

MSMEs undertaking defence R&D slapped with 18% GST notices

Dalip Singh
New Delhi

Private start-ups and other MSMEs are receiving notices to pay 18 per cent taxes under the CGST Act on funding received from the Ministry of Defence for research and development (R&D). Government officials say this amounts to "taxing innovation" as it disincentivises Prime Minister Narendra Modi's focus on 'aatmanirbharta' in the military sector.

Government research associations, universities, colleges and other entities registered under the Department of Scientific and Industrial Research have been exempted from the tax by the GST Council through a notification issued on October 8, 2024.

Meanwhile, private organisations, which continue to be taxed at 18 per cent under the GST Act, have raised this issue with the MoD, sources said.

The MoD funds innovation through R&D allocations to Defence Research and Development Organisation (DRDO) as well as offerings through the iDEX (Innovations for Defence Excellence) scheme to financially help MSMEs become self-sufficient.

TAX ON ADVANCES

In one of the notices issued by a Commissionerate of Central Goods and Services Tax (CGST) of Maharashtra, which *businessline* accessed, a company was asked to shell out 18 per cent tax under Section 13(2) of the CGST Act, 2017, on receipt of advance of the first of five instalments of the grant for an R&D project for the Navy.

Countering the tax liability generated against the grant received from the MoD, the start-up said the R&D amount is meant to cover the

initial expenses for this development and, therefore, it cannot be treated as advance as they are manufacturing a product for the Ministry, the company said in its defence.

"TAXING INNOVATION"

An MoD official dubbed the CGST levy on the government R&D money to private players as "taxing innovations" since it will eventually discourage start-ups and other MSMEs, which are starved of funds.

Further, it is not a true reflection of the government's own announcement of large expenditure on R&D since, by way of 18 per cent CGST, if it is taking back money from private players.

A member of the Society of Indian Defence Manufacturers (SIDM), an apex body of the Indian defence industry, said that the CGST levy on private innovators disturbs the level-playing field the MoD is trying to create through large participation of private players in the manufacturing of military hardware and software.

"It calls for a reform in the grant-in-aid policy framework," the SIDM member said.

Another top defence start-up company owner said: "The move defeats the initiative like that of i-DEX, which has helped 10 to 15 start-ups like me to grow and become a formidable player in developing indigenous defence products, which can compete in the global space."

Private industry sources said that the notices might have come since the MSMEs do not know how to position the government funding in their account books.

Some of them are showing the grants under the sub-head 'revenue' rather than declaring them as liability, which they have to clear after their innovations take the form of products, sources pointed out.