



Unlocking the potential of MSMEs in e-commerce

Policy suggestions under GST: Creating a conducive environment for small sellers selling online

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Preface

Currently, more than 100 million of India's estimated 572 million internet users purchase products online.¹ To cater to these user needs, millions of small retailers are finding innovative ways to sell directly to consumers through a variety of social formats, ranging from conversational commerce on chat platforms and video-led commerce to a vibrant social reseller community.

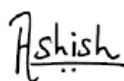
As India's growth story is being written, the shift from offline to online has a significant role to play as this progression must involve participation and contribution of Micro, Small and Medium Enterprises (**MSMEs**). Online shopping and supply chains have now become not just the preferred medium, and in some instances, only medium of trade. The technological support for trade and authorities is more vital now than ever, and the government is leaving no stone unturned to extend as much support as it can to businesses.

Given the accelerated digitisation across sectors due to the COVID-19 pandemic, it is important to identify and remove that the challenges with respect to digital adoption that inhibit small sellers to leverage the opportunities of e-commerce.

The government should act as an enabler for such small businesses by streamlining GST regulations and bringing about parity for offline and online sellers.

This report aims to set the overall context of e-commerce in India, tracing its evolution and highlighting some of the key inhibitions amongst small retailers in transitioning from a purely offline to "Offline + Online" models. Action in this direction will not only increase the economic activity, thereby giving a platform to the SMEs for growth, but with the technology and reporting mechanism now available with the tax authorities and reporting of such transitions being done by the e-commerce operators, it will also bring more transparency and drive stronger and confident tax compliance.

We are thankful to Mr. Prakash Kumar, Chief Executive Officer at Wadhvani Institute for Technology and Policy (Ex-CEO of Goods and Services Tax Network) for his valuable inputs and guidance in preparing this report.



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Executive summary

The Indian e-commerce sector is a powerful ally to the government and plays a key role in the overall growth of the Indian economy, contributing ~US\$800 billion to India's Gross Domestic Product (**GDP**) in Financial Year (**FY**) 2019-20 and employing more than 35 million people.ⁱⁱ COVID-19 also highlighted the agility and resilience of the Indian retail sector as a large number of consumers were forced to shop on online platforms. This has led online retailers to go beyond Tier-I cities and penetrate deeper into Tier-II and Tier-III cities.

Over the past few years, India has seen a surge in small enterprises and homemakers scaling their businesses. While it is true that in the future these small retail players will continue to be the backbone of the Indian retail industry, the new way forward for them would be to transform from offline mode to an "Offline + Online" mode of business.

However, the majority of MSMEs hesitate to transition to online marketplaces, owing to cumbersome tax compliances under the Goods and Services Tax (**GST**) law. The hesitation of small businesses to register under the GST law is not to evade taxes but to avoid cumbersome and time-consuming registration and returns filing processes. This discourages MSMEs from exploring online marketplaces and slows India's vision of a digitally powered economy. Hence, it is important for the government to take steps to remove any arbitrage that is likely to prevent small sellers from transforming themselves into the organised sector and promote entrepreneurship.

For this, the government should bring in parity between online and offline sellers by doing away with the mandatory registration requirement under GST for small sellers that sell online and with a turnover of less than INR 40 lakh and allow such sellers to avail the benefit of composition scheme.

Further, in this digital era of virtuality, sellers should be allowed to register warehouses of e-commerce operators across states, based on a single physical place of business registration in the home state of the seller.

Lastly, the GST system should strengthen reporting-led safeguards in the periodical compliances undertaken by e-commerce operators to enhance the compliance rating of the ecosystem.

