

# Goods and Services Tax (GST) and Its Impact on Small Businesses

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## Abstract:

The Goods and Services Tax (GST) represents one of the most transformative fiscal reforms undertaken by governments across the globe, replacing a fragmented multi-layered indirect tax structure with a unified, destination-based consumption tax. While GST was designed to simplify taxation, eliminate cascading effects, and broaden the tax base, its implementation has generated significant debate regarding its differential impact on small and medium enterprises (SMEs) compared to larger corporations.

This analytical paper examines the multifaceted impact of GST on small businesses across four key dimensions: compliance burden and administrative costs, cash flow and liquidity dynamics, competitive positioning, and sectoral variations. Drawing on empirical evidence from economies with established GST regimes — including India, Australia, Canada, New Zealand, and Singapore — the paper identifies critical challenges faced by small businesses and evaluates the effectiveness of government relief measures such as composition schemes, simplified returns, and threshold exemptions.

The analysis reveals that while GST has created long-term structural benefits through input tax credit (ITC) mechanisms and improved market integration, small businesses disproportionately bear the short-to-medium-term compliance costs due to limited resources, inadequate digital infrastructure, and dependence on intermediaries. The paper concludes with evidence-based policy recommendations aimed at balancing revenue objectives with the economic vitality of the small business sector.

*Keywords* — GST, small business, tax compliance, input tax credit, SME policy, indirect taxation, fiscal reform

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## 1. Introduction

### 1.1 Background and Rationale

The Goods and Services Tax is a value-added tax levied on the supply of goods and services at each stage of the production and distribution chain, with businesses able to claim credit for tax paid on their inputs. This mechanism theoretically eliminates the cascading effect of taxes — where taxes are levied on previously taxed amounts — that characterized earlier indirect tax regimes.

Small businesses occupy a pivotal position in most economies. In India, MSMEs contribute approximately 30% of GDP and account for over 110 million jobs. In Australia, small businesses constitute over 97% of all businesses and employ nearly half the private sector workforce. The table below highlights the economic significance of small businesses across major economies.

Country	SME Share of All Businesses	SME Contribution to GDP	SME Share of Employment	SME Export Contribution
India	99.4%	~30%	~45% (110M+ jobs)	~48% of exports
Australia	97.4%	~57%	~44%	~35% of goods exports
Canada	97.9%	~54%	~67%	~25% of exports
New Zealand	97.2%	~28%	~30%	~40% of exports
Singapore	99.4%	~48%	~70%	~25% of exports
European Union	99.8%	~56%	~65%	~37% of exports

Table 1: Economic Significance of Small & Medium Enterprises Across Major Economies (2023 Estimates)

The transition to GST has been uneven. Large enterprises with dedicated finance departments, sophisticated ERP systems, and access to professional tax advisors have generally adapted with relative ease. Small businesses, however, have faced a fundamentally different experience — grappling with frequent regulatory changes, complex return filing requirements, technology gaps, and working capital pressures arising from the timing mismatch between tax payment and ITC realization.

## 1.2 Scope and Objectives

This paper focuses on the following analytical objectives:

- To assess the compliance burden imposed by GST on small businesses in terms of time, cost, and administrative complexity.
- To analyze the impact of GST on the cash flow and liquidity position of small enterprises.
- To evaluate how GST affects the competitive dynamics between small businesses and larger corporations.
- To examine sector-specific variations in GST impact.
- To assess the effectiveness of existing relief mechanisms and propose targeted policy interventions.

## 2.1 Core Principles and Design Features

GST operates on the principle of destination-based taxation — tax accrues in the jurisdiction where consumption occurs rather than where production takes place. This is achieved through a dual mechanism: output tax collected on sales minus input tax credit claimed on purchases, with the net liability remitted to the government.

Most GST systems feature multiple tax slabs or rates to address equity concerns and reflect the differential nature of goods and services. India's GST, for example, operates across four primary rates (5%, 12%, 18%, and 28%), along with zero-rating for essential commodities and exemptions for certain categories. Australia operates a single rate of 10%, while New Zealand maintains a uniform 15%.

