



GST and Small Businesses in India: Impact, Challenges, and Emerging Opportunities

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ABSTRACT

The introduction of the Goods and Services Tax (GST) on 1 July 2017 represented a major transformation of India's indirect-tax system. By replacing multiple central and state-level indirect taxes with a destination-based value-added tax framework, GST sought to reduce tax cascading, create a common national market, improve compliance, strengthen transparency, and encourage formalisation. Small businesses and Micro, Small and Medium Enterprises (MSMEs) are particularly important in assessing these objectives because they contribute substantially to employment, entrepreneurship, production, and local supply chains while often operating with limited financial, technological, and administrative capacity. This paper examines the impact of GST on small businesses in India with particular emphasis on formalisation, compliance costs, input tax credit, digitalization, interstate trade, working capital, access to finance, and competitiveness. The study is based on secondary evidence from government publications and academic research. Evidence indicates that GST has contributed to the expansion of the formal tax base, greater documentation of economic activity, digitalization, and improved integration of interstate markets. At the same time, research suggests that micro and small enterprises have faced significant adjustment costs, particularly because of compliance complexity, dependence on tax professionals, technological barriers, working-capital pressures, and changes in tax administration. The paper argues that GST's impact is heterogeneous: firms with stronger technological and organizational capabilities are better positioned to benefit, whereas low-productivity micro-enterprises face relatively higher compliance burdens. The future direction of GST policy should therefore emphasize simplicity, proportionality, digital inclusion, predictable administration, efficient input-tax-credit mechanisms, and tangible benefits from formalisation.

Keywords: *Goods and Services Tax, GST, MSMEs, small businesses, formalization, tax compliance, input tax credit, digitalization, interstate trade, India.*



INTRODUCTION

Small businesses constitute an essential component of India's economic structure. They operate in manufacturing, retail, wholesale trade, food processing, transport, construction, handicrafts, textiles, repair services, and a wide range of professional and personal services. Beyond their contribution to output, small enterprises generate employment, support local supply chains, promote entrepreneurship, and provide livelihoods in rural and semi-urban areas.

However, small businesses frequently operate under severe resource constraints. Compared with large corporations, they generally have fewer accounting professionals, weaker technological infrastructure, limited access to institutional finance, and less capacity to absorb regulatory costs. Consequently, changes in taxation can have a disproportionately large effect on their operations.

Prior to GST, India's indirect-tax structure consisted of several central and state taxes, including excise duty, service tax, state value-added tax, central sales tax and various other levies. The coexistence of different tax rules and procedures created administrative and transaction costs, particularly for businesses engaged in interstate commerce.

GST, implemented on 1 July 2017, attempted to address these structural problems by establishing a common framework for taxation of goods and services. It incorporated an input-tax-credit mechanism intended to reduce cascading and placed digital technology at the centre of tax registration, reporting, payment and compliance.

The effects of this reform on small enterprises, however, are complex. GST may generate long-term benefits through formalisation, market integration and improved documentation, but compliance may impose short-term and continuing costs. The central issue is therefore not whether GST has been universally beneficial or harmful, but how its costs and benefits vary across different categories of small businesses.

This Study examines the following research question:

How has GST affected small businesses in India, and to what extent have its formalisation and market-integration benefits outweighed its compliance and adjustment costs?

The study argues that GST has produced important structural benefits for the Indian economy, but that these benefits have been unevenly distributed. The smallest and least technologically capable enterprises continue to face greater compliance challenges than relatively larger and more formalized businesses.



OBJECTIVES OF THE STUDY

The study has the following objectives:

1. To examine the development and objectives of GST in India.
2. To analyze the effects of GST on small businesses and MSMEs.
3. To examine whether GST has encouraged business formalisation.
4. To assess compliance and administrative costs.
5. To analyze the role of input tax credit.
6. To examine GST's effect on interstate trade and market integration.
7. To evaluate the relationship between GST and business digitalization.
8. To examine working-capital and financing implications.
9. To synthesize recent academic and institutional evidence.
10. To identify policy measures that can make GST more supportive of small-business growth.

RESEARCH METHODOLOGY

This study uses a descriptive and analytical research methodology based on secondary data. Information is drawn from government publications, including the Economic Survey and reports of the Ministry of Micro, Small and Medium Enterprises, as well as academic literature examining GST, MSMEs, formalisation and digital taxation.

