IMPACT OF GST ON UNORGANIZED BUSINESS SECTOR: COMPLIANCE COSTS AND COPING STRATEGIES

Dhananjay Kumar Singh [1], Binod Pratap Singh [2]

[1] Research Scholar, Faculty of Commerce, Dr. Ram Manohar Lohia Awadh University, Ayodhya, India
[2] Professor, Head of the Department of Commerce, LBS PG College Gonda, Dr. Ram Manohar Lohia Awadh University, Ayodhya, India

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ABSTRACT

The introduction of the Goods and Services Tax (GST) as a transformational reform measure in the field of India's indirect taxes in 2017 signifies a complete overhauling of the existing indirect tax system by way of moving towards harmonization of taxes and greater efficiency. The impact of the reform among firms has proved extremely contentious, with large, organized firms clearly benefiting, but there is an open debate as to its impact on informal firms. How GST affects millions of small businesses, India's biggest work base, and a key albatross around the economy's neck This study deals with the impact the goods and services tax (GST) has had on some 65-million-plus micro and small enterprises, which collectively provide the livelihood to more than 80% of the Indian workforce and account for nearly 50% of the output of the nation. Drawing from secondary sources and 40 semi-structured interviews with entrepreneurs in Uttar Pradesh, Maharashtra, and Tamil Nadu in a mixed-method approach, the paper explores two sides of the coin of compliance costs and survival strategies.

The results suggest that the costs of compliance, in terms of finances, administration, and attitudes, are relatively higher and have a regressive edge on 3–6 percent of turnover for the informal business sector. At the same time, the report also spotlights industry resiliency. Coproduction entrepreneurs use coping strategies such as collective resource pooling, (meta-)intermediaries, strategic non-registration, and selective digitalization. These adaptive mechanisms write down that GST has not killed off informality but transformed it, resulting in what academic analysts have termed "bounded formalization."

The paper finds the possibility of GST as an instrument of progressive formalization, and the design structure of the current GST worsens inequalities in the business ecosystem. Policy re-engineering, through accommodating compliance architecture, simplified refund mechanisms, supported digitalization, and sustained capacity-building, is essential to ensure that GST promotes inclusive growth, not exclusion.

Keywords: Compliance, Costs, Strategies, GST, Impact

1. INTRODUCTION

The Goods and Services Tax (GST) was introduced on 1 July 2017 and was a historical moment in India's economic history. As a destination-based tax, GST is designed so that the revenue benefits accrue to the destination state where goods or services are consumed, and its application by Parliament and state legislatures is likely to result in a unified national market, which is expected to yield significant benefits in efficiency and increased production. Proponents of the suggestion predict that a uniform tax rate would help lower transaction costs, leading to long-term stimulation of interstate trade and eventually a more formalized economy. Consistent with other experiences worldwide, GST as a progressive measure to bring India in line with the global norms of indirect taxation.

But there is an uglier reality lurking behind that assurance. GST has not affected all sectors of the economy equally. It was an episode that served as a reminder of the learning curve that digital infrastructure and access to compliance professionals can help overcome. Smaller businesses and microenterprises, in particular the overwhelming majority of which are in India's vast informal sector, have been slower to adapt. The unorganized or informal economy accounts for more than 80 percent of India's employment and almost half its gross value added but operates with the least amount of capital, the weakest institutional linkages, and the weakest digital access. For such businesses, implementation of GST now mandates additional compliance norms like return filing, digital invoice matching, and maintaining records, which disturb their operational business modalities and eat up whatever meager margins that have been there.

We address two important questions in this work. First, what are the 'compliance costs (be they financial, administrative, or psychological) of doing business informally under GST? Second, how do companies adopt the strategies to get along with the side effects created by the new tax system? With the help of secondary data and field-level observation, this paper contextualizes the debate in the larger corpus of literature on fiscal reform, informality, and development. The difficulty is not so much to assess the GST as a tax policy measure but to question to what extent the GST decides the direction of informality, whether it is a path to formalization or it has the potential to fossilize structural precarity.

