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# **ANALYZING THE ECONOMIC AND SOCIAL IMPACT OF GST IN INDIA: A LEGAL PERSPECTIVE**

AUTHORED BY - YASH SHARMA & PROF.(DR.) DEVENDRA SINGH

## **Abstract**

One of the most significant tax reforms to be introduced in recent decades in a number of nations is the Goods and Services Tax (GST). In order to streamline compliance, increase tax transparency, and promote economic growth, it seeks to combine several indirect taxes into a single, cohesive system. The consequences of GST on GDP, inflation, corporate compliance, employment, consumer spending, and income inequality are the main topics of this paper's analysis of the economic and social implications of the tax. The article illustrates the advantages and transitional issues of the GST system, which was introduced in India in 2017. It does this by using the country's 2017 implementation as a key case study and by comparing it to global implementations in nations like Australia and Canada. Although the GST has contributed to the expansion of the tax base and the formalization of the economy, concerns about the digital divide, the burden of compliance, and the regressive effects on the poor demand careful consideration. On the other hand, there is hope for a more effective, fair, and growth-friendly tax system in the long run.

**Keywords-** Goods and Services Tax (GST), India, Tax Reform, Economic Impact, Social Impact

## **Introduction**

The objective of the Goods and Services Tax (GST) was to rationalize the taxation system by avoiding the higher-order taxes (central, state, local), as well as the lower-level taxes (production and distribution) of a single good or service. For example, India previously had a baffling tax system that not only imposed multiple direct and indirect taxes simultaneously but also focused on production and distribution. This resulted in a 'cascade of burdens', or taxes accumulating on taxes, driving up the final cost for consumers. The GST seeks to eliminate these inefficiencies by combining disparate taxes into a single tax collected at the point of consumption, thus enhancing revenue collection and compliance. The introduction of GST indicates a remarkable shift from an origin-based tax system to a destination one. This change

affects economic activity, trade between states, and the allocation of revenue substantially. This paper intends to assess the comprehensive effects including the economic ones such as the impact on GDP, fiscal revenue, business activity, and the social effects regarding the cost-of-living, income inequality, and employment.<sup>1</sup>

### **Objectives of the Study**

This study's main goal is to present a comprehensive knowledge of how the GST has impacted social structures and economic metrics. The paper specifically aims to:

1. Examine the macroeconomic effects of GST, including its effects on GDP, inflation, and tax revenue;
2. Examine how the GST affects various societal segments, particularly small businesses, workers in the informal sector, and vulnerable groups;
3. Evaluate the sectoral benefits and challenges arising from the implementation of the GST;
4. Provide policymakers with recommendations for enhancing the tax's administration and structure to ensure more equitable results.

### **Literature Review**

There is a substantial amount of literature that assesses how the implementation of the GST has affected various economies. A seminal analysis on the structure of contemporary VAT (a forerunner and model for GST systems) was presented by Ebrill et al. (2001), who emphasized the system's capacity to reduce distortions and improve transparency. According to studies conducted in India, including those by NITI Aayog and the Indian Council for Research on International Economic Relations (ICRIER), the GST has made it possible to establish a single market, which has improved logistical efficiency and, over time, decreased compliance costs. Critical voices, including those of Roy & Ghosh (2020) and Rao (2019), draw attention to the growing pains throughout the transition, which disproportionately affect SMEs and informal workers who were ill-prepared for digital compliance. According to comparative studies from nations like Australia and Canada, the early phase of implementation usually causes temporary confusion and inflation, but these short-term problems are outweighed by the long-term advantages, which include smoother interstate commerce and better revenue stability.

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<sup>1</sup> Government of India, *GST Concept & Status*, Ministry of Finance, Department of Revenue, Central Board of Indirect Taxes and Customs (CBIC), available at: <https://www.cbic.gov.in>.

## Macroeconomic Impact of GST

The implementation of Goods and Services Tax (GST) has profoundly changed the taxation framework of India since July, 2017<sup>2</sup> GST was intended to consolidate all indirect taxes into a single taxation system to simplify the tax structure, improve tax collection, and stimulate economic activities.<sup>3</sup> Unfortunately, the situation was different for Small and Medium Enterprises (SMEs). This working paper investigates the intricate impact the GST has had on SMEs, looking not only at the obstacles identified, but also at the compliance-enhancing technologies that have emerged.