The study adopts a qualitative synthesis rather than an original econometric estimation. This distinction is important because changes in business performance cannot be attributed exclusively to GST. Economic growth, inflation, interest rates, COVID-19, digital payments, e-commerce, credit conditions, infrastructure and other policy reforms have also influenced the performance of Indian small businesses.

The analysis therefore evaluates GST through several interconnected dimensions: formalisation, compliance, digitalization, input-tax credit, interstate trade, working capital, access to finance and competitiveness.

GST IN INDIA: CONCEPT AND OBJECTIVES

GST is a destination-based indirect tax imposed on the supply of goods and services. Its structure incorporates Central GST, State GST and Integrated GST depending on the nature of a transaction.

A central economic principle of GST is the availability of input tax credit, subject to statutory conditions. Businesses can generally offset eligible GST paid on inputs against GST payable on output supplies. This mechanism is designed to reduce cascading, in which tax becomes embedded in the cost of subsequent stages of production.

The major objectives of GST were to:

- reduce tax cascading;



- simplify India's indirect-tax system;
- create a common national market;
- improve transparency;
- encourage tax compliance;
- facilitate interstate commerce;
- strengthen the input-tax-credit chain; and
- increase formalisation of economic activity.

GST also fundamentally changed the technological character of tax administration. Registration, return filing, payments, invoice-related reporting and several compliance procedures became increasingly digital. This created opportunities for improved transparency but also introduced technological requirements that were particularly significant for micro-enterprises.

EXPANSION OF THE GST TAXPAYER BASE AND FORMALISATION

One of the most visible developments since GST implementation has been the expansion of the registered taxpayer base. According to the Government of India's Economic Survey 2025–26, the number of GST taxpayers increased from approximately 60 lakh in 2017 to more than 1.5 crore by 2025–26. The Survey also reports a 21% year-on-year increase in e-way bill generation during April–December 2025.

These developments indicate a substantial increase in documented economic transactions and participation in the formal tax system. Nevertheless, registration should not be interpreted as complete formalisation. A business may possess GST registration while continuing to rely on informal employment, cash transactions or weak internal governance. GST registration is therefore better understood as one dimension of formalisation rather than formalisation in its entirety.

The formalisation mechanism operates partly through supply chains. Large companies often prefer suppliers capable of issuing compliant tax invoices because documentation is relevant to input-tax-credit and accounting processes. Consequently, small businesses seeking to supply larger firms may have incentives to become GST-compliant.

Ghosh (2022) found that GST introduced more formal business practices among MSMEs but also disrupted established informal arrangements. This demonstrates an important trade-off: formalisation can generate long-term economic opportunities while imposing short-term adjustment costs.



GST AND COMPLIANCE COSTS

Compliance costs are one of the most significant concerns for small enterprises.

GST compliance may involve registration, invoice generation, bookkeeping, return filing, reconciliation, tax payments, e-way bills, responding to notices and maintaining digital records. Although many of these processes have become increasingly automated, automation does not necessarily mean zero cost for the business. For a large corporation, compliance can be managed by an internal tax department. For a micro-enterprise, the same requirements may necessitate hiring an accountant or external tax professional.

This difference creates an important distributional problem. A fixed compliance expense represents a much larger percentage of operating costs for a micro-enterprise than for a medium-sized company. Recent research by Maddileti and Gautami (2026) similarly identifies compliance complexity as a continuing challenge for micro and small enterprises. The issue is therefore not simply the existence of taxation but whether compliance requirements are proportionate to the size, capacity and risk profile of the taxpayer. A scientifically appropriate evaluation of GST must consequently distinguish between tax liability and administrative burden. A tax system may be economically efficient in aggregate while still imposing disproportionate administrative costs on individual low-capacity firms.

GST AND DIGITALISATION

GST has accelerated the digital transformation of small-business administration.

Businesses increasingly use accounting software, electronic records, digital payments, online filing systems, e-invoicing where applicable, and electronic logistics documentation. Digitalization can improve record keeping and reduce errors. It can also generate useful information concerning sales, expenses, inventory and cash flows.

These benefits may improve business management beyond tax compliance.

However, the distribution of these benefits is unequal. Roy and Khan (2021) argue that digital taxation can contribute to premature formalisation when firms are required to adopt sophisticated formal systems before developing sufficient organizational capacity. This finding is particularly relevant for India's micro-enterprise sector. A digitally capable business may perceive GST as a manageable administrative system, whereas an entrepreneur with limited digital literacy may experience the same system as expensive and complex.

INPUT TAX CREDIT AND BUSINESS EFFICIENCY

Input tax credit is a fundamental feature of GST and one of its principal economic advantages.



