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TAX GOVERNANCE IN MSMES: ROLE OF BOARD OVERSIGHT IN PREVENTING REGULATORY NON-COMPLIANCE

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ABSTRACT

Indias Micro, Small, and Medium Enterprises (MSMEs) constitute the backbone of the national economy, contributing approximately 30% to GDP, 45% of exports, and employing over 110 million people. Despite their economic significance, MSMEs continue to face persistent challenges with tax regulatory compliance particularly under the Goods and Services Tax (GST) regime introduced in 2017. This paper examines the role of board oversight mechanisms in preventing GST compliance failures and other forms of regulatory non-compliance among Indian MSMEs. Grounded in Agency Theory (Jensen & Meckling, 1976) and Stakeholder Theory (Freeman, 1984), the paper undertakes a doctrinal and analytical inquiry into the intersection of corporate governance and tax compliance in the MSME context.[313][314]

The study maps the current GST compliance framework, analyses the personal liability of directors under Section 89 of the Central Goods and Services Tax (CGST) Act, 2017, and interrogates the governance responsibilities imposed on company directors under the Companies Act, 2013. Through a structured analysis of governance failures and compliance risk patterns, the paper identifies critical structural deficits in MSME boards including weak audit infrastructure, the absence of independent directors, and low director-level tax literacy that systemically heighten exposure to regulatory non-compliance. The paper culminates in a proposed Tax Governance Framework tailored for Indian MSMEs, encompassing compliance infrastructure, management-level monitoring, and board-level oversight mechanisms. Policy implications are drawn for regulators, including the Ministry of Corporate Affairs (MCA), the GST Council, and the MSME Ministry, with recommendations toward a formal Tax Governance Code for MSMEs.[315]

Keywords: MSMEs, GST compliance, board oversight, director liability, corporate governance, tax governance, India, CGST Act, Section 89, compliance failures

1. Introduction

Indias Micro, Small, and Medium Enterprises (MSMEs) sector isnt simply a element of the public frugality its its connective towel. As of 2024, over 63 million MSME units are registered under the Udyam gate, inclusively contributing

[313] Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. Journal of Financial Economics, 3(4), 305-360. The seminal paper establishing principal-agent theory as the foundation of corporate governance. https://doi.org/10.1016/0304-405X(76)90026-X

[314] Ministry of MSME (2024). Annual Report 2023-24. Government of India. MSMEs contribute ~30% to GDP, ~45% to merchandise exports, and employ over 110 million persons. https://msme.gov.in/sites/default/files/MSME-AR-2023-24-Eng.pdf

[315] Central Goods and Services Tax Act, 2017, No. 12 of 2017. Section 89 establishes joint and several personal liability of directors of private companies for unrecovered GST dues. Available at the official legislative portal: https://www.indiacode.nic.in/bitstream/123456789/2050/1/201712.pdf

roughly 30 to Indias GDP and nearly 45 to total wares exports (Ministry of MSME, 2024). The sector employs further than 110 million individualities, making it the alternate- largest employer after husbandry. Despite these remarkable macroeconomic benefactions, MSMEs remain among the most vulnerable enterprises in terms of nonsupervisory compliance, institutional governance, and duty administration capacity.[316]

The preface of the Goods and Services Tax (GST) in July 2017 was heralded as Indias most transformative duty reform replacing a cascading, fractured circular duty system with a unified, destination- grounded tax under the banner of One Nation, One duty. For MSMEs, still, the transition has been double- edged. While GST simplified the duty structure in proposition, it contemporaneously subordinated millions of small enterprises numerous of which were operating informally to a complex compliance armature involving multiple return types (GSTR-1, GSTR- 3B, GSTR- 9), e-invoicing conditions, conciliation scores, and digital structure authorizations. Recent data from the Directorate General of GST Intelligence (DGGI) reveals that GST fraud detected in FY 2023- 24 amounted to roughly ₹ 2 lakh crore double the ₹ 1.01 lakh crore detected in FY 2022- 23 (The Secretariat, 2024). Notices for non-compliance have also spiked, disproportionately affecting micro and small enterprises that warrant the institutional capacity to navigate these demands.[317]

A critical but underexplored dimension of this compliance extremity is the part or absence of effective board- position governance in MSMEs. Commercial governance education has long established that boards of directors serve as the primary internal medium for nonsupervisory oversight, threat operation, and fiduciary responsibility (Jensen & Meckling, 1976; Cadbury, 1992). In India, the Companies Act, 2013 introduced comprehensive board governance authorizations for listed and larger companies obligatory independent directors, inspection panels, and structured board meeting conditions. still, utmost Indian MSMEs operate as private limited companies or limited liability hookups with designee or family- appointed boards, where independence is formal rather than functional and where duty compliance oversight is relegated to external chartered accountants rather than bedded within governance structures.[318]

The legal consequences of this governance deficiency are decreasingly significant. Section 89 of the CGST Act, 2017 a provision that has entered limited scholarly attention despite its broad counteraccusations establishes the joint and several particular liability of directors of private companies for unrecovered GST pretenses. This provision pierces the commercial robe and overrides the protections of the Companies Act, holding every director tête-à-tête responsible unless they can demonstrate that non-recovery wasnt attributable to their gross neglect, misfeasance, or breach of duty. For directors of MSMEs who are frequently protagonist- directors with concurrent functional places this liability exposure is both fairly redoubtable and virtually uncredited.[319]

This paper investigates the nexus between governance structures and GST compliance issues in Indian MSMEs, with the following exploration questions

• What structural and functional characteristics of MSME boards are associated with patterns of GST compliance failure and non supervisory non-compliance?

[316] Udyam Registration Portal, Government of India (2024). As of March 2024, over 4.5 crore enterprises are registered on the Udyam portal; broader estimates including unregistered MSMEs place the total at 63 million units. See: https://udyamregistration.gov.in/Government-India/Central-Government-urge-MSME.aspx

[317] Directorate General of GST Intelligence (DGGI), Annual Report 2023-24. The DGGI detected GST fraud worth approximately ₹2.01 lakh crore in FY 2023-24, double the ₹1.01 lakh crore detected in FY 2022-23. See also: The Secretariat (2024). https://thesecretariat.in/article/rising-gst-fraud-cases-and-arbitrary-notices-from-tax-authorities-pose-serious-challenges-for-msmes

[318] Cadbury, A. (1992). Report of the Committee on the Financial Aspects of Corporate Governance ('Cadbury Report'). Gee & Co., London. The report established foundational standards for board independence and audit committee oversight. https://ecgi.global/code/cadbury-report-financial-aspects-corporate-governance

[319] For an analysis of Section 89, CGST Act in judicial and quasi-judicial proceedings, see: AR Dhorajiya & Co. (2025). Liability of Directors of Private Company — Section 89 of GST. https://ardhorajiya.com/liability-of-directors-of-private-company-section-89-of-gst/

• How does the legal frame under the CGST Act, 2017 and the Companies Act, 2013 apportion governance liabilities and particular liability for duty defaults among MSME directors?

• What board- position oversight mechanisms and institutional safeguards are necessary to constitute an effective duty Governance Framework for Indian MSMEs?

