionate powers upon the revenue offices in so far as it is highly discretionary upon them to impose penalties or prosecute for offences. There is, thus, no improvement in the proposed GST regime over the existing legal provisions. One would have expected a serious reining-in over the widely abused powers of the investigation officers under the current regime. However the policy-makers seem to have completely ignored this vital aspect in designing the law. The fact that some of these powers will now also be exercised by the State Governments' officers is only an added reason to specifically revisit the policy reasons to continue with such wide powers which are only susceptible of misuse.

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