Under a value-added tax system, eligible tax paid on business inputs can generally be credited against output-tax liabilities subject to legal requirements. This reduces the possibility that tax becomes a permanent cost embedded at multiple stages of production. For small manufacturers and traders, the mechanism can improve cost efficiency and pricing competitiveness. However, the effectiveness of input tax credit depends on accurate documentation and compliance throughout the supply chain. If suppliers fail to report transactions correctly or if documentation does not satisfy statutory requirements, purchasers may face difficulties relating to credit.

GST AND INTERSTATE MARKET INTEGRATION

A major objective of GST was to facilitate the development of a common national market.

Under the earlier indirect-tax structure, interstate trade could involve different state-level tax rules and transaction procedures. GST introduced a more unified framework for interstate transactions, reducing some of the tax-related fragmentation that previously affected businesses.

For small enterprises, this can facilitate:

- interstate sales;
- procurement from suppliers in other states;
- participation in national supply chains;
- e-commerce;
- relationships with large corporate buyers; and
- geographical expansion.

Shobharani and Sumangala (2026), examining sectoral effects of GST reforms on MSMEs, report associations between the post-GST period and improvements in indicators such as exports, employment and industrial production, although their findings do not establish a statistically significant effect on the MSME contribution to GDP. This distinction is important. GST may influence economic performance indirectly through market integration, formalisation and transaction efficiency rather than producing an immediate increase in aggregate MSME output.

GST, E-COMMERCE AND EMERGING OPPORTUNITIES

The combination of GST, digital payments, e-commerce and logistics infrastructure has created new opportunities for small enterprises. A producer of handicrafts, clothing, processed foods or consumer goods can potentially reach customers outside the local market without establishing physical stores in every state. GST provides a common framework within which such commercial expansion can occur. However, tax reform alone does not create competitive businesses. Successful participation in digital markets also requires product quality, marketing,



logistics, customer service, digital literacy and working capital. Thus, GST should be considered an enabling institution rather than an independent determinant of entrepreneurial success.

WORKING CAPITAL AND ACCESS TO FINANCE

Working-capital constraints are particularly important for small businesses because many operate with limited cash reserves. GST can affect working capital through the timing of tax payments, customer receipts, input-tax credits and refunds. If a business sells goods on credit but tax obligations arise before payment is received from customers, liquidity pressure can result. Dwivedi and Agrawal (2024) identify financial and compliance pressures as continuing concerns for MSMEs. At the same time, GST records may improve access to finance by creating a more systematic record of business transactions. Lenders can potentially use documented sales and transaction histories to assess business activity. Nevertheless, GST registration alone cannot eliminate the financing constraints faced by MSMEs. Collateral shortages, weak profitability, limited managerial capacity and inadequate credit histories remain important barriers. GST should therefore be considered one component of a broader financial-inclusion framework.

UNEQUAL EFFECTS ACROSS FIRMS

A central conclusion emerging from the literature is that GST does not affect all small businesses equally.

Relatively larger MSMEs are more likely to possess:

- professional accounting support;
- digital infrastructure;
- formal banking relationships;
- trained employees;
- established supply chains; and
- stronger managerial capacity.

Micro-enterprises, informal businesses and low-productivity firms generally possess fewer of these resources. Roy and Khan (2021) emphasise that digital taxation can produce unequal consequences, while Ghosh (2022) documents disruption associated with formalisation.

More recent literature also indicates that the adjustment process may be dynamic. Kumari and Rathore (2026), in a systematic review and meta-analysis, report a broad pattern in which compliance costs were particularly significant for micro-enterprises, while longer-term outcomes were more favourable regarding formalisation and interstate-market access.



GST, ENTREPRENEURSHIP AND EMPLOYMENT

Tax policy can influence entrepreneurship by changing the relative attractiveness of formal and informal business activity. If compliance is complex and unpredictable, entrepreneurs may avoid formal registration or remain small to minimise regulatory exposure. Conversely, if formalisation provides access to credit, procurement, organised supply chains and larger markets, entrepreneurs may have greater incentives to scale.

If GST improves market access and productivity, expanding enterprises may create additional employment. Conversely, if compliance costs cause very small enterprises to reduce activity or leave the formal market, employment may be negatively affected. The appropriate policy objective is therefore not formalisation for its own sake. The objective should be productive formalisation, in which businesses become formal while simultaneously improving productivity, market access and employment quality.

EMERGING GST REFORMS AND GST 2.0

The evolution of GST since 2017 suggests a gradual shift from initial implementation challenges toward greater emphasis on taxpayer convenience, digital administration and simplification.