## GST Relationship With SMEs: General Information

### a) Definition and Importance of SMEs

In India, an SME is defined by the amount of spending on investment for plant and machinery or equipment. SMEs are crucial for a nation's economy as they aid remarkably in employment opportunities, modern technology, and international trade. As per MSME (Ministry of Micro Small and Medium Enterprises), SMEs form a very large chunk of the industrial output and employment of the country.

## Objectives of GST

GST was introduced with the intent to:

- Eliminate the cascading effect of taxes.
- Simplify the tax structure.
- Enhance compliance and transparency.
- Broaden the tax base.
- Foster a unified national market.

## Challenges Faced by SMEs Under GST

### a) Compliance Burden

The GST regime introduced a comprehensive compliance framework, necessitating SMEs to:

- Register under GST.
- File multiple returns monthly or quarterly.
- Maintain detailed records of transactions.

For many SMEs, especially micro-enterprises, these requirements posed significant challenges

<sup>2</sup> Government of India, *GST Concept & Status*, CBIC, Ministry of Finance, 2017, <https://www.cbic.gov.in>

<sup>3</sup> [Niti Aayog, GST: One Nation, One Tax, Policy Brief, 2018.](#)

due to limited resources and lack of technical expertise.

#### b) Technological Barriers

The digital nature of GST compliance meant that SMEs had to adopt new technologies for:

- Generating e-invoices.
- Uploading returns.
- Reconciling input tax credits.

Many SMEs, particularly in rural areas, faced difficulties due to inadequate internet infrastructure and lack of digital literacy.

#### c) Financial Constraints

The initial costs associated with GST compliance, such as:

- Upgrading accounting software.
- Training staff.
- Hiring consultants.

were burdensome for SMEs operating on thin profit margins.

### **Government Initiatives to Support SMEs**

#### a) Threshold Exemptions

To alleviate the compliance burden, the government exempted SMEs with an annual turnover below a specified threshold from GST registration and filing requirements. This measure aimed to reduce the regulatory load on small businesses.

#### b) Composition Scheme

The Composition Scheme allowed eligible SMEs to pay tax at a reduced rate on their turnover, simplifying the filing process by permitting quarterly returns instead of monthly filings. This initiative was designed to ease the tax burden on small businesses.

#### c) Technology Support

Recognizing the technological challenges faced by SMEs, the government and various agencies introduced:

- Training programs to enhance digital literacy.
- Subsidies for software adoption.
- Helplines and support centers to assist with GST-related queries.

### Positive Impacts of GST on SMEs

- **Input Tax Credit (ITC) Mechanism:** GST's ITC mechanism allowed SMEs to offset the tax paid on inputs against the tax collected on outputs, reducing the overall tax burden and promoting competitiveness.
- **Formalization of the Economy:** GST encouraged many SMEs to formalize their operations, gaining access to a broader market and benefiting from various government schemes and incentives.
- **Enhanced Market Access:** The removal of interstate barriers and the introduction of a unified tax system enabled SMEs to expand their market reach, both domestically and internationally.

### Case Studies and Real-World Data

- **Credit Growth to MSMEs:** According to the Economic Survey 2022-23, credit growth to the Micro, Small, and Medium Enterprises (MSME) sector has been remarkably high, over 30.6 percent, on average during Jan-Nov 2022. This surge was supported by the extended Emergency Credit Linked Guarantee Scheme (ECLGS) of the Union government, indicating improved financial access for SMEs post-GST implementation.
- **Digital Adoption Among SMEs:** A study by the National Institute for Micro, Small and Medium Enterprises (NIMSME) highlighted that a significant number of SMEs adopted digital tools for GST compliance,

### GST and State Revenue: A Regional Perspective

India's taxation system underwent a substantial change with the introduction of the Goods and Services Tax (GST) on July 1, 2017. GST was developed to consolidate the myriad of state indirect taxes, initiate a single uniform market within the country, and aid with the socio-economic growth of India. In this particular analysis, we focus on the implications of GST with regard to state revenues in India and the benefits as well as the challenges states have undergone regarding the revenues post GST.

The government divides the revenue for intrastate transactions between the Central Government and the State Government equally under the GST. For inter-state transactions, the Central Government levies the Integrated Goods and Services Tax (IGST) and subsequently shares it among the states in reference to where the goods or services are provided or consumed. The objective of this framework is to provide equity in the collection and redistribution of tax revenues among the states.