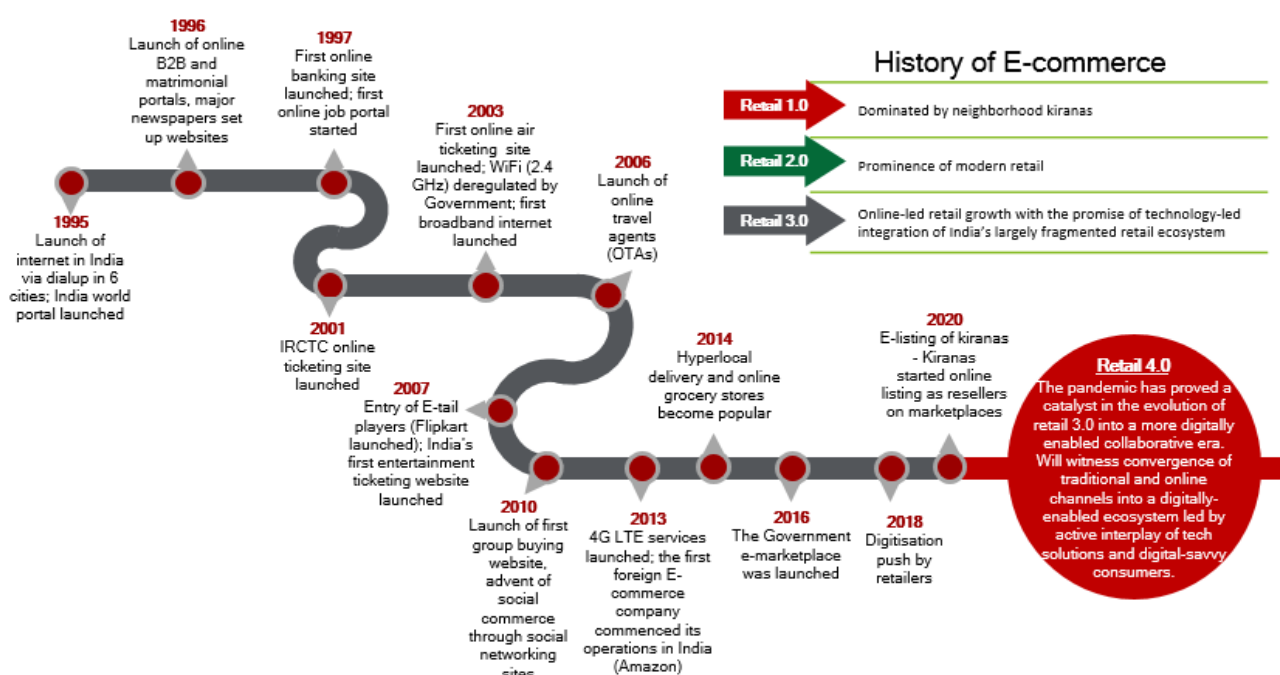
This report examines each of these suggestions in detail to understand the potential benefits harnessed and minimise any scope for misuse or any unintended outcome.

I. Evolution of e-commerce and the transition to “Offline + Online” retail

India is currently one of the largest retail markets in the world, accounting for ~US\$800 billion of India’s GDP in FY2019-20 and employs more than 35 million people.ⁱⁱⁱ The role of technology in retail has evolved significantly with tech-enabled retail models and solutions driving efficiencies across the retail ecosystem.

Since 1999, we have witnessed a rise in modern retail with the launch of a few online services. Modern retail evolved with the emergence of hyper-marts, super-marts, and cash-and-carry store formats, coupled with geographical expansion from metros to Tier-I cities. However, it was in 2007 that e-commerce entered the retail sector and reshaped the industry landscape (Figure 1). Since then, online retail (or e-commerce) became the fastest growing channel in Retail 3.0, contributing 4% to the retail market within a decade.^{iv}

Figure 1: Timelines for e-commerce growth



Source: Deloitte Research

Growing internet penetration, entry of global majors, rise in smartphone adoption, innovation in mobile technologies, access to funding, millennial consumers, the influence of social media, and digital payments are some factors fuelling the growth of e-commerce market in the country.

The pandemic also highlighted the agility and resilience of the Indian retail sector and proved to be a catalyst in the evolution of Retail 3.0 into a more digitally enabled collaborative era. It led to a shift to online marketplaces for many consumers (first-time users), especially in Tier-I and Tier-III cities. The retailers also took the online route that offered uninterrupted supply and enabled real-time tracking. With several factors driving growth in e-commerce, more offline stores need to be onboarded into the online space (refer Box 1 below).

Box 1: Growth in e-commerce

As per NASSCOM Strategic Review Report “Resilience to Resurgence: Technology Sector in India 2022”, the estimated revenue of the Indian e-commerce business in FY2022 is ~US\$ 79 billion. This is expected to reach US\$350 billion by 2030. This is no surprise, as India is likely to see a rapid growth in:

- Internet users, who are expected to go up to a billion in FY2025, up by 45% from 650-700 million in 2020^v
- Smartphone users, expected to grow at a CAGR of 10% up to 800-850 million during this period.^{vi}
- Online transactions, where currently, close to 45% internet users transact online for products and services; this segment of the population is expected to grow at a CAGR of 22%.^{vii}
- Digital payments and payment solutions have enabled easy and contact-less transactions with multiple FinTech players driving such payment revolution
- Online shopping in Tier-II and Tier-III cities
- Start-ups in various sectors such as health care, food and retail, travel, FinTech, home delivery of services (such as electricians, plumbers, barbers), Over-the-Top (OTT) platforms, and in-home entertainment.
- Massive infusion from global PEs and VCs that are keen on investing in such start-ups and turning ideas into unicorns.^{viii}

As per RedSeer Consulting, this is likely to feed into the manifold growth of retail and groceries—online retail is expected to grow at a CAGR of 28.3% to US\$140-160 billion by FY2026 and e-grocery is expected to increase by 43.5%.^{ix}

II. Role of Micro, Small and Medium Enterprises

MSMEs, with 65 million units, constitute around 90% enterprises in India, employing over 110 million people.^x This excludes millions of small units operating from home such as housewives, small boutiques, and mom-and-pop stores, which are estimated to be over 15 million.