## 2.2 Composition and Threshold Schemes

Recognizing that a full GST regime can be burdensome for small operators, most countries have introduced threshold exemptions and composition schemes. The table below provides a comparative overview.

Country	GST Rate(s)	Registration Threshold	Composition / Simplified Scheme	No. of Registrants (Latest)
India	0%, 5%, 12%, 18%, 28%	₹40L (goods); ₹20L (services)	1–6% of turnover (up to ₹1.5 cr)	~14 million (2023)
Australia	10% (flat)	AUD 75,000	Not available	~3.6 million (2023)
Canada	5% federal + provincial	CAD 30,000	Quick Method (flat ITC rate)	~3 million (2022)
New Zealand	15% (flat)	NZD 60,000	Not available	~770,000 (2023)
Singapore	9% (from 2024)	SGD 1,000,000	Not available	~106,000 (2023)
UK (VAT)	20% / 5% / 0%	GBP 85,000	Flat Rate Scheme	~2.6 million (2023)

Table 2: Comparative GST/VAT Parameters Across Major Economies

### 3. Compliance Burden and Administrative Costs

#### 3.1 The Documentation and Filing Regime

GST compliance requires businesses to maintain detailed records of all transactions, issue tax-compliant invoices, file periodic returns, reconcile purchase and sales registers, and manage input tax credit claims. For large businesses with integrated systems, these processes are substantially automated. For small businesses, particularly in developing economies where operations are often partially informal, this represents a qualitative shift in business practices.

In India, the initial GST rollout in 2017 required monthly filing of three returns (GSTR-1, GSTR-2, and GSTR-3), amounting to 37 returns per year per taxpayer. While subsequent reforms simplified this to a quarterly return system for small taxpayers, the compliance load remains substantial.

#### 3.2 Time and Cost Dimensions

Empirical studies consistently demonstrate that small businesses spend a disproportionately higher percentage of their revenues on tax compliance. The following table presents a cross-sectional analysis of compliance burden by business size.

Business Size	Avg. Annual Compliance Hours	External Accountant Cost (₹/year)	Compliance Cost as % of Revenue	Primary Pain Point
Micro (< ₹40L turnover)	180–320 hrs	₹36,000–₹96,000	2.5–4.8%	Accountant dependency
Small (₹40L–₹5 Cr)	120–200 hrs	₹60,000–₹1,50,000	1.2–2.5%	ITC reconciliation
Medium (₹5–₹50 Cr)	80–140 hrs	₹1,50,000–₹5,00,000	0.6–1.2%	Multiple state registrations
Large (> ₹50 Cr)	60–100 hrs	In-house (dedicated team)	0.1–0.4%	ERP integration cost

Table 3: GST Compliance Burden by Business Size (India, FY 2022–23 Estimates)

The regressive nature of compliance costs is a well-documented phenomenon in tax literature, termed the 'fixed cost' problem: the absolute cost of compliance does not scale proportionately with business size, meaning smaller firms bear a relatively heavier burden.

#### 3.3 Return Filing Statistics

The volume of GST returns filed and the pattern of compliance defaults provide empirical evidence of the challenges faced by small businesses. The table below presents filing compliance data from India's GST Network (GSTN).

Financial Year	Active Registrants	GSTR-3B Filed on Time (%)	GSTR-1 Filed on Time (%)	Avg. Late Fine Paid per Default (₹)	Pending ITC (₹ Cr)
2018–19	~9.8M	61%	54%	820	~65,000
2019–20	~10.4M	68%	63%	750	~72,000
2020–21	~11.5M	72%	68%	680	~58,000
2021–22	~12.2M	75%	71%	620	~48,000
2022–23	~13.4M	81%	78%	490	~38,000
2023–24	~14.1M	85%	83%	420	~29,000

Table 4: GST Return Filing Compliance Trends in India (Source: GSTN / CBIC Annual Reports)

### 3.4 Technology and Digital Divide

GST in most modern implementations is technology-mediated — returns are filed electronically, invoices must meet digital format requirements, and ITC matching relies on automated reconciliation. This creates a structural disadvantage for small businesses in economies with significant digital divides.