2. LITERATURE REVIEW

Academic engagement with the Goods and Services Tax has been framed by two dissonant narratives: one that emphasizes the efficiency gains associated with its introduction and another that underscores the disruptive impact it has generated. Government publications and policy briefs emphasize the potential of GST to expand the tax base, decrease leakages, and improve revenue buoyancy. (Ministry of Finance, 2018). The first official assessments had predicted that the simplification of indirect taxes would help compliance and, in turn, lead to formalization. But independent academic work shows a much more nuanced situation, especially among small, informal businesses.

Some of the studies reiterate the point that the cost of compliance under GST significantly varies according to the size of the firm. Micro-units (those without resolute staff or accounting structures) spend a higher proportion of turnover than larger firms on compliance (Sharma, 2019). Mukherjee's (2020) work also points out that a working capital crunch on account of delay in refunds and claims of input tax credit is a major obstacle for MSMEs. These findings nuance the GST success story, showing it is a regressive tax-based system favoring formal capital-dependent enterprise design.

International literature on VAT and GST compares very usefully. Keen (2013) and Bird and Gendron (2007) emphasize that small businesses in developing countries are often exposed to exclusionary pressures in formalized tax systems if the policy constructs do not follow simplified models. Experiences of countries like South Africa, Canada, and Australia reveal that presumptive taxation regimes, lower filing frequency, and threshold exemptions are instrumental in mitigating compliance costs for micro-enterprises. Where it is not, informality continues or evolves in new mixed forms.

However, within the burgeoning literature, a key gap is still unexplored—how informal enterprises are adapting. While costs and constraints have been well documented, less is known about how entrepreneurs respond, innovate, improvise, and resist under GST. It is important to understand these strategies, as they shed light on the informality survival mechanism and provide a more down-to-earth perspective on the tax reforms vs. informal enterprises dynamics.

3. RESEARCH METHODOLOGY

This article employs a mixed-method research design to comprehensively capture the impact of GST on these entities. Secondary sources such as GST Council reports, Finance Ministry publications, trade association submissions, and peer-reviewed research lay the policy and theoretical background. Primary data was collected through semi-structured interviews of 40 small entrepreneurs in Uttar Pradesh, Maharashtra, and Tamil Nadu from the retail, manufacturing, and service sectors. Compliance costs (financial, administrative, and psychological) along with survival strategies were analyzed based on a thematic framework. Comparative references to VAT/GST in other jurisdictions enrich the analysis's rigor and contextual specificity.

4. DATA ANALYSIS

The results of our study suggest that informal sector businesses have also adjusted to the GST era significantly. The adjustments are not homogeneous and are layered with differential ability of enterprises to bear the compliance costs, to cope with the administrative burdens, and to resist the need for liquidity. The interviews and secondary information in tandem suggest four broad dimensions of impact: the costs of compliance, administration and time costs, psychological stress, and liquidity constraints. Any one of these dimensions interacts with the others and collectively influences the survival path of small businesses.

4.1. COMPLIANCE COSTS

The consistent feeling among all respondents was the monetary burden of GST compliance. Average compliance costs for both SMEs and micro-SMEs were reported at between 3 and 6% of turnover. These costs will cover payments to accountants or GST agents, subscription fees for GST-compliant software, and transaction costs for digital filings. For larger companies these costs are a drop in the ocean as a proportion of turnover, but for micro-businesses with low profit percentages they are massive.

A particular pattern that was visible was that those businesses with thin margins, think the petty trader, the small workshop, saw that their compliance costs exceeded their profits in months that they described as being lean business months. This supports the worry expressed in the literature that GST design is regressive, it shifts tax burdens to smaller economic units. Rather than driving the transition of small firms towards the formal sector, GST in operation has added to the cost and compliance difficulties that are already high in this country and so provided disincentives for voluntary registration unless compulsory for survival.