## Positive Impacts on State Revenue

### a) Enhanced Revenue Collection

Post-GST, many states have reported an increase in tax collections due to the broader tax base and improved compliance mechanisms. For instance, Karnataka projected a 14% growth in revenues from GST and compensation from the 2015-16 base year, starting from 2018-19<sup>4</sup>

### b) Reduction in Tax Evasion

The digitalization of tax administration under GST has led to better tracking of transactions, reducing opportunities for tax evasion. The introduction of e-invoicing and the e-way bill system has enhanced transparency and accountability in the tax collection process.

### c) Formalization of the Economy

GST has encouraged businesses to formalize their operations to avail of tax credits and avoid penalties, thereby increasing the overall tax base. This formalization has led to more consistent and predictable revenue streams for states.

## Challenges Faced by States

### a) Revenue Losses in Initial Years

Several states experienced revenue shortfalls in the initial years following GST implementation. To address this, the Central Government provided compensation to states for any revenue losses incurred due to the transition. However, the compensation mechanism has been a subject of debate, with some states expressing concerns over delays and adequacy.

### b) Technical and Administrative Hurdles

The shift to a digital tax system posed challenges for state tax departments, especially in regions with limited technological infrastructure. States had to invest in upgrading their IT systems and training personnel to handle the new GST processes effectively.

### c) Disparities in Revenue Generation

States with a higher concentration of manufacturing and service industries have seen more significant revenue gains under GST. In contrast, states that rely heavily on agriculture or have smaller industrial bases have faced challenges in maintaining revenue levels, leading to concerns about fiscal imbalances.

## Broader Economic Implications

### A. Economic Growth

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<sup>4</sup> Karnataka Budget Speech, 2019–2020, Department of Finance, Govt. of Karnataka. <https://finance.karnataka.gov.in/116/budget-volumes/en>

Studies indicate that GST has a positive impact on India's economic growth in both the short and long run. The simplification of the tax structure and reduction in tax cascading have improved the efficiency of resource allocation, thereby fostering economic development.

#### B. Inflationary Effects

The immediate aftermath of GST implementation saw a rise in inflation, primarily due to adjustments in tax rates and prices. Research by the National Institute of Public Finance and Policy revealed that GST contributed to a 37 percentage point increase in Consumer Price Index (CPI) inflation. However, these inflationary pressures were transient, with prices stabilizing as the market adapted to the new tax regime.

#### C. Sectorial Impacts : GST's impact varied across different sectors:

- a. Manufacturing: The removal of cascading taxes has reduced production costs, enhancing the competitiveness of Indian manufacturers.
- b. Services: The taxation of services under GST has expanded the tax base, contributing to increased government revenue.
- c. Logistics: The implementation of GST has led to a reduction in transportation and storage costs due to the elimination of state barriers, improving supply chain efficiency.

### **Challenges and Considerations**

While GST has brought numerous benefits, several challenges persist:

1. Revenue Shortfalls for States: Some states have experienced a decline in revenue post-GST implementation, leading to concerns about fiscal autonomy and the adequacy of compensation mechanisms.
2. Compliance Burden: Small and medium-sized enterprises (SMEs) have faced challenges in adapting to the new compliance requirements, necessitating capacity-building initiatives.
3. Inflationary Pressures: Although transient, the initial increase in prices post-GST implementation impacted consumer sentiment and purchasing power.

### **GST and International Trade: Impact on Exports and Imports**

The introduction of GST in India on July 1, 2017, marked a notable development in the country's taxation system. With the intention of forming a sustained indirect tax system and a unified marketplace, GST sought to improve market compliance and facilitate trade moving

across state borders. The current paper studies the ramifications of GST on international trade of India focusing on both exports and imports, as well as determining the impact of the reform on Indian trade.

## **GST's Effect on Exports**

### **1. Zero-Rated Exports**

- a. Under the GST regime, exports are regarded as a type of supply that falls under the category of “zero-rated.”<sup>5</sup> This implies that the export of goods and services is free from taxation under GST (Goods and Services Tax). This policy is in place to ensure that exporters are not burdened with domestic taxes on their products, thus, Indian goods can be comparatively exported in the international market. Exporters have the option to not pay tax under Bond or Letter of Undertaking (LUT), and claim a refund of unutilized Input Tax Credit (ITC); alternatively, they can pay Integrated GST (IGST) and put forward a refund request.