The MSME sector has emerged as a vibrant and dynamic sector of the Indian economy over the past five decades. It contributes significantly towards the country's economic and social development by fostering entrepreneurship and generating large employment opportunities at comparatively lower capital costs. This sector is estimated to contribute around 30% to India's GDP and around 48% to exports.^{xi}

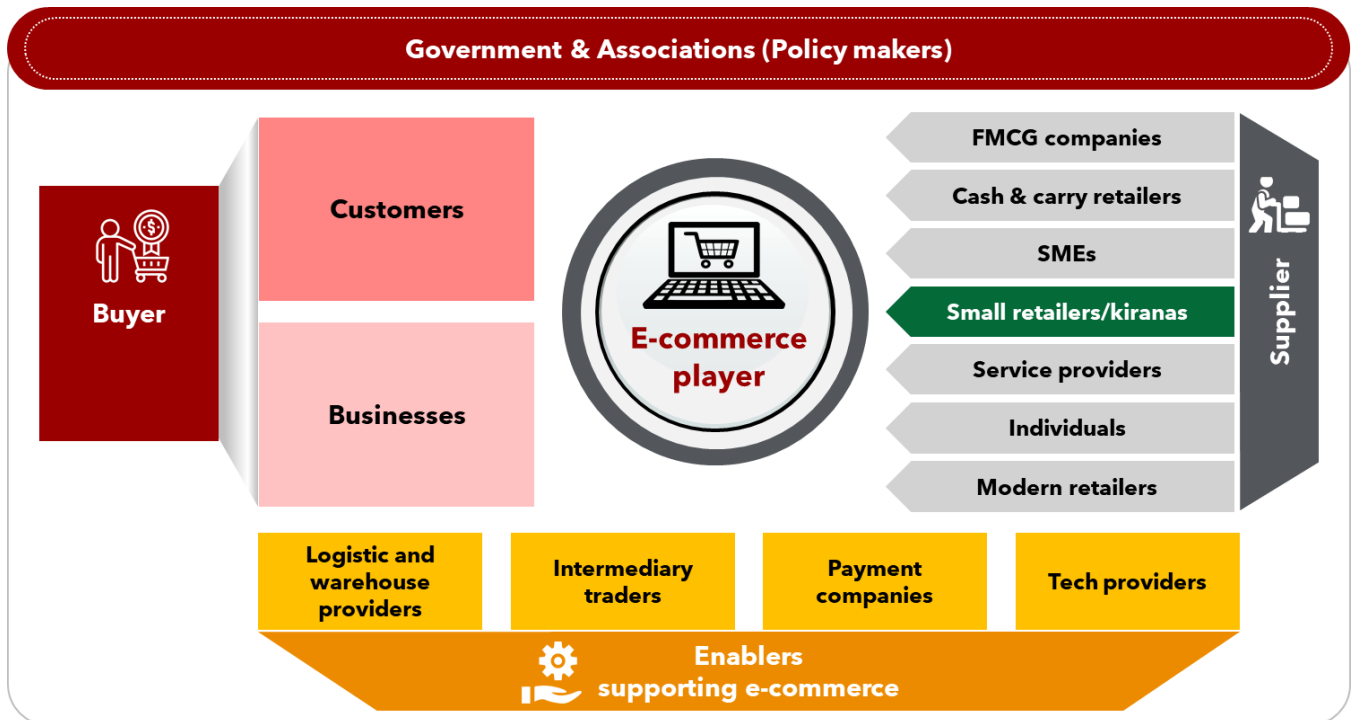
Over the past few years, India has witnessed a surge in small enterprises and homemakers scaling their businesses. E-retail has created millions of jobs and empowered delivery personnel, mom-and-pop *kirana* stores, and several small sellers. Not only has e-retail broken the go-to-market barriers for new brands, but also helped traditional brands accelerate new product launches.

