

# TAX ACCOUNTING FOR MSMEs IN THE POST-COVID ERA: A GUIDE TO NAVIGATING THE NEW TAX LANDSCAPE

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## Abstract

MSMEs are the backbone of the Indian economy and have been disproportionately affected by the COVID-19 pandemic. The Indian government has introduced several tax reforms in recent years to support MSMEs. The government has reduced the GST rates for a number of goods and services that MSMEs commonly use. This paper provides an overview of the key tax changes that have been announced for MSMEs in the post-COVID era. It also covers the key tax accounting considerations that MSMEs need to be aware of in order to take advantage of these changes. It also discusses the new income tax rates for MSMEs and the revised GST rates. In addition to the new tax rates, the government has also introduced a number of other tax benefits for MSMEs. These benefits include increased depreciation rates, tax deductions for start-ups, and tax breaks for research and development. The paper concludes by discussing India's tax policy outlook in the post-COVID era. The government is committed to supporting MSMEs, and it is likely that further tax reforms will be introduced in the coming years.

**Keywords:-** MSMEs, Tax accounting, Covid 19, Digital transformation, GST, Post-Covid

The Micro, Small and Medium Enterprises (MSME) sector in India is a vital component of the Indian economy, playing a pivotal role in generating employment, promoting entrepreneurship and fostering economic development. The

MSME sector encompasses a wide array of industries ranging from manufacturing to services.

As per the report of the Ministry of Statistics & Programme Implementation, the share of MSME Gross Value Added (GVA) in all of India's Gross Domestic

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Product (GDP) during the year 2019-20, 2020-21 and 2021-22 was 30.5 per cent, 27.2 per cent and 29.2 per cent respectively. The share of MSME manufacturing output in all India Manufacturing output during the year 2019-20, 2020-21 and 2021-22 was 36.6 per cent, 36.9 per cent and 36.2 per cent respectively. (Ministry of Micro, Small and Medium Enterprises, 2023). The sector also plays a crucial role in achieving inclusive growth by bridging regional disparities. As of August 2, 2023, the Udyam Registration Portal reported that the total number of persons employed in MSMEs registered between July 1, 2020, and August 1, 2023, amounted to an impressive 12,36,15,681. According to the Directorate General of Commercial Intelligence and Statistics (DGCIS), the share of export of MSME specified products in all India exports during the year 2020-21, 2021-22 and 2022-23 was 49.4 per cent, 45.0 per cent and 43.6 per cent respectively.

The COVID-19 pandemic has had a devastating impact on the Indian economy, and the MSME sector has been one of the hardest hits. The pandemic which resulted in widespread disruptions to global supply chains and economic activities had a profound impact on MSMEs across the nation. The lockdown imposed to contain the spread of the virus led to a sharp decline in demand for goods and services, disruption in supply chains, and labour shortages. As a result, many MSMEs were forced to shut down their operations or operate at reduced capacity. According to a study by the World Bank, the MSME sector in India lost around \$30 billion in revenue

due to the COVID-19 pandemic in 2020. Also the pandemic led to a 10 per cent decline in employment in the MSME sector (World Bank, 2022). According to a study by the All-India Manufacturers' Organisation (AIMO), over 60 per cent of MSMEs reported a decline in revenue of more than 50 per cent during the pandemic and over 30 per cent of MSMEs were forced to lay off employees.

## 2. Review of Literature

### 2.1 *Tax Compliance and tax optimization:*

One of the primary benefits of tax accounting for MSMEs is its role in ensuring tax compliance. Accurate record-keeping and financial reporting is essential to meet tax obligations and avoid legal complications. Several studies have emphasized the positive impact of tax accounting in promoting compliance (Bird, 2008). For instance, research found that proper tax accounting practices can reduce the likelihood of tax evasion and increase the likelihood of MSMEs meeting their tax obligations (Pomeranz, 2015).

### 2.2 *Tax Optimization:*

Tax optimization is another crucial aspect of tax accounting for MSMEs. By analyzing their financial data and transactions, MSMEs can identify tax-saving opportunities and optimize their tax liabilities legally. It highlights the potential for tax accounting to reduce the tax burden on businesses, thus freeing up resources for investment and growth (Mooji & Sjef Ederveen, 2003). Effective tax accounting also contributes to overall financial management within MSMEs. It

enables better financial planning, budgeting, and resource allocation. Studies by Chen et al. (2010) demonstrate that MSMEs with strong tax accounting practices tend to make more informed financial decisions, leading to improved financial performance and sustainability.