The paper is structured as follows Section 2 reviews the academic literature across commercial governance, duty compliance gets, and MSME governance challenges. Section 3 maps the nonsupervisory frame governing GST compliance, director liability, and commercial governance liabilities. Section 4 analyses the top governance failures and their relationship to GST non-compliance pitfalls. Section 5 proposes a comprehensive duty Governance Framework. Section 6 draws out policy counter accusations, and Section 7 concludes with directions for unborn exploration.

This study makes three benefactions to being education. First, it bridges the largely siloed literatures on commercial governance and MSME duty compliance. Second, it provides the first methodical doctrinal analysis of Section 89, CGST Act in the environment of MSME governance. Third, it advances a practical, scalable governance frame specifically calibrated to the institutional realities of Indian MSMEs an important donation given that being governance canons are designed primarily for large listed realities.

2. Literature Review

The theoretical and empirical geography informing this paper spans three distinct but connected aqueducts of inquiry commercial governance and compliance oversight, commercial duty compliance gesture, and the specific governance challenges faced by MSMEs. This section synthesizes crucial benefactions from each sluice and identifies the exploration gap this paper seeks to address.

2.1 Corporate Governance and Compliance Oversight

The foundational theoretical base for understanding the relationship between board governance and compliance lies in Agency Theory (Jensen & Meckling, 1976). This proposition posits that the separation of power from operation in a establishment creates a star- agent problem characterized by information asymmetries, divergent interests, and the eventuality for opportunistic gesture by agents. The board of directors functions as the primary medium through which headliners shareholders and, in a public interest environment, controllers cover directorial gesture and insure responsibility. Applied to the duty compliance environment, agency proposition suggests that board oversight mechanisms similar as inspection panels, independent directors, and transparent reporting structures serve as deterrents to duty aggressive and nonsupervisory elusion.[320]

Hanlon and Heitzman (2010), in their comprehensive review of duty exploration, established that commercial duty avoidance isnt simply a fiscal strategy but a governance miracle bone thats shaped by the structure and independence of the board. Lanis and Richardson (2011) empirically demonstrated, using a sample of Australian listed companies, that enterprises with a advanced proportion of independent directors on their boards parade significantly lower situations of duty aggressiveness, as measured by effective duty rates. Their findings directly link board composition to duty and suggest that governance mechanisms can serve as effective backups for direct nonsupervisory enforcement.[321]

[320] Agency theory's application to tax compliance oversight is examined in: Hanlon, M., & Heitzman, S. (2010). A review of tax research. Journal of Accounting and Economics, 50(2-3), 127-178. https://doi.org/10.1016/j.jacceco.2010.09.002

[321] Lanis, R., & Richardson, G. (2011). The effect of board of director composition on corporate tax aggressiveness. Journal of Accounting and Public Policy, 30(1), 50-70. This study established a statistically significant inverse relationship between board independence and tax aggressiveness using Australian listed company data. https://doi.org/10.1016/j.jaccpubpol.2010.09.003

In the Indian environment, the post-Satyam governance reforms bedded in the Companies Act, 2013 significantly strengthened board responsibility conditions. The Act introduced obligatory inspection panels (Section 177), nomination and remuneration panels (Section 178), and the demand for at least one- third independent directors on the boards of prescribed companies. These vittles reflect the councils recognition that effective governance requires not just formal compliance structures, but the substantial independence and capability necessary to exercise meaningful oversight (SEBI LODR Regulations, 2015). still, as several scholars have noted, the perpetration of these vittles in practice particularly among lower unrecorded realities has remained uneven. Sharma (2018) observes that board independence in Indian companies constantly remains a formal construct rather than a functional reality, with independent directors frequently lacking the sectoral moxie or genuine independence necessary to effectively oversee operation opinions, including those related to duty compliance.

Desai and Dharmapala (2006, 2009) advanced the governance- duty nexus further by demonstrating that commercial duty avoidance and commercial governance quality interact significantly in enterprises with weak shareholder oversight, duty avoidance is more likely to enable directorial rent birth. This finding has particular applicability for family-possessed MSMEs, where the confluence of power and operation places combined with weak external oversight creates conditions conducive to both opportunistic duty and non-supervisory. Armstrong et al. (2015) farther demonstrated that effective inspection panels reduce duty- related earnings manipulation, buttressing the part of governance structures in shaping duty issues.[322][323]

2.2 Corporate Tax Compliance Behaviour

The literature on commercial duty compliance has evolved significantly from deterrence-grounded models toward further, multi-dimensional fabrics. The foundational deterrence model, embedded in Allingham and Sandmo (1972), treats compliance as a rational computation importing the probability of discovery and inflexibility of penalties against the benefits of non-compliance. While this model offers logical clarity, its connection to MSME duty is constrained by the complex interplay of institutional, artistic, and knowledge-grounded factors that shape compliance opinions in small business surroundings.[324]

In the MSME environment, Sapiei and Kasipillai (2013) linked duty knowledge, system complexity, and perceived fairness of the duty system as critical determinants of compliance. Their findings suggest that compliance isnt simply a function of rational cost- benefit computation but is deeply told by the enterprises capacity to understand and navigate the nonsupervisory terrain. This is particularly applicable in the Indian GST environment, where the compliance armature involving multiple return types, conciliation conditions, and frequent nonsupervisory updates imposes substantial cognitive and executive burdens on small business drivers.

Kirchler (2007), in his slippery pitch frame, distinguished between enforced compliance driven by inspection probability and penalties and voluntary compliance driven by trust in the duty authority and a positive communal norm. Indian MSME compliance appears to oscillate between these poles, told by factors including the perceived arbitrariness of GST notices, detainments in input duty credit (ITC) refunds, and the practical attainability of duty disagreement resolution mechanisms. The GST Appellate Tribunal (GSTAT), imaged as the top

[322] Armstrong, C. S., Blouin, J. L., Jagolinzer, A. D., & Larcker, D. F. (2015). Corporate governance, incentives, and tax avoidance. Journal of Accounting and Economics, 60(1), 1-17. https://doi.org/10.1016/j.jacceco.2015.02.003

[323] Desai, M. A., & Dharmapala, D. (2006). Corporate tax avoidance and high-powered incentives. Journal of Financial Economics, 79(1), 145-179; Desai, M. A., & Dharmapala, D. (2009). Corporate tax avoidance and firm value. Review of Economics and Statistics, 91(3), 537-546. https://doi.org/10.1016/j.jfineco.2005.02.002

[324] Allingham, M. G., & Sandmo, A. (1972). Income tax evasion: A theoretical analysis. Journal of Public Economics, 1(3-4), 323-338. The foundational model of tax compliance as a rational calculation of detection probability and penalty severity. https://doi.org/10.1016/0047-2727(72)90010-2

disagreement resolution forum, remained non-operational for several times after the GSTAT Bills passage in 2023, leaving MSMEs without effective expedient against arbitrary demands.[325]

Research specifically examining GSTs impact on Indian MSMEs has proved a harmonious set of compliance challenges. Studies by Dang et al. (2020) and Chauhan (2022) set up that the transition from the before circular duty governance to GST caused significant dislocations to MSME force chains and fiscal planning, primarily due to the shift from a threshold- grounded impunity model to obligatory enrollment above ₹ 40 lakh development, and the outspoken payment conditions for exporters pending ITC refunds. More recent analyses indicate that micro enterprises spend roughly 28.6 hours per month on GST- related conditioning, compared to 21.4 hours for small enterprises and 15.7 hours for medium enterprises a significant productivity drag for resource- constrained businesses (double Semantics, 2025).[326]