### **2. Simplified Procedures for Exportation**

- a. GST has simplified export procedures by removing several forms, cutting down on the documentation required. The need to file ARE-1/ARE-2 ceases to exist and the shipping bill submitted along with the Customs is treated as application<sup>6</sup>

### **3. Refund Mechanisms**

- a. The GST framework provides for timely refunds to exporters. Refunds of IGST paid on exports are processed promptly, with 90% of the refund granted provisionally within seven days of acknowledgment of the refund application. The remaining 10% is paid within a maximum period of 60 days from the date of receipt of the application complete in all respects. Interest at 6% is payable if full refund is not granted within 60 days.<sup>7</sup>

## **GST's Impact on Imports**

### **1. Integrated Tax on Imports**

- a. Under GST, imports are treated as inter-State supplies and are subject to Integrated GST (IGST), which is equivalent to the sum of Central GST (CGST)

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<sup>5</sup> Section 16, Integrated Goods and Services Tax Act, 2017. <https://www.cggst.com/wp-content/uploads/2017/12/IGSTActSection-16.pdf>

<sup>6</sup> Rule 96, CGST Rules, 2017. <https://www.cggst.com/wp-content/uploads/2018/09/Rule-96.pdf>

<sup>7</sup> Section 54, Central Goods and Services Tax Act, 2017. <https://www.cggst.com>

and State GST (SGST). This approach ensures that imported goods are taxed uniformly, aligning the tax treatment of domestic and imported goods and promoting fairness in the market.

## 2. Input Tax Credit on Imports

- a. Importers can avail themselves of ITC on IGST paid on imports, provided they are registered under GST. This credit mechanism reduces the cascading effect of taxes and lowers the overall tax burden on imported goods, enhancing the competitiveness of Indian industries that rely on imported inputs.

## Broader Economic Implications

### 1. Enhanced Competitiveness

By eliminating the cascading effect of taxes and providing a seamless credit flow, GST has enhanced the competitiveness of Indian goods and services in the global market. The uniform tax structure and simplified procedures have made it easier for businesses to engage in international trade, fostering economic growth and integration into global supply chains.

### 2. Data-Driven Insights

The GST regime has facilitated the collection of comprehensive trade data, enabling policymakers and businesses to gain insights into trade patterns, identify bottlenecks, and formulate strategies to enhance trade efficiency. This data-driven approach supports informed decision-making and targeted interventions to boost exports and manage imports effectively.

## Challenges and Considerations

### 1. Transitional Issues

The transition to the GST regime posed challenges for exporters and importers, including the adaptation to new procedures, understanding the refund mechanisms, and aligning with the digital infrastructure. While efforts were made to address these issues, some stakeholders faced initial difficulties in navigating the new system.

### 2. Sector-Specific Impacts

The impact of GST on exports and imports varied across sectors. For instance, the textile industry experienced a decline in exports in the immediate aftermath of GST implementation, attributed to the adjustment to new tax structures and

compliance requirements. However, over time, the benefits of GST, such as improved transparency and streamlined procedures, contributed to the industry's recovery and growth.

### **Policy Recommendations**

To enhance the effectiveness of GST in promoting formalization and supporting the informal sector, the following measures are recommended:

- **Capacity Building:** Implement targeted training programs to improve digital literacy and GST compliance knowledge among informal sector stakeholders.
- **Simplification of Procedures:** Streamline GST compliance processes, reducing documentation requirements and clarifying tax rates to make the system more accessible for small businesses.
- **Financial Incentives:** Provide subsidies or financial support to offset the initial costs of transitioning to the formal sector, including digital infrastructure setup and training expenses.
- **Awareness Campaigns:** Launch comprehensive awareness campaigns to educate informal businesses about the benefits of formalization, including access to credit, legal protections, and market expansion opportunities.

### **The Role of GST in Promoting a Digital Economy**

The Goods and Services Tax (GST), implemented in India in July 2017, has significantly transformed the nation's taxation landscape. Beyond its primary objective of streamlining indirect taxes, GST has played a pivotal role in promoting a digital economy.<sup>8</sup> By incentivizing digital payment systems and online transactions, GST has fostered a more transparent and efficient economic environment. This analysis explores how GST has contributed to the promotion of a digital economy in India, supported by factual data and insights from official government reports.