### *2.3 Tax compliance before Covid 19 pandemic.*

The willingness of taxpayers to report taxes in appropriate with tax law and administration without the application of tax law enforcement activities is a form of voluntary tax compliance (James & Alley, 2002). SMEs taxpayers tend to comply with tax regulations, such as in African countries namely Botswana and in Nigeria (Nkwe, 2013). It was revealed that most SMEs in Zimbabwe evaded taxes by temporarily relocating businesses during compliance attacks and paying bribes. In addition, 67 per cent of the respondents in the study admitted to never complying and it was also revealed that a large number of SMEs in Zimbabwe do not pay their taxes (Gatzinsi, 2015). In line with research in Zimbabwe, in a survey conducted in Tanzania it was found that the majority of 68 per cent of SMEs taxpayers defaulted in the form of inconsistency in conducting tax reporting in accordance with the required tax regulations (Lubua, 2014).

In European countries such as Belgium, Ethiopia, and Greece as well as countries in Asia such as Malaysia and Vietnam it was revealed that SMEs face a higher tax burden than large companies. Therefore, SME taxes are harm to the survival of SME business actors and have an impact on reducing the level of tax compliance (Mascagni & Mengistu, 2019).

Research on the understanding of SME taxpayers in Indonesia towards tax regulations shows that, overall, SME Taxpayers understand and comply with in carrying out tax obligations. In addition, SME Taxpayers are well aware of the substance of taxes that include an obligation, are used for public expenditure, and are based on laws and regulations. On the other hand, SMEs do not yet understand which taxes are final and which taxes are not final (Rahayu, 2017). In addition, SME taxpayers feel burdened with taxes and tend to perform the obligation to pay taxes because they feel that there is no other option but to pay. Therefore, tax payments are made in order to cancel the obligation to pay taxes. In addition to it, taxes for SMEs are considered unfair and burdensome, so this unfairness must be reassessed and corrected (Aneswari & Irianto, 2016). The fairness of taxes felt by taxpayers, can encourage them to be willing to cooperate and more likely to comply with decisions made by tax authorities. The loss of trust in the government is considered to be the cause of low public compliance with government authorities in the field of taxation (Gangl et al., 2015).

### **3. Statement of Problem**

The Micro, Small, and Medium Enterprises (MSME) sector in India recognized as the backbone of the economy, contributing significantly to GDP, employment, and regional development. However, the sector faced severe disruptions due to the COVID-19 pandemic, leading to substantial economic challenges, reduced revenue, and employment losses. While the pandemic exposed vulnerabilities in the

MSME sector, it also accentuated the critical role of effective tax accounting practices in navigating such crises. Despite its importance, there exists a gap in comprehensive understanding and guidance on tax accounting for MSMEs in the post-COVID era. Moreover, varying levels of tax compliance across different regions and sectors within the MSME landscape indicate the necessity for a cohesive and updated approach to tax accounting practices. Thus, this study aims to address the complexities and nuances of tax accounting for MSMEs in the post-COVID era, providing insights and recommendations to foster resilience, growth, and compliance in this crucial economic segment.

#### 4. Objectives of the Study

- To study the tax accounting for MSMEs in the post covid era in India.

#### 5. Significance of the Study

Given the severe economic disruptions caused by COVID-19, the insights derived can guide governmental bodies in formulating supportive policies and tax relief measures tailored to address the unique challenges faced by MSMEs. Furthermore, for MSME owners and operators, offers recommendations and strategies to navigate the intricate tax landscape efficiently, ensuring compliance while optimizing tax benefits. Ultimately, the study bridging the knowledge gap between the evolving tax regulations and the practical realities of MSMEs, fostering resilience, growth, and sustainability in the post-COVID economic landscape of India.

#### 6. Scope of the Study

The scope of this study primarily revolves around understanding and analyzing the tax accounting practices and compliance requirements for Micro, Small, and Medium Enterprises (MSMEs) in India, especially in the post-COVID era. By focusing on tax accounting practices, compliance requirements, government initiatives, digital transformation, and challenges and opportunities, the study seeks to offer valuable insights and recommendations to MSMEs, policymakers, tax professionals, and other stakeholders involved in the MSME ecosystem.