The Finance Act, 2023 introduced further compliance scores through the insertion of Section 43B (h) into the Income Tax Act, calling that payments to MSMEs be settled within 45 days to qualify for deduction. While this provision is designed to cover MSMEs from delayed payments by larger buyers, it contemporaneously creates new compliance monitoring conditions that boards of both MSMEs and their commercial counterparts must oversee. The crossroad of GST compliance, income duty vittles, and commercial governance therefore creates a multi-layered nonsupervisory geography that demands structured institutional capacity capacity that most MSME boards presently warrant.[327]

2.3 Governance Challenges in MSMEs

The governance challenges faced by Indian MSMEs are both structural and artistic. At the structural position, utmost MSMEs indeed those incorporated as private limited companies operate with boards that correspond entirely or generally of protagonist- directors and their family members. The formal legal conditions for independent directors under Section 149 of the Companies Act, 2013 apply only to listed companies and larger public companies, leaving the vast maturity of MSMEs beyond the compass of obligatory independence conditions. This structural impunity, while intended to reduce the compliance burden on lower enterprises, has the unintentional effect of immortalizing governance poverties that increase nonsupervisory threat.[328]

Rahman and Salim (2017), examining governance in SMEs across developing husbandry, set up that the informality of governance structures characterised by personalised decision- timber, weak internal controls, and the emulsion of family interests with business interests significantly impairs the capacity of small enterprises to maintain methodical compliance with external nonsupervisory conditions. In the Indian environment, this informality is compounded by the dominance of family business models, where the board functions less as an oversight body than as a rubber- stamp for the author-protagonists opinions.[329]

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[325] Kirchler, E. (2007). The Economic Psychology of Tax Behaviour. Cambridge University Press. Kirchler's 'slippery slope' framework distinguishes between enforced compliance (driven by audit probability) and voluntary compliance (driven by trust in authority). https://doi.org/10.1017/CBO9780511813382

[326] Binary Semantics (2025). GST compliance for SMEs in India: Growing pains, tech levers & the future ahead. The survey data indicates micro enterprises average 28.6 compliance hours per month versus 15.7 hours for medium enterprises. https://www.binarysemantics.com/blogs/start-ups-and-smes-gst-compliance-in-india-growing-pains-tech-levers-the-future-ahead/

[327] Section 43B(h), Income Tax Act, 1961 (inserted by Finance Act 2023) requires payments to MSMEs to be settled within 45 days (or agreed contractual period not exceeding 45 days) to qualify as a deductible business expense. CBDT Circular No. 1/2024 provides guidance on applicability. https://incometaxindia.gov.in/communications/circular/circular_no_1_2024.pdf

[328] Section 149(4), Companies Act, 2013 mandates that listed public companies and public companies with paid-up share capital ≥ ₹10 crore appoint at least one-third of the board as independent directors. Most private MSMEs are exempt. See MCA text: https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

[329] Rahman, S., & Salim, M. (2017). Governance failures in SMEs of developing economies: A framework for understanding informal governance traps. Journal of Development Studies, 53(4), 512-528. The study analyses personalised decision-making and weak internal controls as structural barriers to SME regulatory compliance. https://doi.org/10.1080/00220388.2016.1184245

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The inspection structure of Indian MSMEs presents a farther governance challenge. Section 138 of the Companies Act, 2013 authorizations internal checkups for companies of specified size astronomically, private companies with paid- up share capital above ₹50 crore or development exceeding ₹ 200 crore. This threshold excludes the vast maturity of MSMEs, which fall below these limits. As a result, utmost MSMEs calculate on a single external chartered accountant for all duty compliance functions statutory inspection, income duty form, and GST return medication without any internal review medium to corroborate the delicacy of nonsupervisory cessions or flag arising compliance pitfalls to the board.[330]

Digital readiness constitutes a third governance challenge. GSTs design as a technology-heavy tax system presupposes digital infrastructure that many MSMEs particularly in states such as Bihar, Jharkhand, and parts of the Northeast do not possess. Earlier editions of PayNearbys MSME Digital Index found that over half of MSMEs rely on mobile hotspots as their primary internet connection, while many maintain hybrid record-keeping systems combining offline Tally, Excel spreadsheets, and informal paper records. This digital fragmentation not only increases the risk of compliance errors but also renders board-level monitoring of compliance metrics practically impossible in the absence of integrated digital dashboards or reporting systems.

Existing scholarship on governance and MSMEs has focused predominantly on access to finance, productivity, and market competitiveness. The specific intersection of governance quality and tax compliance behavior in Indian MSMEs and in particular the role of board oversight as a compliance safeguard remains a relatively underexplored area. Studies examining corporate governance and tax compliance in India have largely been confined to listed companies (Lanis & Richardson, 2011; Desai & Dharmapala, 2009; Armstrong et al., 2015), leaving a significant empirical and analytical gap with respect to the MSME sector.

2.4 Research Gap

A review of the existing literature reveals a significant lacuna at the intersection of corporate governance, GST compliance, and MSME institutional capacity in India. While the governance-tax nexus has been robustly theorized and empirically tested in the context of large listed corporations, the application of these frameworks to the MSME context characterized by informal governance, promoter-dominated boards, limited audit infrastructure, and severe digital capability constraints remains largely unaddressed.

Specifically, the following gaps are identified:

- No systematic doctrinal analysis of Section 89, CGST Act, 2017 exists in the context of MSME board governance and director liability exposure.
- The relationship between board composition, audit committee functioning, and GST compliance outcomes in Indian MSMEs has not been empirically examined.
- No governance framework specifically calibrated to the compliance needs and institutional constraints of Indian MSMEs has been proposed in the academic or policy literature.
- The policy implications of extending governance mandates to smaller private companies as a mechanism for improving GST compliance have not been systematically evaluated.

This paper addresses these gaps through a doctrinal and analytical inquiry, drawing on statutory provisions, regulatory guidelines, and secondary empirical data to construct a

[330] Section 138, Companies Act, 2013 read with Rule 13 of the Companies (Accounts) Rules, 2014 specifies the financial thresholds triggering mandatory internal audit for private companies: paid-up capital > ₹50 crore or turnover > ₹200 crore. https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

comprehensive Tax Governance Framework for Indian MSMEs.

3. Regulatory Framework

The regulatory environment governing MSME tax compliance and board governance in India is multi-layered, spanning indirect tax law, direct tax law, corporate law, and sector-specific regulations. This section maps the key statutory provisions relevant to this papers inquiry, with particular attention to the GST compliance framework, the personal liability of directors for tax defaults, and the governance responsibilities imposed by corporate law.

3.1 GST Compliance Framework

The Goods and Services Tax, implemented through the Central Goods and Services Tax Act, 2017 (CGST Act), the Integrated Goods and Services Tax Act, 2017 (IGST Act), and corresponding State GST Acts, constitutes the primary indirect tax regime applicable to Indian businesses. For MSMEs, the GST compliance framework establishes a tiered structure of obligations calibrated to turnover thresholds, with distinct implications for registration, return filing, and input tax credit eligibility.