However, despite the aforementioned benefits, a majority of MSMEs still hesitate to transition to online marketplaces, owing to cumbersome tax compliance issues under the GST law. Based on industry inputs, on an average, more than 1 lakh sellers drop out every month due to the GSTIN details mandated at the time of registration with e-commerce operators. This hesitation of small businesses is not to evade taxes, but to avoid cumbersome and time-consuming registration and returns filing processes. This discourages MSMEs from exploring online marketplaces and is against India's vision of having a digitally powered economy. Hence, it is important for the government to take steps that will motivate small sellers to transform themselves into the organised sector and promote entrepreneurship.

III. E-commerce: A facilitator for the ecosystem

The e-commerce sector is a powerful ally to the government and plays a key role in the overall growth of the Indian economy. While growth amongst e-commerce players has been recent, they are and will likely continue to be crucial for the entire retail ecosystem (Refer to Figure 2 below). Be it supporting the government, buyers, or sellers (specifically small-scale retailers), e-commerce players will be the key enablers, supported by logistics and warehouse providers, intermediary traders, payment companies, and tech providers.

Figure 2: E-commerce players are an important enabler to the retail ecosystem



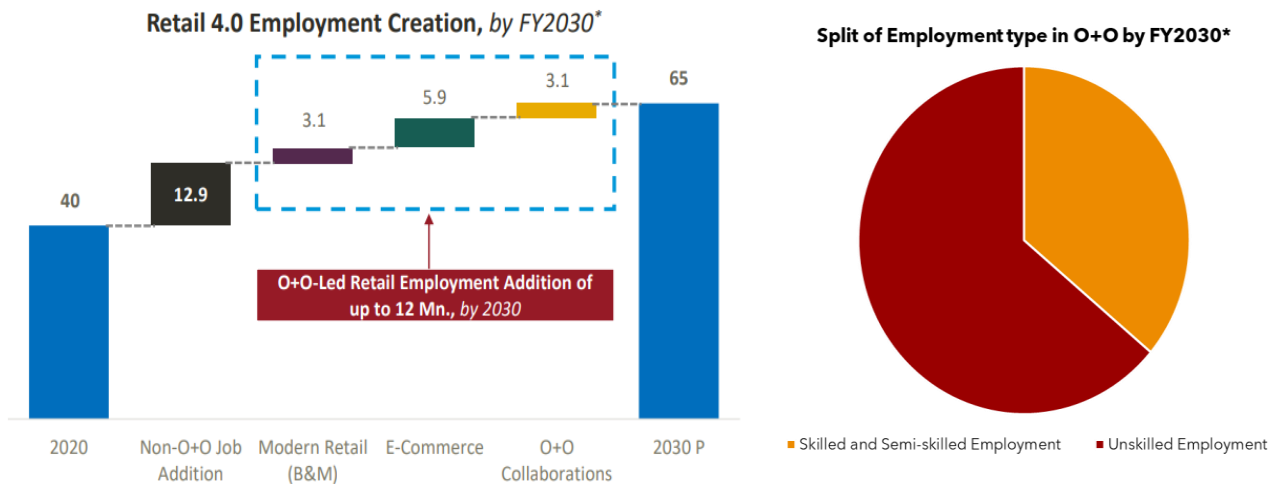
Source: Deloitte Research

A. Employment generation

The convergence of “Offline + Online” retail has enormous potential in incremental economic contribution, job growth, exports, and an inclusive retail ecosystem with greater MSME participation. According to NASSCOM report titled, “Retail 4.0 – India Story: Unlocking Value Through Online + Offline Collaborations”, e-commerce contributed 4.2% of the total employment and added 1.7 million jobs in FY2020.^{xii} Currently, platform-based gig jobs such as food delivery, e-retailing and grocery deliveries are largely concentrated in large towns or cities where job mobility is high. This will continue to be the biggest job growth driver in Tier-II and -III cities, with suburban areas as the next frontiers.

The sector is likely to add 5.9 million jobs between FY2020 and FY2030. Supply chain and logistics will witness an incremental 3.2 million jobs, of which e-commerce will account for 2.6 million by FY2030.^{xiii} (See Figure 3 below).

Figure 3: Retail 4.0 employment creation



Source: NASSCOM Report titled "Retail 4.0 – India Story: Unlocking Value Through Online + Offline Collaborations"

B. Interplay with digitisation

While India is poised for strong growth in e-commerce, currently less than 10% of India's 80+ million small businesses sell online (including mom-and-pop stores).^{xiv} With the pandemic's impact, an increasing number of small businesses have had and will need to re-invent themselves as digital businesses. As a result, with greater formalisation due to e-commerce, MSMEs will get better access to funding and growth markets. This will also help formalise the economy and dilute geographical boundaries.