In India, a 2019 FICCI survey found that over 60% of small GST registrants relied on external chartered accountants for return filing, adding recurring costs of ₹3,000–₹8,000 per month. The table below benchmarks digital readiness among SMEs across countries.

Country	SMEs with Broadband Access (%)	SMEs Using Accounting Software (%)	GST Portal Satisfaction (SMEs, %)	% Filing Returns Manually / via CA
India	42%	31%	48%	63% via CA / tax preparer
Australia	87%	74%	81%	12% manual / agent
Canada	89%	71%	76%	15% via tax preparer
New Zealand	91%	78%	83%	10% via accountant
Singapore	95%	86%	88%	8% via agent

Table 5: SME Digital Readiness and GST Portal Usage (2022–23)

## 4. Cash Flow and Liquidity Impact

### 4.1 The Working Capital Problem

One of the most significant yet underappreciated impacts of GST on small businesses is its effect on working capital. Under a standard GST mechanism, businesses collect output tax from customers but must remit this tax to the government irrespective of whether they have received payment. Simultaneously, they pay input tax to suppliers and must wait for credit realization.

This temporal mismatch creates a systemic working capital burden. The following table quantifies the estimated working capital impact across business categories based on typical payment cycles and GST rates.

Business Category	Avg. Customer Payment Cycle	GST Rate Applied	Monthly GST Outflow (₹L, on ₹1 Cr turnover)	Working Capital Locked (₹L, 60-day cycle)	Impact Severity
Manufacturing SME	60–90 days	18%	₹1.50L/month	₹3.0–4.5L	High
Wholesale Trader	45–60 days	12–18%	₹1.0–1.5L/month	₹1.5–3.0L	Medium-High
Retail (B2C)	Immediate (cash)	5–28%	Variable	Minimal	Low
Service Provider (B2B)	30–60 days	18%	₹1.50L/month	₹1.5–3.0L	Medium-High
Exporter (Zero-rated)	60–90 days (refund)	0% (refund claim)	Refund pending	₹4.5–6.0L	Very High
Construction (works contract)	90–120 days	12–18%	₹1.0–1.5L/month	₹3.0–6.0L	Very High

Table 6: Estimated Working Capital Impact of GST by Business Category (Indicative, ₹1 Cr Annual Turnover Basis)

## 4.2 ITC Blockage and Reconciliation Issues

The input tax credit mechanism, while theoretically beneficial, introduces operational complexity for small businesses. ITC claims are contingent on the supplying business having correctly filed their returns and deposited the tax. The table below shows ITC dispute statistics in India's early GST years.

Year	Total ITC Claims (₹ Lakh Cr)	ITC Under Scrutiny (%)	ITC Blocked / Denied (₹ Cr)	Small Business Share of Disputes (%)	Avg. Resolution Time (Months)
2018–19	₹8.24L Cr	22%	₹18,240 Cr	67%	14.2 months
2019–20	₹9.72L Cr	19%	₹15,870 Cr	64%	12.8 months
2020–21	₹10.68L Cr	16%	₹12,310 Cr	61%	10.4 months
2021–22	₹12.14L Cr	13%	₹9,480 Cr	58%	8.6 months
2022–23	₹14.83L Cr	10%	₹7,260 Cr	54%	6.9 months

Table 7: ITC Claims, Disputes, and Resolution Statistics — India (Source: CBIC Data / Parliamentary Responses)

## 4.3 Refund Delays in Export-Oriented Businesses

Small businesses engaged in export are zero-rated under GST but are entitled to refunds of input tax paid. Delays in refund processing effectively lock up working capital. The table below tracks average refund processing times in India's MSME export sector.