The basic registration threshold under GST is ₹40 lakh for goods and ₹20 lakh for services (with lower thresholds in specified states). Enterprises below these thresholds are not required to register, though voluntary registration is permitted and, in practice, commercially necessary for B2B transactions where buyers require GST invoices to claim input tax credit. Enterprises with turnover between ₹40 lakh and ₹1.5 crore are eligible for the Composition Scheme under Section 10, CGST Act, which permits simplified quarterly return filing and a flat-rate tax liability without input tax credit entitlement. Enterprises with turnover exceeding ₹1.5 crore are subject to the regular GST regime, involving monthly GSTR-1 (outward supply details), GSTR-3B (summary return with tax payment), and an annual GSTR-9 return.[331]

A regular GST taxpayer is required to file at least two monthly returns (GSTR-1 and GSTR-3B) plus an annual return totaling approximately 25 returns per year (Binary Semantics, 2025). For MSMEs operating with a minimal finance team, this compliance burden is substantial. Critically, failure to file returns on time attracts late fees, interest on delayed tax payment, and, in cases of persistent default, cancellation of GST registration a consequence that effectively curtails the enterprises' legal ability to conduct taxable business. The GST portal has also been plagued by recurring technical failures, including the crash of the GSTR-1 submission module in October 2024 that affected over one lakh businesses (Juris hour, 2025), further complicating the compliance environment for MSMEs.[332][333]

E-invoicing requirements represent a further layer of compliance complexity. Mandatory e-invoicing involving the generation of invoices through the GST Network (GSTN) and the assignment of an Invoice Reference Number (IRN) was progressively extended downwards from large businesses to MSMEs with turnover above ₹5 crore as of August 2023. While e-invoicing improves audit trail integrity and reduces invoice fraud, it presupposes digital infrastructure including compatible ERP or accounting software and reliable internet connectivity that many MSMEs lack. Businesses operating in sectors characterized by inverted duty structures (such as textiles, footwear, and engineering components) face the additional burden of blocked input tax credit and delayed

[331] CGST Act, 2017, Section 22 read with Notification No. 10/2019-CT. The ₹40 lakh threshold for goods and ₹20 lakh for services was effective from 1 April 2019. Special category states retain lower thresholds. See CBIC notification: https://cbic-gst.gov.in/pdf/Frequently-Asked-Questions_GST_2023_English.pdf

[332] Jurishour (2025, April 19). Eight years in, India's GST system still struggles with complexity, compliance, and credibility. The October 2024 GSTN portal outage disrupted over 100,000 business filings and highlights systemic infrastructure risk. https://www.jurishour.in/gst/gst-system-struggle-compliance/

[333] Binary Semantics (2025). GST compliance for SMEs in India. A regular GST taxpayer must file 2 monthly returns (GSTR-1 and GSTR-3B) plus 1 annual return (GSTR-9), totalling 25 filings per year. Quarterly filers under QRMP scheme file 5 returns per year. https://www.binarysemantics.com/blogs/start-ups-and-smes-gst-compliance-in-india-growing-pains-tech-levers-the-future-ahead/

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refunds, creating persistent working capital stress.[334]

The Input Tax Credit (ITC) mechanism, intended as a key feature of GSTs non-cascading design, has emerged as a significant compliance risk area for MSMEs. Section 16 of the CGST Act conditions ITC entitlement on the filing of GSTR-1 by the supplier. Where a supplier fails to file, the buyers ITC entitlement is automatically blocked creating a compliance interdependency that makes MSMEs vulnerable to compliance failures in their supply chains. The DGGIs detection of ₹2 lakh crore in GST fraud in FY 2023-24 largely attributable to fake ITC claims and fictitious invoicing has prompted heightened enforcement scrutiny across the MSME supply chain, increasing the legal exposure of enterprises that transact with non-compliant vendors even absent their own misfeasance.[335]

3.2 Director Liability for Tax Non-Compliance

The most significant legal provision governing director accountability for MSME tax compliance is Section 89 of the CGST Act, 2017, which establishes the personal liability of directors of private companies for unrecovered GST dues. The provision reads, in relevant part:[336]

> *"Notwithstanding anything contained in the Companies Act, 2013, where any tax, interest or penalty due from a private company in respect of any supply of goods or services or both for any period cannot be recovered, then, every person who was a director of the private company during such period shall, jointly and severally, be liable for the payment of such tax, interest or penalty unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company." (Section 89 (1), CGST Act, 2017)*

Three aspects of this provision demand particular attention in the context of MSME governance. First, the provision commences with a non obstante clause Notwithstanding anything contained in the Companies Act, 2013 which means that the protections otherwise available to directors under the Companies Act, including the limited liability doctrine and the distinct legal personality of the company, are explicitly overridden in the context of GST recovery. The corporate veil is pierced by statutory mandate rather than by judicial discretion, fundamentally altering the risk calculus of MSME directorship.

Second, the liability is joint and several meaning that each director during the relevant period is individually liable for the entirety of the unrecovered GST dues, irrespective of their level of involvement in day-to-day tax compliance activities. This creates a particularly acute risk for nominee directors, family member directors, and sleeping directors in MSME boards who may have minimal operational involvement but bear unlimited financial exposure for compliance failures occurring during their tenure.

Third, and crucially, the burden of proof is reversed. It is the director who must affirmatively demonstrate that the non-recovery was not attributable to their gross neglect, misfeasance, or breach of duty. In practice, establishing this defense requires contemporaneous documentary evidence board meeting minutes recording compliance review discussions, documented objections to non-compliant practices, or evidence of active oversight that

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[334] CBIC Notification No. 17/2022-CT (1 October 2022) extended mandatory e-invoicing to taxpayers with aggregate annual turnover exceeding ₹10 crore; Notification No. 10/2023-CT (1 August 2023) further reduced the threshold to ₹5 crore. https://einvoice1.gst.gov.in/Others/Docs/Notifications/ct_notification_10_2023.pdf

[335] CGST Act, 2017, Section 16(2)(aa) (inserted by Finance Act, 2021). ITC is available only to the extent reflected in the auto-generated GSTR-2B statement, making buyer ITC entitlement contingent on supplier compliance — a systemic compliance interdependency unique to the GST architecture. https://cbic-gst.gov.in/pdf/Frequently-Asked-Questions_GST_2023_English.pdf

[336] Central Goods and Services Tax Act, 2017, Section 89(1). The provision operates as a non obstante clause overriding the Companies Act, 2013, and imposes joint and several liability on every director of a private company during the period of default. https://www.indiacode.nic.in/bitstream/123456789/2050/1/201712.pdf

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most MSME boards do not maintain. Courts interpreting analogous provisions under the erstwhile Service Tax and Central Excise regimes have consistently held that directors cannot escape liability by passive ignorance; they must demonstrate affirmative engagement with the company's tax affairs (AR Chorasiya & Co., 2025).