C. Enabler to sellers as well as buyers

E-commerce can empower small craftsmen and local producers by helping them navigate online disruptions in doing businesses, creating demand for their products, and giving them wider reach and an expanded customer base. It also eliminates middlemen by providing them direct access to customers, which can result in higher margins and profits. As a result, small businesses can increase their scale and scope, get a platform to showcase their enhanced product supply across the globe and compete with large retailers.

From a buyer's perspective, ecommerce ensures ease and convenience, round-the-clock availability, quality products at affordable prices as well as the ease of returns and exchange and informed choice from product ratings and reviews.

Figure 4. Small retailers can benefit from e-commerce platforms



Source: Deloitte Research

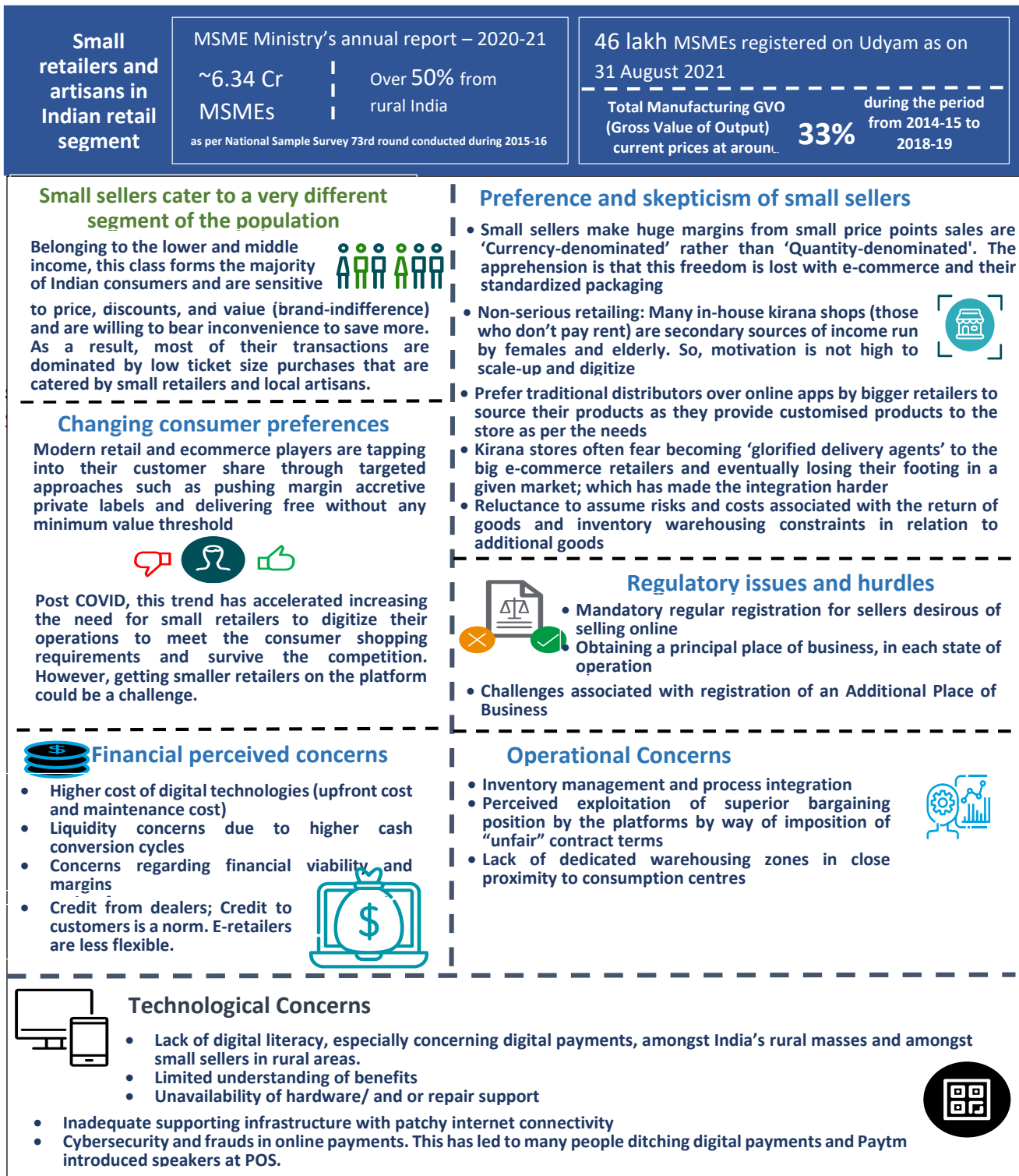
D. Enabler to the government in taxation

When unorganised businesses onboard e-commerce platforms, it helps formalise the economy and create income and employment opportunities. It also enables the government to access granular data, which in turn aids better policy making in the following ways:

- Ensure accurate tax deposits to states and the centre: Compliances undertaken, and the disclosures made by e-commerce suppliers of goods and services are already in place as the e-commerce industry has a robust mechanism that allows the tax type being paid/disclosed to be correctly identified using a delivery pin code-based check.
- Educate sellers on compliances.
- Collect or deduct taxes at source on consideration received for sales made online, which is deposited periodically, and its related reporting, which enables authorities to directly check a seller's sales and undertake comparisons.
- Ensure availability of an end-to-end sales trail made by sellers on online platforms, which equips authorities to undertake informed decisions on assessments, scrutiny, as well as policy.
- Act on directions and requests from the authorities to block sellers who are non-compliant.

In spite of the aforesaid benefits, small retailers and neighbourhood grocery businesses often resist transitioning to online modes of business because of disadvantages, such as high compliance costs, high working capital requirements, logistics costs and inventory management (**Figure 5**).

Figure 5: Inhibitions amongst small retailers to adopt online platforms



IV. Recommendations for creating an all-inclusive ecosystem along with e-commerce marketplace



A. Bringing in parity between online and offline sellers in GST registration and compliances would be the first and most encouraging step to promote online marketplaces and eliminate tax policy discrimination.

In the Indian tax policy, a seller is eligible to avail exemption from registration and payment of GST until their annual sale/turnover crosses the prescribed threshold of INR 40 lakh.^{xv} However, in case of sellers selling goods online, similar exemptions from registration and payment of GST do not apply, and such sellers are liable for GST registration from the very first transaction. This places such suppliers at a disadvantage, compared with their peers who sell offline within the INR 40 lakh threshold. Further, the requirement to obtain GST registration mandatorily across multiple states results in routine compliance and operation costs for such sellers, which negatively affects their margins. This results in a significantly high drop-out rate in the range of 60-70 percent.^{xvi}

To ensure that more MSMEs sell online, it is important to do away with the mandatory registration requirement for small sellers selling online and have a turnover less than INR 40 lakh.

This will enable small sellers to transform themselves into organised players and with the increase in sales, they would automatically evolve into registered sellers. Notably, the hesitation of small businesses to register under GST is not to evade tax but to avoid the cumbersome and time-consuming registration and returns filing process. Thus, it would be prudent for the government to simplify the GST process in the interest of small suppliers.

Some of the guardrails that could be considered for enabling small sellers to sell through online platforms include the following:

Authentication at the time of onboarding

The government should allow onboarding of such small sellers on online platforms based on a three-way authentication of Aadhaar, Permanent Account Number (PAN) and bank details. The onus can be placed on e-commerce marketplaces to ensure that these details are obtained at the time of onboarding. Alternatively, the facility can be made available through the GSTN portal itself (API/ on-site).



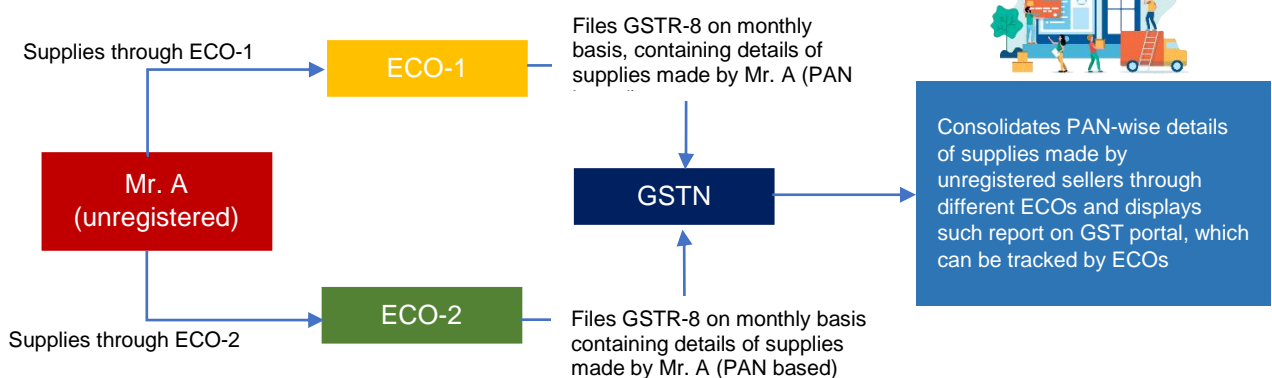
Declaration from sellers

A declaration from unregistered sellers on an annual basis can be made mandatory stating that their turnover (both online sales and offline sales) is within the limit (as applicable) for obtaining GST registration. Further, the declaration may also provide that such sellers will only sell intra-state, until such time that they are within the threshold limits/ obtain a GST registration. This also can be routed through the GSTN portal by enabling a PAN based login.