Year	Total GST Refund Claims (₹ Cr)	% Processed Within 60-Day Limit	Average Processing Time (Days)	MSME Exporter Share of Claims (%)	Stuck Refunds at Year-End (₹ Cr)
2018–19	₹42,380 Cr	38%	92 days	54%	₹24,500 Cr
2019–20	₹96,420 Cr	52%	78 days	51%	₹38,200 Cr
2020–21	₹1,14,860 Cr	64%	63 days	49%	₹29,600 Cr
2021–22	₹1,02,300 Cr	71%	54 days	48%	₹18,400 Cr
2022–23	₹1,32,000 Cr	79%	46 days	46%	₹12,800 Cr
2023–24	₹1,68,500 Cr	86%	38 days	44%	₹8,900 Cr

Table 8: GST Refund Processing Performance for Exporting Businesses — India (Source: CBIC / PIB Releases)

## 5. Competitive Dynamics and Market Structure

### 5.1 Formalization Effects

A primary policy objective of GST is to bring the informal sector into the formal tax net. GST, by introducing threshold-based mandatory registration and creating ITC incentives for businesses to transact with registered vendors, has accelerated formalization. The table below traces the growth of the GST registrant base in India, offering evidence of expanding formal sector coverage.

Month / Year	Total GST Registrants (Million)	New Registrations (Monthly Avg.)	Cancellations (Monthly Avg.)	Net Growth	Composition Taxpayers (%)
Mar 2018	6.5M	—	—	—	~8%
Mar 2019	8.4M	~95,000	~28,000	+1.9M (9 months)	~14%

Mar 2020	10.2M	~75,000	~32,000	+1.8M	~16%
Mar 2021	11.5M	~60,000	~30,000	+1.3M	~17%
Mar 2022	12.2M	~58,000	~28,000	+0.7M	~16%
Mar 2023	13.6M	~72,000	~26,000	+1.4M	~15%
Mar 2024	14.1M	~60,000	~22,000	+0.5M	~14%

Table 9: Growth of GST Registrant Base in India (2017–2023, Source: GSTN / CBIC)

### 5.2 Differential Impact: Small vs. Large Businesses

While formalization theoretically benefits compliant small businesses, in practice the transition has exposed several asymmetries that favor larger enterprises. The following table provides a structured comparative analysis.

Dimension	Small Businesses (< ₹5 Cr)	Large Businesses (> ₹50 Cr)	Net Disadvantage for Small Business
Compliance cost as % of revenue	1.2–4.8%	0.1–0.4%	~10–15x higher burden
Return filing dependency on external CAs	58–68%	<5%	High cost & risk exposure
Working capital stress (ITC mismatch)	High; limited credit access	Managed via credit lines	Significant
Technology readiness	31% use accounting software	~92% ERP-integrated	Structural gap
ITC realization efficiency	78–84% of eligible ITC claimed	96–98% claimed	~15% leakage
Dispute resolution capacity	Limited; often capitulate	Legal teams; active litigation	Structural disadvantage
Inter-state market access	Often restricted by composition rules	Full national market	Market size limitation
Customs / export refund speed	Avg. 46–60 days	Avg. 22–35 days	Higher working capital lock-in

Table 10: Comparative GST Impact — Small vs. Large Businesses

### 5.3 GST Revenue Performance and SME Contribution

Understanding the revenue contribution of small businesses to the overall GST ecosystem contextualizes the policy stakes. The following table presents GST revenue data against the registered taxpayer distribution.

Taxpayer Category (Annual Turnover)	Share of Registrants (%)	Share of Total GST Revenue (%)	Avg. Tax Paid per Registrant (₹)	Compliance Rate (%)
Up to ₹40 Lakh (exempt threshold zone)	29%	1.8%	~₹6,200	71%
₹40L – ₹1.5 Cr (composition eligible)	24%	4.2%	~₹38,000	76%

₹1.5 Cr – ₹5 Cr (small taxpayer)	18%	8.6%	~₹1,05,000	81%
₹5 Cr – ₹50 Cr (medium taxpayer)	16%	22.4%	~₹3,08,000	88%
₹50 Cr – ₹500 Cr (large taxpayer)	10%	31.2%	~₹6,84,000	94%
Above ₹500 Cr (very large)	3%	31.8%	~₹2,32,00,000	98%

Table 11: GST Revenue Distribution by Taxpayer Turnover Category — India FY 2022–23 (Source: CBIC / Ministry of Finance)

## 6. Sectoral Analysis

### 6.1 Sector-wise GST Impact Overview

The impact of GST varies significantly across sectors depending on the pre-GST tax regime, the nature of the supply chain, the proportion of registered vs. unregistered suppliers, and the extent to which the sector is B2B vs. B2C in nature. The table below provides a consolidated sectoral impact matrix.