#### 7. Methodology

The study is based on the secondary data collected from annual report of MSME Ministry, online journals, press release, articles, websites of ministry of finance, Central Board of Direct Taxes, Goods and Services taxes and other sites. Study discusses the data of tax accounting for MSMEs in the post covid era in India.

#### 8. Results and Discussion

##### *8.1 Tax accounting and MSME*

Micro, Small, and Medium Enterprises (MSMEs) are the backbone of many economies worldwide, representing a significant portion of businesses and contributing to job creation and economic development. Effective tax accounting practices are essential for MSMEs to navigate the complex tax landscape and remain competitive in today's globalized business environment. Tax accounting practices includes:

- *Maintain Accurate Records:* Keep detailed records of all financial transactions, including income, expenses, assets, and liabilities. Use accounting software or tools to help organize and track financial data.
- *Understand Tax Regulations:* Stay updated with local tax laws and regulations that apply to MSMEs. Consider hiring a tax advisor or consulting with a tax professional to ensure compliance.
- *Choose the Right Accounting Method:* MSMEs can typically use either cash basis or accrual basis accounting. They should evaluate which method is more suitable for their business and stick to it consistently.
- *Separate Personal and Business Finances:* Business should maintain separate bank accounts for personal and business finances. Avoid using business funds for personal expenses and vice versa.
- *Track Expenses and Deductions:* Keep detailed records of all business expenses, including receipts and invoices. Also understand which expenses are deductible according to local tax laws.
- *Utilize Tax-Advantaged Accounts:* MSMEs should take advantage of tax-advantaged accounts like retirement plans, health savings accounts (HSA), or similar options available in their jurisdiction.
- *Payroll Compliance:* Ensure that the business comply with payroll tax requirements. This includes accurately

withholding and remitting taxes for employees of their firm.

- *File Taxes on Time:* MSMEs should be aware of tax filing deadlines and ensure that all necessary forms and documents are submitted accurately and on time. For that they can consult professional tax practitioners.
- *Claim Applicable Tax Credits:* Investigate if there are any tax credits or incentives available for MSMEs in respective jurisdiction, and take advantage of them.
- *Monitor Changes in Tax Laws:* Stay informed about any changes in tax laws and regulations that may affect the business. Make necessary adjustments to tax strategy accordingly.
- *Plan for Tax Liabilities:* Set aside funds for tax liabilities to avoid financial strain when tax payments are due. Reserve can also be set aside for meeting such expenses.
- *Engage a Professional:* Consider hiring a qualified tax accountant or advisor who specializes in small business taxation. They can provide expert advice and ensure compliance with tax laws.
- *Review and Reconcile Regularly:* Regularly review financial statements, reconcile accounts, and address any discrepancies promptly.
- *Maintain Documentation:* Keep a well-organized record of all tax-related documents, including tax returns, receipts, invoices, and correspondence with tax authorities.

The benefits of tax accounting are:

- *Enhanced Tax Compliance:* Proper tax compliance reduces the risk of errors, audits, and penalties. Proper documentation also facilitates the timely payment of taxes, preventing the accumulation of interest and penalties.
- *Tax Planning and Optimization:* Tax accounting allows MSMEs to identify tax planning opportunities, such as deductions, credits, and exemptions, that can legally reduce their tax liabilities. By optimizing their tax strategies, MSMEs can preserve capital and reinvest in their businesses.
- *Improved Financial Management:* MSMEs can track their income, expenses, and cash flow more effectively, enabling them to make informed decisions about pricing, investments, and expansion plans.
- *Access to Financing:* It helps to secure financing from banks and investors. Well maintained records can instil confidence in potential investors.
- *Risk Mitigation:* By maintaining accurate financial records and complying with tax regulations, MSMEs can mitigate legal and financial risks. This reduces the likelihood of facing lawsuits or financial crises related to tax issues.