Tracking of sales made on online platforms by small sellers through PAN based consolidation

E-commerce operators as mentioned above would be reporting sales by unregistered sellers on a monthly basis. GSTN can then consolidate PAN wise turnover and published on the common portal. (Please refer flowchart below)



Geo-location tracking

E-commerce operators can also place a check based on PIN code (both bill to and ship to) to be in the same state as that of the seller. To illustrate, Mr. A, an unregistered dealer based out of Karnataka should not be allowed to make sales if the PIN code of the recipient (bill to or ship to) is of other state. ECOs can also restrict particular unregistered sellers shown in search criteria where the billing and/ or delivery is to another state.

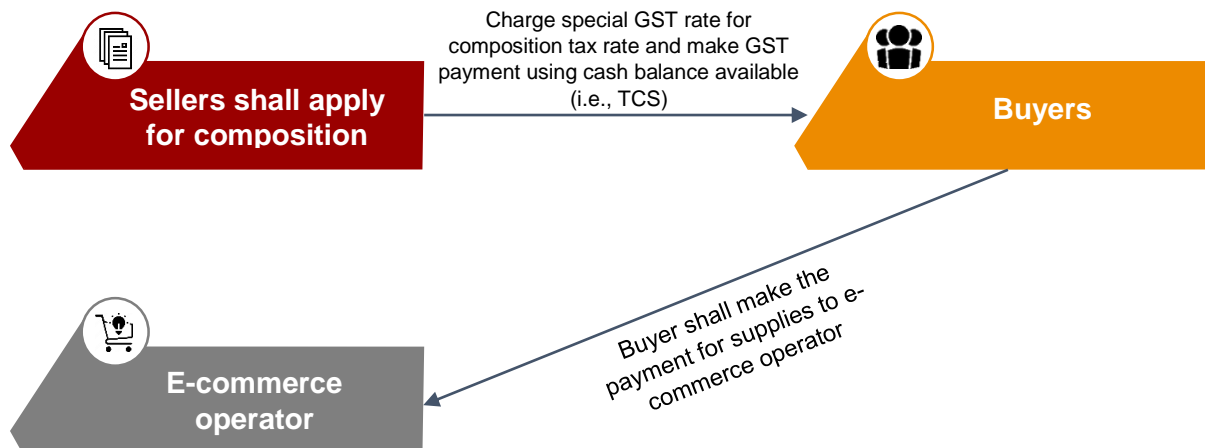


Government authorities would have better oversight and control over such unorganised sellers, even when they are not registered under GST. Additional changes to reporting requirements (detailed in point D below) will ensure robust tracking through PAN to ensure that sellers are registered as and when they cross the threshold.

While there was a loss estimated to States as the intra-state supply revenue reduced due to higher exemption threshold (estimated to be INR 5,225 crores per year), the merits outweigh the demerits as highlighted in the report of Group of Minister (**GoM**).^{xvii} Going by the analogy provided by the GoM, the impact on the States' revenue by enabling sellers to sell intra-state with a threshold exemption would be offset by the growth in economic activity.

B. Allowing composition dealers to operate through e-commerce platforms would provide additional avenues of growth to small sellers. The composition scheme is a simple, hassle-free compliance scheme for small taxpayers wherein a taxpayer opting for the scheme is required to pay 1% tax on their annual turnover, instead of calculating GST liability monthly and are permitted to make only intra-state supplies. This scheme can be opted for by any taxpayer whose turnover is less than INR 1.5 crore. However, any seller supplying goods through online platforms is not eligible to opt for the composition scheme.^{xviii}

It is important to note that until June 2021, there were 16.67 lakh registered composition dealers who paid INR 2,093 crore GST in FY2020-21.^{xix} Considering the scale of such sellers and the GST collections made, the government should allow small and mid-size sellers to opt for the composition scheme while supplying goods through an online portal. This will not have any revenue impact, considering that e-commerce operators will report sales made by such suppliers in their existing monthly GST reporting and even comply with the requirements of 1% tax collection at source. We have illustrated the flow of the mechanism below:



From a compliance perspective, this will encourage small sellers to adopt GST compliances effectively as composition dealers are exempt from the maintenance of elaborate accounts and records and are instead required to file quarterly returns.

The combined benefit of lower compliance and reporting under the composition scheme and wider market reach provided by online platforms could result in more small suppliers shifting to organised reporting and tax payments.