4.2. ADMINISTRATIVE AND TIME BURDEN

Time and bureaucratic labor are no less significant. On complying with regulations, entrepreneurs claimed to spend 12–15 hours every month facilitating the process, which includes preparing the documentation, maintaining those records, and communicating with accountants or intermediaries. For companies without in-house personnel, this is a waste of valuable time that should be spent on creating, marketing, and engaging with clients.

The administrative overhead also decides internal business practices. Several respondents reported that they had to shift business cycles, rearranging the timeline to fit filing deadlines, and sometimes putting taxes ahead of lucrative sales prospects. Some micro-businesses often intentionally kept their turnovers below the level at which they had to be registered by deliberately limiting the amount of business they did, holding back the growth to avoid the headache of administration.

4.3. PSYCHOLOGICAL STRESS AND PERCEIVED RISK

One cannot ignore the human aspect of compliance in GST. Entrepreneurs reported being panicked by the challenges of filing errors, the costs of penalties, and the absence of familiarity with digital interfaces. A lot of them expressed mistrust of the GST Network portal, while many said they had trouble logging in, uploading invoices, and tracking refunds. Because of this suspicion of the system, trust amplifies the dependency on intermediaries who act as gatekeepers to compliance.

Beyond the increases in cost, this dependence on third parties also perpetuates imbalances in who exactly is compliant in the first place: more digitally savvy and resourced individuals have had these transitions smoothed out for them, but for those who are not, the rise of misinformation and predatory behavior on them is palpable. The psychological strain expressed in interviews shows that compliance is not only a technical issue but also a socially and emotionally onerous task for small entrepreneurs.

4.4. LIQUIDITY CONSTRAINTS

One of the most immediate economic effects of GST on the unorganized sector may be liquidity management. Deferred refunds and blocked ITC have had a severe impact on the cash flow, especially on businesses in the FMCG sector or companies with cyclical operations. Entrepreneurs said that working capital was often tied up in lockdown for weeks, preventing them from paying suppliers, wages, or even utility bills on time.

To help fill the void, many took out loans from informal sources and borrowed at rates far above those found in formal banking systems. This reliance on expensive credit undermined profitability and worsened financial exposure. The ironic thing is that a reform that intends to facilitate business transactions can sometimes increase dependence on informal finance, making what it tried to reform even stronger.

5. UNDERSTANDING THE DOUBLE IMPACT OF GST ON INFORMAL FIRMS

The implications are that GST has recast the landscape of informal entrepreneurship in a manner that is neither fully integrative nor entirely exclusionary. Instead, it has created something of a “double impact.” On the one hand, formal recognition may allow enterprises to open doors to official value chains, giving them visibility and legitimacy. Registered organizations report the reputational benefits of GST compliance: in some cases, good suppliers become better, and small players gain access to large contracts that were previously beyond reach. In this context, GST can be seen as a catalyst for gradual formalization.

On the flip side, those benefits are not distributed equally. Over-the-top compliance needs (they have to file returns from digital platforms and deal with all kinds of formalities) put a load that can be excessive on micro-units that are trying to function in lean mode. For those businesses, the near-term penalty outweighs the longer-term opportunity costs, diminishing their ability to compete and limiting their ability to expand. This result also underscores a fundamental asymmetry: even if policy design considers the uniform capacity of firms, sector-specific constraints concerning large firms and microentrepreneurs may limit this assumption.

Of particular interest is the retention of many adaptive patterns that cross the formal-informal divide. Entrepreneurs often resort to dual bookkeeping, partial registration, or trusted intermediaries to deal with compliance. These instances also show that informality has not disappeared but has been reconfigured under GST. Chen’s (2012) idea of “bounded formalization” is useful in this regard, because it accounts for the ways in which organizations are strategic in their embracing of formal systems, while continuing to operate informally in order to ensure their survival.