## **8.2 Tax Accounting in the post covid era**

The COVID-19 pandemic has significantly impacted businesses worldwide, and Micro, Small, and

Medium Enterprises (MSMEs) in India are no exception. In the wake of economic challenges, understanding and effectively managing tax accounting has become crucial for the survival and growth of these enterprises. Tax accounting in the post covid era can be discussed in the following points:

### **8.2.1 GST Compliance and Filing**

The Goods and Services Tax (GST) is a comprehensive indirect tax levy on the supply of goods and services within a country. It was introduced in India on July 1, 2017, and has since become the largest tax reform in the country's history. It is imperative for MSMEs to maintain accurate records and comply with GST filing requirements. Regularly updating of GST returns ensures smooth business operations and avoids penalties. The government has taken a number of steps to support businesses during the pandemic time, including relaxing GST compliance requirements and providing financial relief. In the post-COVID era, it is important for businesses to ensure that they are in full compliance with GST regulations. This will help them to avoid penalties and interest charges, and to maintain a good reputation with the government. The GST compliance requirements for businesses vary depending on their turnover. Businesses with a turnover of less than ₹ 40 lakh per annum are required to file quarterly returns. Businesses with a turnover of ₹ 40 lakh or more per annum are required to file monthly returns. In addition to filing returns, businesses are also required to pay GST on their taxable supplies. The GST rate varies depending on the type of goods or services supplied. GST returns

can be filed online through the GST portal. Businesses can either file their returns themselves or hire a tax professional to do it for them. When filing their returns, businesses are required to provide information about their taxable supplies, input tax credit, and tax payable. Businesses must also attach invoices and other supporting documents to their returns.

The government has taken a number of steps to make GST compliance easier for businesses in the post-COVID era. These include:

- The government has extended the due dates for filing GST returns on a number of occasions during the pandemic. This has given businesses more time to file their returns and comply with GST regulations.
- The government has also relaxed the late filing fees for GST returns. This has reduced the financial burden on businesses that are unable to file their returns on time.
- The government has launched various online training programs on GST compliance which are designed to help businesses understand and comply with GST regulations.
- The government has set up GST call centres to help businesses with their GST queries which are staffed by experienced tax professionals who can provide businesses with guidance on GST compliance.

### **Challenges of GST Compliance in the Post-COVID Era**

Despite the steps taken by the government, there are still a number of

challenges that businesses face in complying with GST regulations in the post-COVID era. These challenges include: Financial constraints, Complexity of GST regulation, Lack of awareness leading to missing deadlines and filing incorrect returns (Ministry of finance, 2023).

#### *8.2.2 Income tax Compliance and filing*

One of the key challenges faced by MSMEs is income tax compliance. MSMEs may find it difficult to understand and comply with the complex tax laws and regulations also they may not have the resources to maintain proper accounting records and file their tax returns on time. The COVID-19 pandemic has further exacerbated the challenges faced by MSMEs. Many MSMEs have seen their businesses decline sharply during the pandemic, making it difficult to pay their taxes on time. In recognition of these challenges, the Indian government has taken a number of steps to simplify and streamline the tax compliance process for MSMEs. For example, the government has introduced a new simplified tax return form for MSMEs with turnover of up to Rs. 5 crores. Additionally, the government has extended the deadline for filing tax returns and paying taxes for MSMEs (Central Board of Direct taxes, 2023). The following are some of the key income tax compliance requirements for MSMEs in India:

- MSMEs are required to file income tax returns on an annual basis. The

deadline for filing income tax returns is usually July 31<sup>st</sup> of the following financial year.

- MSMEs with an estimated annual income tax liability of more than Rs. 10,000 are required to pay advance tax in instalments. The advance tax instalments are due on June 15<sup>th</sup>, September 15<sup>th</sup>, December 15<sup>th</sup>, and March 15<sup>th</sup>.
- MSMEs are required to deduct tax at source (TDS) from certain payments they make, such as salaries, rent, and professional fees. The TDS deducted must be deposited with the government within seven days of the date of payment.

#### **Tax relief measures for MSMEs**

- *Reduced tax rate:* Domestic manufacturing companies, including MSMEs, are eligible for a reduced tax rate of 25 per cent instead of the standard rate of 30 per cent.
- *Increased deduction for research and development:* MSMEs can claim a deduction of up to 200 per cent of their expenditure on research and development.
- *Deduction for start-ups:* MSMEs that are start-ups can claim a deduction of 100 per cent of their profits for the first three years.
- *Concessional tax rates for specified sectors:* MSMEs operating in certain sectors, such as food processing and logistics, are eligible for concessional tax rates.