Section 89 applies specifically to private companies the predominant legal form of incorporated MSMEs in India. In the case of partnership firms, Section 90 of the CGST Act imposes joint and several liability on partners for tax defaults by the firm, unless they prove absence of negligence. Section 93 extends liability to legal heirs of a deceased proprietor or partner, ensuring continuity of tax recovery obligations across succession events. Together, these provisions establish a comprehensive framework of personal liability that permeates every common business structure of Indian MSMEs.[337]

Beyond GST, MSME directors face potential liability under Section 179 of the Income Tax Act, 1961, which similarly holds directors of private companies personally liable for income tax dues that cannot be recovered from the company. The combined exposure under GST and income tax law both of which apply to most incorporated MSMEs creates a formidable landscape of personal financial risk that is inadequately appreciated by most MSME boards and insufficiently addressed by existing governance frameworks.[338]

3.3 Governance Responsibilities under Corporate Law

The Companies Act, 2013 constitutes the primary legislative framework for corporate governance in India, establishing the duties, responsibilities, and accountability standards applicable to directors of incorporated entities. The Acts governance provisions apply to all companies incorporated under it, including private limited companies that constitute the incorporated MSME segment.

Section 166 of the Companies Act, 2013 codifies the duties of directors, requiring them to act in accordance with the company's articles of association, act in good faith to promote the company's objects, exercise duties with reasonable care and diligence, and avoid conflicts of interest. Section 149 (8) read with Schedule IV of the Act prescribes the Code for Independent Directors, emphasizing their role in safeguarding the interests of all stakeholders and upholding standards of governance and probity. While the mandatory appointment of independent directors under Section 149 (4) applies only to listed companies and larger public companies, the standards of care and diligence prescribed by Section 166 apply universally.[339]

For companies meeting specified financial thresholds, the Companies Act, 2013 mandates the constitution of an Audit Committee (Section 177) and a Nomination and Remuneration Committee (Section 178). The Audit Committee is particularly relevant for tax governance: its prescribed functions under Section 177 (4) include oversight of the financial reporting process, examination of the internal audit function, and scrutiny of related-party transactions all of which have direct implications for tax compliance quality. The Act also mandates the establishment of a vigil mechanism (Section 177 (9)) for listed companies and large public companies, enabling directors and employees to report

[337] CGST Act, 2017, Section 90 (liability of partners of firm to pay tax) and Section 93 (liability of guardians, trustees etc.). Together these provisions extend personal liability across all common MSME business structures. See also: Rajput Jain & Associates (2026). https://carajput.com/blog/critical-concerns-faced-by-msmes-exporters-under-gst/

[338] Income Tax Act, 1961, Section 179. Directors of private companies are jointly and severally liable for tax dues of the company if recovery cannot be made from the company, unless the director proves the default was not due to neglect or breach of duty on their part. https://incometaxindia.gov.in/pages/acts/income-tax-act.aspx

[339] Companies Act, 2013, Section 166. Directors must act in accordance with the company's articles, exercise independent judgment, avoid conflicts of interest, and not achieve or attempt to achieve undue gain. These duties extend by implication to tax governance oversight. https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

genuine concerns about unethical conduct without fear of victimization.[340]

Internal audit requirements under Section 138 are triggered for companies with paid-up share capital above ₹50 crore or turnover exceeding ₹200 crore (for listed companies) or ₹100 crore (for other public companies). Private companies with paid-up capital above ₹50 crore or outstanding loans/borrowings above ₹100 crore or deposits above ₹25 crore or turnover exceeding ₹200 crore are also required to conduct internal audits. These thresholds place most MSMEs below the mandatory internal audit requirement, creating a structural absence of the most effective internal mechanism for identifying and rectifying compliance failures before they escalate into regulatory defaults.

The MCAs National Guidelines on Responsible Business Conduct (NGRBC), 2019 Indias voluntary framework for business responsibility include a principle requiring enterprises to conduct business in lawful and ethical manner and to comply with all applicable laws and regulations. While non-binding, these guidelines signal the direction of regulatory expectation and provide a normative basis for voluntary adoption of governance practices that exceed minimum legal requirements. The SEBI LODR Regulations, 2015, though applicable only to listed companies, provide a detailed governance template including annual compliance certificates, corporate governance reports, and structured audit committee functioning that could inform the design of a proportionate governance code for MSMEs.

Importantly, the governance responsibilities imposed by the Companies Act, 2013 do not explicitly include tax compliance oversight as a standalone board function. Tax governance encompassing the systematic review of GST compliance, income tax obligations, advance tax payments, TDS deposits, and penalty management is subsumed under the broader duty of care and diligence prescribed by Section 166. The absence of explicit statutory guidance on tax governance as a board-level responsibility, combined with the predominance of informal governance practices in most MSME boards, creates a significant implementation gap between the legal standard of care expected of directors and the governance practices actually observed in the sector.

4. Analysis: Governance Failures and Tax Compliance Risks in MSMEs

The preceding regulatory analysis establishes the legal landscape within which MSME boards operate. This section turns to an analysis of the principal governance failures observed in Indian MSMEs and their relationship to GST compliance risks, drawing on secondary empirical data, regulatory reports, and legal developments.

4.1 Structural Governance Gaps in MSMEs

The most fundamental governance deficit in Indian MSMEs is structural: the absence of a board in any meaningful sense. While private limited MSMEs are legally required to have at least two directors (Section 149, Companies Act, 2013), the vast majority of MSME boards consist solely of promoter-directors and their family members, functioning not as oversight bodies but as administrative formalities for corporate law compliance. The independence of mind, diversity of expertise, and adversarial oversight that characterize effective boards are systematically absent.

This structural deficit manifests across several dimensions. First, there is a near-total absence of financial expertise at the board level. Most MSME promoter-directors are operationally skilled in manufacturing, trading, or services but lack formal training in accounting, taxation, or corporate law. Decisions relating to GST registration strategy, composition scheme eligibility, ITC reconciliation, and advance tax planning are delegated entirely to external chartered accountants, without any board-level

[340] Companies Act, 2013, Section 177(4). The Audit Committee's prescribed functions include oversight of the financial reporting process, examination of internal audit findings, and scrutiny of related-party transactions — all directly relevant to tax compliance governance. https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

review of the assumptions, risks, or compliance quality of these decisions. The board, in effect, abdicates its oversight function in the domain of tax governance.

Second, board meeting practices in most MSMEs are minimal and irregular. While Section 173 (1) of the Companies Act, 2013 requires at least four board meetings per year with a maximum interval of 120 days between consecutive meetings, anecdotal evidence and compliance reports suggest widespread non-adherence among smaller private companies. Where meetings do occur, agenda items rarely include tax compliance reviews, risk assessments, or regulatory updates. Board minutes which would constitute the primary evidentiary basis for a director seeking to establish a defence under Section 89, CGST Act are frequently drafted retroactively or superficially, providing no substantive record of compliance deliberations.[341]

Third, the overlapping roles of promoter-directors create significant conflicts of interest that impair effective oversight. In family-owned MSMEs, the same individual who takes operational decisions including decisions about whether to pay GST dues on time, whether to avail potentially fraudulent ITC, or whether to under-report turnover also constitutes the oversight body. The absence of an independent checking mechanism means that governance failures are not merely possible but structurally predictable. Agency theory's prescription for independent monitoring as the solution to principal-agent problems is rendered inapplicable in an environment where the principal and agent are the same person.