C. Permissibility of a virtual place of business is also essential in a highly tech-oriented ecosystem. As per the GST law, a supplier is required to have a physical presence and obtain a Principal Place of Business (**PPoB**) registration in every state from where taxable supplies are made.^{xx}

In the digital era, the present policy that mandates a physical PPoB in each state of business not only adds to the working capital requirements and increased manpower, but also creates significant inefficiencies. This is because, while all the stock is maintained at the warehouses of e-commerce marketplaces in various states, the books of accounts are maintained digitally at the head office of the seller in the home state.

Suitable changes are therefore warranted where online sellers store goods in warehouses operated by these marketplaces. Such sellers should be allowed to register the warehouses of e-commerce operator across states, on the basis of a single PPoB registration in the home state of the seller. This will make more sellers store their goods in e-commerce operators' warehouses (located in multiple states) for better reach to customers and quicker delivery times. These changes would not result in any revenue leakages as the authorities would still have comprehensive state-wise GST tax deposits. Enabling this option will result in the following benefits:



Opportunity for small sellers to sell across India without having a physical PPoB in each state;



Operate virtually from the home-state office in respect of operations in other states;



Administrative efforts in obtaining GST registration for multiple places of business will greatly reduce. State authorities can continue to have the power to exercise other controls in relation to assessments, audits, etc.; and



Increase in efficiency and ease of doing business in India

D. Streamlining compliances is vital given that the present compliance matrix involves multiple registrations and reporting by the seller as well as e-commerce operators. The current reporting framework in GSTR-1 requires a supplier to disclose supplies made to each e-commerce operator. Although, the original reporting format of GSTR-1 envisaged reporting at

an invoice-level for supplies made through e-commerce operators (in Table 4C of GSTR-1), the same is yet to be implemented.

Similarly, every e-commerce operator is required to report details of supplies made through it by every supplier in the GSTR-8 form at a gross level. The introduction of seller-wise reporting based on Aadhar/PAN by the e-commerce operator in GSTR-8 will help in comprehensive reporting. Further, as both these data inputs are incongruent, retailers and e-commerce operators alike, face scrutiny by multiple levels of tax authorities. Hence, it is important to:



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END NOTES

- ⁱ <https://www.bain.com/insights/unlocking-the-future-of-commerce-in-india/>
- ⁱⁱ As per NASSCOM report “Retail 4.0 – India Story: Unlocking Value Through Online + Offline Collaborations”
- ⁱⁱⁱ Pinaki Rajan Mishra, “[Retail Players are Looking at Kirana Stores for Growth.](#)” *CNBCTV18*, 25 September 2019.
- ^{iv} As per NASSCOM report “Retail 4.0 – India Story: Unlocking Value Through Online + Offline Collaborations”
- ^v [Draft Red Herring Prospectus \(icicisecurities.com\)](#). Refer page no - 124
- ^{vi} [DRAFT RED HERRING PROSPECTUS \(icicisecurities.com\)](#), page no - 125
- ^{vii} <https://msme.gov.in/sites/default/files/MSME-ANNUAL-REPORT-ENGLISH%202020-21.pdf>
- ^{viii} <https://economictimes.indiatimes.com/tech/funding/pe/vcs-invest-6-8-billion-in-indian-firms-in-november-shows-report/articleshow/88316211.cms>
- ^{ix} [DRAFT RED HERRING PROSPECTUS \(icicisecurities.com\)](#), page no - 125
- ^x <https://msme.gov.in/sites/default/files/MSME-ANNUAL-REPORT-ENGLISH%202020-21.pdf>
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- ^{xii} As per NASSCOM report “Retail 4.0 – India Story: Unlocking Value Through Online + Offline Collaborations”
- ^{xiii} As per NASSCOM report “Retail 4.0 – India Story: Unlocking Value Through Online + Offline Collaborations”
- ^{xiv} <https://www.news18.com/news/opinion/small-suppliers-entrepreneurs-must-be-integrated-with-e-commerce-it-starts-with-gst-parity-4076666.html>
- ^{xv} As per S.22 of Central Goods and Services Tax Act, 2017 read with Notification no. 65/2017-Central Tax dated November 15, 2017 & Notification No. 10/2019-Central Tax dated March 7, 2019
- ^{xvi} Based on industry inputs
- ^{xvii} Refer para (III) on page 8 and GOM’s recommendation on 61 to 63 of the 32nd Council meeting minutes – 10 January 2019 - [link](#)
- ^{xviii} As per S.10 of Central Goods and Services Tax Act, 2017
- ^{xix} https://tutorial.gst.gov.in/offlineutilities/gst_statistics/4YearReport.pdf
- ^{xx} As per S.22 of Central Goods and Services Tax Act, 2017