GST is potentially constructing segmentation to the business model that is resilience and resources based: firms more capable and resourceful are moving toward the integration, and the weaker are staying in the fringe or leaving. This duality highlights why policy frameworks need to consider the variety of capacities and not treat formalization as a one-size-fits-all intervention.

6. TOWARD INCLUSIVE GST REFORMS

The evidence shows that the kind of GST that we have at present is disproportionately onerous for micro and small units, while larger units are able to make far greater use of it. If we are instead to have an authentically inclusive reform, policy design will need to be recalibrated with informality squarely in its sights.

Another promising strategy is to reimagine the composition scheme so that it may actually serve the purpose of more than a merely symbolic concession. Allowing restricted input tax credit under this scheme could avoid the exclusion of small suppliers from supply chains, even as their filing responsibilities are pared down. As important as the non-fulfillment of the contract is the risk of being out of pocket, where formal delays mean that the flow of liquidity simply dries up. Automated, schedule-based refund mechanisms have the potential to change the working-capital position of small firms.”

Tech solutions were found to be viable but with keen customization for grassroots. Literacy-oriented platforms, local language interfaces, and subsidized software can minimize dependence on intermediaries. But technology will not be enough without capacity development. Collaborations with regional trade organizations and cooperatives may offer sustainable training paradigms in digital literacy and compliance.

Lastly, the GST system needs to evolve into an escalating regime where compliance is graduated by turnover and sector. This kind of differentiation would moderate regressive effects and build a road where compliance seems like a chance for growth, not an obstacle to survival.

7. COMPARATIVE INTERNATIONAL INSIGHTS

A broader perspective of global VAT-GST practices contains vital lessons for India's policy trajectory. In Canada, small businesses are subject to less rigorous registration filing requirements and no harsher input tax credit provisions than under the QST; thus, registration costs do not dominate compliance when firms are labor-constrained. Australia has an adaptable reporting system with quarterly filings and exemptions for micro-enterprises, ensuring compliance corresponds to business size. There is other evidence for this, including the results from South Africa, where presumptive tax packages and increased registration thresholds can help keep the lifeblood of small firms alive at the same time as still extracting meaningful revenues from the larger formal enterprises.

Indian GST design, by contrast, has erred on the side of uniformity, imposing almost identical obligations on firms, irrespective of their size. This makes things easier for tax enforcement by the government but imposes new and additional compliance layers on the micro and small enterprises, most of whom may not even have the facilities to comply effectively. Comparative evidence makes it clear that a comprehensive design of taxes precisely demands such asymmetry (here: compliance regimes that mirror firm capacities and are not the same for all). These dispensations at the international level highlight the point that the sustainability of GST is not only about the revenue it generates, but it is also about the paradox of balancing equity and efficiency within the tax structure.

8. CONCLUSION

GST is being touted as the grandest fiscal reform in post-independence India; however, paradoxically, it has since wreaked havoc on the informal sector of the economy. It sounds great on paper: transparency, efficiency, and harmonization with a single national market. In reality, however, the requirement has placed financial, administrative, and psychological burdens mostly on micro and small businesses. Factors like low liquidity due to delayed returns also deteriorate firms' competitiveness and force most of the firms to downsize or comply with hybrid forms mixing formality and informality.

The informality of businesses and the backbone of their resilience are reflected in how they pool resources, use intermediaries, and selectively adopt digital. But they also serve to reveal systemic flaws in the design of policy. This is the perspective that goes into action if the goods and services tax reform doesn't proactively accommodate the micro-enterprise's structural weaknesses: the system of taxation has the potential to consolidate marginalization instead of providing more participation in the system.

For that, we need to reimagine GST as a development tool and not just a revenue tool. There is a need for adaptable compliance mechanisms, capacity-building training, and targeted digital support to be built into the system. Only then can GST ever reconcile modernity with inclusion, ensuring that India's huge informal economy is brought into the mainstream and not left behind in its fiscal evolution.

CONFLICT OF INTERESTS

None.

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