Latest reforms and SMEs

What is the issue?

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- The government's recent demonetisation drive and the introduction of GST are contributing to the increasing formalisation of economy.
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- However, the plight of SMEs as a result of these large scale reforms is highly uncertain given their nature of operation.
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What are the positive outcomes of recent reforms?

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- Given the record on suspicious deposits after the demonetisation drive, there is optimism with tackling black money.
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- This is because those claiming that the money they deposited was genuine income would pay taxes on this additional income.
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- More importantly, demonetisation and the various policy measures such as the GST have changed peoples' attitudes in using cash.
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- While cash continues to be used for small purchases, many more big ticket purchases are being done in the digital mode.
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- Evidently, transactions via pre-paid instruments and usage of debit cards at PoS machines are increasing.
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- Along with these, the new tax procedure under the GST regime is expected to bring more firms into the formal economy.
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- Resultantly, there is greater awareness that the government was monitoring larger transactions and it was getting harder to not pay taxes or file returns.
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- All these reforms and the resultant developments should certainly help boost

tax revenues.
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What do these mean for the SMEs?

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- **Cash Shortage** - The economy has been disrupted, first by the acute shortage of cash in the economy and subsequently by GST reforms.
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- The operations of small and mid-sized units which typically transact in cash were almost paralysed by the cash shortage.
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- **Tax Compliance** - The GST rules are now being changed to accommodate the interests of smaller businesses as well.
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- However, there are many firms that were earlier not paying a central excise duty, a VAT or a service tax, but will now need to do so.
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- If these tax incentives and exemptions offered the main competitive advantage for these firms in the past, their future in the business space now seems to be at risk.
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- **Formalisation** - The process of formalisation means that SMEs would find it easier to get credit, and at lower rates.
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- However, being in the formal economy also entails other unfavourable costs such as higher wages, EPFO deductions, etc.
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- They could choose not to get formal, but in a post-GST world the larger companies may stop sourcing supplies from them.
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- In the long term, it is obvious an economy cannot afford to have enterprises outside the tax bracket when the system is being increasingly formalised.
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- However, it is evident that the cost of timely disruption is huge for the SMEs and, this will have an impact on both output and jobs.
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Source: Financial Express

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