Uma Maheshwari and Alivelu (2026), studying SME perceptions of GST 2.0, report positive relationships between simplified filing, administrative transparency, digital compliance and compliance behaviour. The emerging reform agenda should therefore focus on reducing unnecessary administrative friction while preserving the transparency and revenue objectives of the tax system. A mature GST framework should ideally become increasingly predictable, automated and risk-based.

POLICY RECOMMENDATIONS

1. **Simplify Compliance for Micro Enterprises-** Compliance requirements should be proportional to enterprise size and risk. Very small businesses should not face administrative procedures designed primarily for large taxpayers.
2. **Strengthen Digital Literacy-** Government agencies and industry associations should provide accessible GST training, particularly in regional languages.
3. **Expand Assisted Filing-** Assisted digital services can reduce the technological barriers faced by entrepreneurs who are not comfortable using online systems.
4. **Improve Input-Tax-Credit Predictability-** Small businesses require transparent and predictable rules concerning eligible input tax credits.
5. **Reduce Working-Capital Pressure-** Efficient processing of legitimate refunds and credits can reduce unnecessary liquidity constraints.



6. **Increase Regulatory Stability-** Frequent procedural changes can impose adjustment costs. Greater predictability would allow small businesses to plan more effectively.
7. **Link Formalisation with Tangible Benefits-** Registration should generate visible economic benefits, including improved access to credit, government procurement, digital services and business-development programmers.
8. **Adopt Risk-Based Compliance-** Tax administration should concentrate intensive scrutiny on high-risk taxpayers rather than imposing identical administrative burdens on businesses with very different levels of risk.
9. **Strengthen Dispute Resolution-** Small enterprises are particularly vulnerable to prolonged tax disputes because they have limited financial resources. Faster and simpler dispute-resolution mechanisms could therefore generate substantial benefits.

DISCUSSION

The evidence reviewed in this study indicates that GST has generated a structural transformation rather than a uniformly positive or negative outcome for India's small businesses. Its major contribution has been the creation of a more integrated and documented economic environment. GST has strengthened the importance of formal invoices, digital records, compliant supply chains and interstate transactions.

These changes create opportunities for firms capable of adapting. A formally documented business can potentially access larger customers, organised supply chains, institutional finance and national markets. Digital records can also improve internal management. However, these benefits require investment. Accounting systems, professional services, digital infrastructure and employee training impose costs. Such costs are relatively manageable for medium-sized enterprises but may be significant for micro-enterprises operating on narrow margins. The literature therefore supports a differentiated interpretation of GST. The reform should not be viewed as having either succeeded completely or failed completely. Rather, its outcomes depend substantially on enterprise size, productivity, technological capability and integration into formal supply chains. This leads to an important policy conclusion: the appropriate response to the costs of GST is not to reverse formalisation but to reduce the cost of becoming and remaining formal.

CONCLUSION

GST has fundamentally changed India's indirect-tax environment and has become an important institutional component of the formal economy. For small businesses, its principal potential benefits include reduced tax cascading, greater market integration, improved documentation, digitalization, access to organized supply chains and potentially better information for institutional finance. At the same time, GST has imposed significant adjustment and compliance costs, particularly on micro-enterprises with limited technological, financial and



administrative capacity. The evidence suggests that the benefits of GST are therefore heterogeneous and may depend on the firm's ability to absorb the costs of formalisation. Recent evidence from the Economic Survey 2025–26 indicates substantial expansion in the GST taxpayer base, from approximately 60 lakh in 2017 to more than 1.5 crore in 2025–26, alongside strong growth in e-way bill activity. These developments indicate the growing role of GST in documenting economic transactions. However, the number of registered taxpayers alone should not be treated as a complete measure of GST success. A stronger measure is whether formalisation produces productive economic outcomes for enterprises.

The future of GST should therefore be guided by five principles: simplicity, proportionality, digital inclusion, predictability and accessibility. Micro-enterprises should receive simplified compliance mechanisms; digital assistance should be expanded; input-tax-credit administration should become more predictable; disputes should be resolved rapidly; and formalisation should provide tangible economic benefits. Ultimately, GST should be evaluated not only by tax revenue or registration numbers but by its contribution to the productivity, competitiveness and sustainability of India's small-business sector. If compliance becomes simpler and the economic benefits of formalisation become more visible, GST can evolve from a tax-reform instrument into an important institutional foundation for the growth and transformation of India's MSME economy.

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