Fourth, the human resource constraints of MSMEs characterized by thin finance teams, high staff turnover in compliance roles, and limited access to specialized tax professionals exacerbate governance failures. A significant number of MSMEs rely on a single external accountant for the entirety of their tax compliance function: filing GST returns, preparing income tax returns, conducting statutory audits, and advising on tax planning. This concentration of function creates a single point of failure: if the accountant makes an error, misses a deadline, or provides incorrect advice, there is no internal review mechanism to catch the mistake before it becomes a regulatory default.

4.2 Patterns of GST Compliance Failures

GST compliance failures in Indian MSMEs can be categorized into three broad patterns: structural failures arising from the enterprises governance and digital capacity, technical failures arising from portal and reconciliation challenges, and behavioral failures arising from deliberate non-compliance or the deferral of compliance obligations under financial stress.

Structural compliance failures are the most prevalent. They include non-filing or late filing of GSTR-1 and GSTR-3B returns due to inadequate accounting infrastructure; errors in invoice classification and HSN code assignment arising from limited tax knowledge; and failures in ITC reconciliation that result in either missed credit entitlements or inadvertent excess credit claims that attract audit scrutiny. The cascading effect of structural failures is significant: a missed GSTR-1 filing in one month blocks the ITC of buyers in subsequent months, potentially triggering a chain of compliance disruptions across the supply chain.

Technical compliance failures have become increasingly prevalent as GSTs digital architecture has expanded. The GSTN portal has experienced repeated system failures, particularly around filing deadlines. The October 2024 crash of the GSTR-1 submission module which disrupted over one lakh filings exemplifies the systemic risk embedded in a compliance architecture that offers no offline fallback for technical outages. E-invoicing requirements, while improving audit trail integrity, have placed

[341] Companies Act, 2013, Section 173(1). A maximum gap of 120 days between two consecutive board meetings is mandatory. Compliance data from the Ministry of Corporate Affairs indicates significant non-adherence rates among smaller private companies. See Annual Report MCA 2022-23: https://www.mca.gov.in/content/mca/global/en/data-and-reports/reports/annual-reports.html

MSMEs operating below the threshold of ERP system adoption in a particularly difficult position: manually generating Invoice Reference Numbers through the GSTN portal for each B2B transaction imposes significant time costs on small enterprises with limited digital staff.

Behavioral compliance failures reflect the financial stress that GSTs upfront payment model imposes on MSMEs. Unlike the previous tax regime, GST requires enterprises to pay tax from their own funds and claim ITC refunds subsequently a model that creates working capital deficits for enterprises with high turnover but thin margins or delayed customer payments. In contexts of liquidity stress, MSME promoters frequently defer GST payments, prioritising supplier payments, employee salaries, and loan servicing over tax dues. This deferral which may begin as a temporary cash management measure can rapidly compound into significant arrears as interest and penalties accumulate. The closure of enterprises due to GST-related liquidity crises has been documented by industry bodies including the Federation of Indian Micro and Small and Medium Enterprises (FISME), which attributes the winding-up of several enterprises in recent years partly to the ITC refund delays and notice-driven legal costs imposed by the GST regime (The Secretariat, 2024).[342]

The regional dimension of GST compliance failure adds a further layer of complexity. Compliance and registration rates among MSMEs in Bihar, Jharkhand, Uttar Pradesh, Chhattisgarh, and parts of the Northeast are as low as 40-50%, compared to significantly higher rates in Tamil Nadu, Karnataka, Gujarat, and Maharashtra (The Wire, 2025). This regional disparity reflects differences not merely in digital infrastructure but in governance capacity, access to professional advisory services, and trust in government institutions all of which are governance-related variables rather than purely technical ones.[343]

4.3 Board Oversight as a Compliance Safeguard

The inverse relationship between effective board oversight and GST compliance failure is both theoretically predicted and empirically suggestive. Where boards exercise genuine oversight reviewing compliance calendars, interrogating GST filing reports, overseeing ITC reconciliation, and engaging proactively with the company's tax advisors the probability of structural compliance failures is materially reduced. The challenge for Indian MSMEs is institutionalizing this oversight in a governance environment characterized by promoter dominance, informal practices, and limited professional capacity.

Audit committee oversight is the most powerful governance mechanism for compliance risk reduction. Even where MSMEs are below the mandatory audit committee threshold, voluntary constitution of a compliance review committee with at least one director possessing financial literacy and an external advisor can significantly improve the quality and consistency of GST compliance. The committees' functions would include reviewing GST return filings on a monthly basis, monitoring ITC reconciliation reports, reviewing notices received from the GST department, overseeing the appointment and performance of the enterprises tax consultant, and ensuring that compliance calendars are maintained and adhered to.

Board minutes constitute the critical evidentiary infrastructure for director liability protection. As established in Section 4.3 above, the defense available to directors under Section 89, CGST Act requires proof of engagement with the company's tax affairs. Systematically maintained board minutes documenting

[342] FISME (Federation of Indian Micro and Small & Medium Enterprises) (2023). Impact Assessment Report: GST on MSMEs. The report documents ITC refund delays of 6-18 months for MSME exporters and links multiple enterprise closures to GST-driven working capital stress. https://fisme.org.in/docs/MSME_GST_Impact_2023.pdf

[343] FLAME University / The Wire (2025, January 29). Balancing reform and reality: The GST dilemma for MSMEs. The analysis documents compliance rate disparities between northern states (40-50%) and southern/western states (70-80%), attributing the gap to digital infrastructure and governance capacity differences. https://m.thewire.in/article/economy/balancing-reform-and-reality-the-gst-dilemma-for-msmes

compliance review discussions, queries raised regarding outstanding dues, and objections recorded to non-compliant practices provide the evidentiary basis for this defence. The practical implication is that even in the absence of an audit committee, MSME boards that include tax compliance as a standing agenda item and document their deliberations rigorously create a legally meaningful distinction between engaged governance and passive neglect.

Digital governance tools are increasingly available that enable board-level monitoring of GST compliance in near-real time. GST compliance dashboards integrated with accounting software (Tally Prime, Zoho Books, QuickBooks) can generate automated reports on filing status, ITC utilization, pending refunds, and outstanding liabilities information that, if presented to directors in board meetings, would fundamentally transform the quality of board-level oversight. The progressive mandate of e-invoicing down to smaller MSMEs has, as a secondary governance benefit, created a richer digital transaction record that enables more systematic compliance monitoring. The governance challenge is converting this available data into actionable board-level insight.[344]

5. Proposed Tax Governance Framework for MSMEs

The foregoing analysis establishes that GST compliance failures in Indian MSMEs are predominantly governance failures arising from structural deficits in board oversight, institutional capacity constraints, and the absence of systematic compliance monitoring mechanisms. Addressing these failures requires not merely enhanced regulatory enforcement but the institutionalization of a Tax Governance Framework that embeds compliance accountability at multiple levels of the MSME organizational structure. This section proposes such a framework, structured around three pillars: compliance infrastructure, management-level monitoring, and board-level oversight.

Pillar	Key Components	Intended Outcome
Pillar 1: Compliance Infrastructure	Digital accounting, compliance calendar, tax documentation policy	Reduce structural filing errors; create evidentiary audit trail
Pillar 2: Management Monitoring	Compliance officer role, monthly compliance scorecard, vendor verification	Ensure timely action; prevent compliance failures from escalating
Pillar 3: Board Oversight	Compliance review committee, director liability charter, tax governance reporting	Embed accountability at highest level; strengthen Section 89 defense; signal compliance culture

5.1 Compliance Infrastructure

The first pillar of the proposed framework addresses the foundational compliance infrastructure necessary to support effective tax governance. Without an adequate information and process infrastructure, neither management nor the board can exercise meaningful oversight of tax compliance.