### **GST's Incentives for Digital Payments**

#### **Introduction of Digital Payment Incentive Schemes**

To encourage the adoption of digital payment methods, the Government of India introduced incentive schemes targeting small merchants and consumers. One notable

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<sup>8</sup> Central Board of Indirect Taxes and Customs (CBIC), *GST – A Catalyst for the Digital Economy*, Government of India, 2021. <https://cbic-gst.gov.in/>

initiative is the BHIM-UPI Incentive Scheme, which offers a 0.15% incentive on every UPI transaction up to ₹2,000 conducted by small merchants. For example, a ₹1,000 UPI payment would earn the merchant an incentive of ₹50. <sup>9</sup>This scheme aims to reduce reliance on cash transactions and promote a cashless economy.

#### Zero Merchant Discount Rate (MDR) Policy

Since January 2020, the government has waived the Merchant Discount Rate (MDR) for UPI and RuPay debit card transactions. This policy eliminates transaction fees for merchants, encouraging them to adopt digital payment methods without incurring additional costs. The zero-MDR initiative has been instrumental in accelerating the adoption of digital payments, especially among small and medium enterprises.<sup>10</sup>

### Impact of Digital Payments on GST Revenue

- Correlation Between Digital Transactions and GST Collections

Empirical studies have demonstrated a positive relationship between digital payments and GST revenue collections. Research indicates that a one-standard-deviation increase in the value of digital transactions can boost GST revenue by approximately ₹62 billion. This correlation underscores the effectiveness of digital payments in enhancing tax compliance and revenue generation.

- Economic Growth and Digital Payment Adoption

The adoption of digital payments has not only simplified transactions but also contributed to economic growth. Digital transactions generate paper trails, which tax authorities can use to assess tax liabilities, thereby increasing tax revenues. Moreover, the knowledge that transactions are recorded deters tax evasion, further strengthening the tax system.

### Government Initiatives to Promote Digital Transactions

1. Financial Inclusion Programs

Initiatives like the Pradhan Mantri Jan Dhan Yojana (PMJDY) have enabled millions of underbanked and unbanked Indians to open bank accounts, providing a foundation for digital transactions. These accounts facilitate access to services like UPI and mobile wallets, promoting financial inclusion and

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<sup>9</sup> Press Information Bureau, *Launch of BHIM-UPI Incentive Scheme for Promotion of Digital Transactions*, Government of India, 2023 <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2112771>

<sup>10</sup> Merchant transactions through debit cards - costs and prices <https://dspace.library.iitb.ac.in/handle/100/25218>

digital literacy.<sup>11</sup>

## 2. Digital Infrastructure Development

The establishment of robust digital infrastructure, including widespread internet connectivity and affordable smartphones, has been crucial in supporting digital payment systems. Government efforts to enhance digital literacy have further empowered citizens to engage in online transactions confidently.

GST has been a catalyst in promoting a digital economy in India by incentivizing digital payments and streamlining tax processes. Through policies like the BHIM-UPI Incentive Scheme and the zero-MDR initiative, the government has encouraged businesses and consumers to adopt digital payment methods. The positive correlation between digital transactions and GST revenue highlights the effectiveness of these initiatives in enhancing tax compliance and economic growth. Continued efforts to address challenges related to digital literacy and cybersecurity are crucial for sustaining the momentum towards a fully digital economy.

## Recommendations

There are various actions that can be made to increase the effectiveness and equality of GST. First, the system would be more transparent and simpler to use if the rate structure were simplified to have fewer slabs. Second, SMEs and rural enterprises should receive more specialized assistance and digital training. Third, in order to support taxpayers, strong grievance redressal procedures and assistance desks need to be set up. Finally, to evaluate the social effects of GST and enable data-driven policy improvements, a continuous evaluation system must to be put in place.

## Conclusion

Indirect taxes has changed in several economies as a result of the historic Goods and Services Tax. In terms of the economy, it has enhanced revenue generation, increased efficiency, and wider tax compliance. Its effects on society are more complex, encompassing both positive trends like greater formalization and bad outcomes like regressive effects on the poor. In the end, GST's effectiveness depends on ongoing adaptation, simplification, and a taxation strategy

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<sup>11</sup> Ministry of Finance, Pradhan Mantri Jan Dhan Yojana Progress Report, Government of India, 2023 <https://www.pib.gov.in/PressReleaseDetail.aspx?PRID=1985619#:~:text=2023%2C%20a%20total%20of%2051.04,question%20in%20Rajya%20Sabha%20today.>

that prioritizes individuals. GST has the potential to be a pillar of equitable and long-term economic growth with the correct backing and changes.

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