#### **Tax compliance measures for MSMEs:**

- The Government of India has extended the due dates for filing income tax returns and paying taxes for MSMEs.
- The Government of India has waived late fees and penalties for MSMEs that have delayed filing their income tax returns or paying their taxes.
- MSMEs can file their income tax returns online, which is a convenient and hassle-free process.

#### **8.2.3 Digital Transformation and Taxation**

Taxation policies also evolved to address the challenges and opportunities posed by the pandemic. Here are some key points to consider regarding digital transformation and taxation:

- *E-commerce Adoption:* This necessitated the establishment of online sales channels, payment gateways, and digital marketing strategies.
- *Remote Work and Collaboration Tools:* Adoption of cloud-based collaboration tools and technologies to enable remote work and ensure seamless communication among employees and stakeholders.
- *Automation and AI:* Integration of automation tools and AI-driven solutions to streamline processes, reduces manual effort, and enhances productivity.



- *Data Analytics and Business Intelligence:* Leveraging data analytics for insights into customer behaviour, market trends, and operational efficiency.
- *Cyber security Measures:* Implementing robust cyber security measures to protect sensitive information and maintain trust with customers.
- *Digital Payment Solutions:* Encouraging digital payments to reduce reliance on cash transactions and improve cash flow management.
- *Online Marketing and Customer Engagement:* Utilizing social media, content marketing, and other digital strategies to engage with customers and build brand presence.
- *Supply Chain Digitization:* Implementing technologies like IoT, blockchain, and ERP systems for efficient supply chain management.

## 9. Findings

MSMEs are foundational to many economies globally, contributing significantly to job creation and economic development. Their vitality underscores the importance of effective tax accounting practices tailored to their unique needs. Key Tax Accounting Practices for MSMEs include keeping detailed and accurate financial records, stay updated and compliance with local tax laws and regulations and using appropriate tax accounting suitable for the business. Engaging tax professionals and staying abreast of tax law changes can aid MSMEs in optimizing their tax strategies. The benefits of tax accounting include reducing the risk of errors, audits, and

penalties, financial optimization and improved financial management. Enhanced financial records can bolster an MSME's ability to secure financing and instil confidence in stakeholders. The COVID-19 pandemic has necessitated adjustments in GST regulations, with the Indian government introducing measures like extending due dates and offering online training to ease compliance burdens. The pandemic accentuated the challenges in income tax compliance for MSMEs, prompting the government to introduce simplifications, such as extended deadlines and reduced tax rates for specific sectors. The pandemic accelerated the adoption of digital platforms among MSMEs, leading to enhanced online sales channels and digital marketing strategies with increased digital adoption, there's a heightened focus on implementing robust cyber security measures and ensuring regulatory compliance in the digital realm.

## 10. Suggestions

Given the evolving nature of tax regulations, MSMEs should invest in continuous training programs for their finance and accounting teams. This will help them stay updated with the latest tax laws, especially the modifications made due to the pandemic. MSMEs should embrace digital accounting and tax tools that can automate many of the tax-related processes. Tax accounting not only improves accuracy but also save time, reduces errors, and ensures compliance. MSMEs should consider establishing long-term relationships with tax consultants or advisors who specialize in their industry. MSMEs should prioritize cash flow management. They should

explore avenues like government relief measures, loans, or grants aimed at supporting businesses during economic downturns. They should actively engage with government initiatives aimed at supporting businesses, such as tax relief measures, subsidies, or incentives for adopting digital technologies or expanding into specific sectors. Enhance cyber security measures and invest in robust digital infrastructure to protect sensitive financial data, especially when conducting online transactions or collaborations. Establish a feedback mechanism with stakeholders, including customers, suppliers, and employees. This will provide insights into areas of improvement, potential risks, and

opportunities for innovation or diversification.

## 11. Conclusion

In the post-COVID era, understanding and effectively managing tax accounting is crucial for the success of MSMEs in India. By staying compliant with GST regulations, accounting for COVID-19 support measures, embracing digital transformation, managing assets of the firm, staying updated on tax policy changes, implementing tax planning strategies suitable for the firm, and seeking professional assistance, MSMEs can navigate the new tax landscape with confidence and resilience.

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