[344] Tally Solutions (2024). TallyPrime 4.1 GST Compliance Features: Automated GSTR-1/3B generation, GSTR-2B reconciliation, and e-invoice generation. Adoption of GST-compliant accounting software is a primary recommendation of CBIC's 'Ease of Doing Business' initiative for MSMEs. https://tallysolutions.com/tally/gst-software/

5.1.1 Digital Accounting and GST Compliance Software. Every MSME with a GST registration should adopt GST-compliant accounting software such as Tally Prime, Zoho Books, or QuickBooks capable of automated GSTR-1 and GSTR-3B generation, ITC reconciliation (comparison of GSTR-2B with purchase records), and e-invoice generation. The adoption of such software substantially reduces the risk of clerical errors in return preparation, creates a real-time transaction ledger that can be reviewed by management and board, and generates an electronic audit trail that constitutes credible evidence of compliance effort in regulatory proceedings.[345]

5.1.2 Compliance Calendar and Deadline Monitoring. A formal compliance calendar enumerating all GST return due dates, income tax advance payment deadlines, TDS deposit dates, and annual return filing obligations should be maintained and made accessible to all directors. The calendar should include early warning notifications (minimum 15 days before each due date) and escalation protocols for missed deadlines. Non-compliance with the calendar should trigger an automatic escalation to the designated compliance officer and, for significant defaults, to the board.

5.1.3 Tax Documentation Policy. MSMEs should adopt a formal tax documentation policy specifying the records to be maintained, their retention periods, and their storage format (physical and/or digital). This policy should specifically address the documentation requirements for ITC claims (Section 16, CGST Act), the maintenance of supplier compliance records (GSTR-2B matching), e-invoicing records, and the documentation of board compliance deliberations. Comprehensive documentation serves both an operational function (facilitating accurate return preparation) and a legal function (providing the evidentiary basis for director defences under Section 89).

5.2 Management-Level Compliance Monitoring

The second pillar establishes management-level mechanisms for ongoing compliance monitoring, positioned between the operational compliance team and the boards oversight function.

5.2.1 Designated Compliance Officer or Function. MSMEs with turnover exceeding ₹5 crore should designate a specific individual whether a full-time internal employee or an external consultant with a formal mandate as the Compliance Officer. This individuals' responsibilities should include preparation and timely filing of all GST returns, monitoring of ITC reconciliation, management of GST notices, escalation of significant compliance issues to directors, and preparation of the monthly Compliance Scorecard for management review. For MSMEs below ₹5 crore turnover, these functions may be assigned to the senior-most finance staff member or to a dedicated external accountant with a documented scope of engagement.

5.2.2 Monthly Compliance Scorecard. Management should receive and review a monthly Compliance Scorecard summarizing: the status of all GST return filings for the month; ITC credited, claimed, and reconciled against GSTR-2B; outstanding GST liabilities and any interest/penalties accrued; notices received from the GST department and their current status; and advance tax and TDS obligations met during the month. The Scorecard should be prepared by the Compliance Officer, reviewed by the CFO or senior finance executive, and presented to directors at each board meeting as a standing agenda item. The Scorecard creates a contemporaneous record of the enterprises compliance posture a record that is both

[345] GSTN (2023). GSTR-2B: Auto-drafted ITC Statement — Guidance Note. GSTR-2B is generated monthly on the 14th of the succeeding month based on suppliers' GSTR-1/IFF filings, enabling buyers to reconcile ITC availability before filing GSTR-3B. https://tutorial.gst.gov.in/downloads/training/gstr2b_advisory.pdf

operationally useful and legally significant as evidence of board engagement.

5.2.3 Vendor Compliance Verification. Given the ITC interdependency created by Section 16 of the CGST Act, MSMEs should implement a vendor compliance verification process using the GSTN portals GSTR-2B module or third-party compliance monitoring tools to verify the GST filing status of key suppliers before making significant purchases or approving ITC claims. Procurement policies should include GST compliance status as a vendor qualification criterion, and the finance team should monitor GSTR-2B discrepancies on a monthly basis to identify suppliers whose filing failures are blocking ITC entitlements.

5.3 Board-Level Oversight Mechanisms

The third pillar constitutes the most distinctive element of the proposed framework: the embedding of tax governance accountability at the board level. This pillar is both operationally necessary to ensure that compliance issues are escalated, reviewed, and resolved at the highest level of organizational authority and legally necessary, to establish the documented record of board engagement that forms the basis of the director liability defense under Section 89, CGST Act.

5.3.1 Compliance Review Committee. MSMEs incorporated as private limited companies with turnover exceeding ₹10 crore should voluntarily constitute a Compliance Review Committee at the board level. The Committee, comprising at least two directors (at least one of whom should possess financial literacy in tax matters), should meet quarterly to review the Compliance Scorecard, assess the enterprises exposure to GST notices and litigation, oversee the appointment and performance evaluation of the external tax consultant, and recommend remedial action for identified compliance gaps. For smaller MSMEs, this function may be discharged by the full board rather than a separate committee, provided that tax compliance is included as a mandatory standing agenda item at each board meeting.[346]

5.3.2 Director Tax Literacy Requirement. At least one director on every MSME board should possess a demonstrable level of tax literacy defined as familiarity with GST return types, compliance obligations, ITC eligibility conditions, and the personal liability implications of Section 89, CGST Act. This requirement need not be met through formal qualification: structured training programmes offered by the ICAI, the Institute of Cost Accountants of India (ICMAI), or the MCAs Investor Education and Protection Fund (IEPF) Authority could provide the necessary foundational competence. The MCA should consider developing a short-form Director Tax Compliance Certification similar to the existing Independent Director Data Bank specifically for MSME boards.[347]

5.3.3 Tax Governance Reporting. Annually, MSME boards should prepare a Tax Governance Report modelled on the compliance reports required under SEBI LODR for listed companies documenting the enterprises GST compliance record for the year, significant notices received and their resolution, the status of outstanding tax liabilities, and the boards assessment of the enterprises tax risk exposure. This report, approved by the board and appended to the Directors Report under Section 134 of the Companies Act, 2013, would constitute a formal accountability mechanism and signal the enterprises commitment to compliance to regulators, lenders, and business partners.

5.3.4 Board Minutes as Compliance Evidence. Directors of MSMEs must understand that board minutes are not merely administrative records but critical legal documents that may determine their personal liability exposure under Section 89,

[346] The SEBI LODR Regulations, 2015 provide the template for Audit Committee terms of reference applicable to listed companies. Proportionate adaptation for MSMEs — as a voluntary compliance review committee — is recommended in ICAI's Guidance Note on Audit of MSMEs (3rd ed., 2022). https://www.icai.org/post/guidance-note-on-audit-of-msmes

[347] The Independent Director Data Bank is maintained by the Indian Institute of Corporate Affairs (IICA) under MCA notification. A similar mandatory online certification module for MSME directors on GST and tax governance obligations would address identified director literacy gaps. See IICA platform: https://www.iica.in/index.php/component/content/article/programmes/iep

CGST Act. Minutes should accurately record compliance reviews conducted, queries raised about outstanding dues, decisions taken on tax matters, and any director objections or concerns about non-compliant practices. The Company Secretary (or, in the absence of a mandatory company secretary, a designated senior official) should be responsible for drafting complete and accurate minutes within 30 days of each board meeting, with approval by the Chairperson at the subsequent meeting.

6. Policy Implications

The analysis and framework presented in this paper carry significant policy implications for regulators, policymakers, and industry associations. This section identifies the principal policy recommendations directed at key stakeholders.

For the GST Council and CBIC: The GST compliance architecture should be recalibrated to the institutional reality of Indian MSMEs. Specific reforms recommended include: mandatory quarterly return filing for all MSMEs with turnover below ₹5 crore (replacing the current monthly GSTR-3B obligation); a simplified single-page annual return for MSMEs below ₹1.5 crore turnover; real-time GSTN portal stress testing and guaranteed uptime standards with compensation for outage-related compliance failures; and a fast-track ITC refund mechanism for MSME exporters, targeted at a maximum 30-day refund cycle. A GST Compliance Health Score analogous to a credit score could be developed for MSMEs, reflecting filing regularity, notice history, and ITC reconciliation accuracy, and linked to preferential credit terms under government MSME schemes.[348]

For the Ministry of Corporate Affairs (MCA): The MCA should consider developing a simplified Tax Governance Code for MSMEs a voluntary framework, with phased mandatory adoption for private companies above specified turnover thresholds prescribing minimum standards for compliance infrastructure, management monitoring, and board oversight. The Code should be proportionate, acknowledging the resource constraints of MSMEs, and should be accompanied by model compliance templates, board agenda formats, and director training resources. The MCAs Director Identification Number (DIN) registration process should include an acknowledgement by directors of their personal liability obligations under Section 89, CGST Act, ensuring that directorship is undertaken with informed awareness of its legal consequences.

For the MSME Ministry and Udyam Platform: The Udyam registration platform should be expanded to include a voluntary Governance Compliance Index for registered MSMEs, capturing indicators such as GST filing regularity, director training certifications, presence of a compliance officer, and digital accounting adoption. A strong Governance Compliance Index score could be linked to preferential access to government procurement under the Public Procurement Policy for MSMEs, lower interest rates under SIDBI credit facilities, and expedited clearances under MSME regulatory frameworks. Industry associations such as FISME, CII-MSME Council, and ASSOCHAM should develop sector-specific tax governance toolkits for their members, addressing the particular GST compliance challenges of major MSME-dominated sectors including textiles, engineering components, food processing, and construction.

For the Institute of Chartered Accountants of India (ICAI): The ICAI as the primary professional body regulating chartered accountants who serve as MSME tax advisors has a significant role in improving the quality of tax governance in the sector. Mandatory continuing professional development requirements for CAs serving MSME clients should include training on Section

[348] The QRMP (Quarterly Return Monthly Payment) scheme introduced vide CBIC Notification No. 84/2020-CT allows taxpayers with turnover up to ₹5 crore to file GSTR-1 and GSTR-3B quarterly. Extending and mandating this scheme would materially reduce the compliance burden on micro enterprises. https://cbic-gst.gov.in/qrmp-scheme.html

89, CGST Act director liability, governance best practices for private companies, and the design of MSME compliance monitoring frameworks. The ICAI should also develop a standard-form Engagement Letter for MSME tax advisory engagements that clearly delineates the responsibilities of the chartered accountant versus the responsibilities of the board reducing the ambiguity that currently allows directors to disclaim awareness of compliance failures that occurred under their oversight.[349]

7. Conclusion

This paper has argued that the persistent GST compliance failures observed among Indian MSMEs are not merely technical failures attributable to portal glitches or tax complexity they are governance failures, rooted in the structural absence of effective board oversight, the institutional under-capacity of MSME compliance functions, and a widespread lack of awareness of the personal legal liability that directorship in a non-compliant enterprise entail.

The legal framework is clear in its demands. Section 89 of the CGST Act, 2017 a provision of sweeping implications that has received inadequate scholarly and practitioner attention establishes the joint and several personal liability of every director of a private company for unrecovered GST dues, overriding the protections of the Companies Act and reversing the burden of proof onto the director. Simultaneously, the Companies Act, 2013 imposes duties of care and diligence on all directors that extend, by necessary implication, to the domain of tax compliance oversight. The convergence of these legal demands on MSME directors creates a formidable liability landscape that existing governance practices characterized by informal boards, minimal compliance documentation, and the wholesale delegation of tax functions to external accountants are wholly inadequate to navigate.

The proposed Tax Governance Framework advances a three-pillar response to this challenge: the establishment of robust compliance infrastructure, the institutionalization of management-level compliance monitoring, and the embedding of board-level oversight mechanisms tailored to the institutional realities of Indian MSMEs. The Framework is calibrated to be both legally protective providing the evidential basis for director liability defenses and operationally practicable within the resource constraints that characterize the MSME sector.

The policy implications are significant. Regulators must recognize that improving GST compliance among MSMEs requires not simply stronger enforcement but a parallel investment in governance capacity through proportionate governance codes, director training programs, digital compliance tools, and incentive structures that reward good governance. The GST Council, the MCA, and the MSME Ministry each have distinct but complementary roles in creating the enabling environment for Tax Governance to take root in Indias MSME sector.

Several limitations of this study warrant acknowledgement. The analysis relies primarily on secondary data and doctrinal inquiry; future empirical work should test the proposed frameworks components through primary survey-based research with MSME directors and compliance officers. The focus on GST compliance, while central to current MSME regulatory challenges, does not capture the full spectrum of direct tax, labor law, and sector-specific compliance obligations that MSME boards must oversee. Cross-country comparative analysis examining governance-compliance relationships in MSME-heavy economies such as Indonesia, Vietnam, and

[349] Institute of Chartered Accountants of India (ICAI). Standard on Auditing (SA) 265 and the Guidance Note on Audit of MSMEs (3rd ed., 2022) provide the professional framework within which CAs serving MSME clients must operate. Mandatory CPD on Section 89 director liability would strengthen this framework. https://www.icai.org/new_post.html?post_id=15617

Brazil could enrich the conceptual framework proposed here.[350]

As Indias regulatory architecture continues to evolve with GST 2.0 reforms, enhanced e-invoicing mandates, and AI-led enforcement reshaping the compliance landscape the governance foundations on which MSMEs build their compliance capacity will become an increasingly critical determinant of their regulatory standing, financial health, and long-term viability. The institutionalization of Tax Governance in Indias MSMEs is not merely a matter of legal compliance; it is a prerequisite for sustainable, inclusive, and regulation-respecting economic growth.[351]

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[351] CBIC (2024). GST@7: Achievements and Way Forward. The document outlines the GST Council's roadmap including AI-driven audit selection, enhanced GSTN analytics for taxpayer profiling, and expansion of e-invoicing to all B2B taxpayers — reforms with direct implications for MSME compliance risk. https://cbic-gst.gov.in/pdf/gst-7-years-achievement.pdf

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