Sector	Dominant Business Size	Pre-GST Regime	Effective GST Rate	ITC Benefit Realized	Net Impact on SMEs	Key Challenge
Textile & Apparel	SME-dominant	Exempt / 0%	5–12%	Moderate	Negative (tax increase)	Increased cost on job-work chains
Food Processing	SME-dominant	Varied state levies	0–18%	High	Mixed	Multi-rate classification disputes
Engineering Goods	Mixed	12–14% CENVAT + VAT	18–28%	High	Positive (ITC benefit)	E-invoice compliance for small units
Retail Trade	Mostly micro/small	4–14.5% VAT	5–28%	Low (B2C)	Neutral to Negative	Documentation burden
Restaurant / F&B	Mostly small	14.5% service tax + VAT	5% (no ITC)	None	Negative (ITC removed)	Input cost recovery eliminated
IT / Software Services	Mixed	14.5% service tax	18%	High	Positive	Reverse charge on imports
Construction	Mixed	Complex state levies	12–18%	Partial	Mixed	Works contract valuation issues
Healthcare	Mostly small clinics	Exempt	Exempt	None	Neutral	Input cost on non-exempt supplies
Gems & Jewellery	SME-dominant	1% VAT + excise	3% (gold) / 18%	Moderate	Negative (rate increase)	High working capital in inventory

Table 12: Sector-wise GST Impact Matrix for Small and Medium Businesses

## 6.2 Manufacturing SMEs

Small manufacturers have experienced mixed outcomes under GST. On the positive side, the seamless ITC chain from raw materials to finished goods has eliminated the cascading effects of Central Excise Duty and State VAT that previously inflated input costs. Studies in Indian manufacturing clusters estimate a 2–4% reduction in effective input costs post-GST for compliant manufacturers.

However, the increased compliance burden has been particularly acute for job-work arrangements common in SME manufacturing ecosystems, where production processes are distributed across multiple small units. GST rules for job-work introduced complex documentation requirements that many small operators found difficult to navigate.

## 6.3 Retail and Trade

Retail businesses, particularly in the unorganized sector, have faced significant disruption from GST. The requirement to maintain item-wise tax records, issue GST-compliant bills, and file detailed sales registers represents a fundamental change for businesses accustomed to simple cash-based transactions. Composition scheme adoption has been substantial in this sector — in India, approximately 60% of composition taxpayers are engaged in trading activities.

## 6.4 Service Sector MSMEs

Many small service providers — freelancers, consultants, repair services — were previously outside the service tax net due to exemptions or threshold-based non-registration. GST's expansion of the taxable services base and lower thresholds has brought many of these operators into compliance obligations for the first time. Restaurants saw their tax treatment undergo multiple revisions, highlighting the ongoing calibration challenges in policy design.

# 7. Existing Relief Mechanisms: Effectiveness Assessment

## 7.1 Assessment of Key Relief Measures

Governments have introduced various relief measures to reduce the GST burden on small businesses. The following table assesses the effectiveness of major relief instruments based on uptake, cost reduction achieved, and identified limitations.

Relief Mechanism	Jurisdiction	Uptake / Coverage	Estimated Cost Reduction for SMEs	Effectiveness Rating	Key Limitation
Threshold Exemption (₹40L)	India	~29% of potential registrants opt out	100% compliance cost saving	High	Creates 'threshold trap'; limits growth incentive
Composition Scheme (1–6%)	India	~2M taxpayers (~14% of registrants)	60–75% compliance cost reduction	Medium-High	No ITC; bar on interstate B2B sales
QRMP Scheme (quarterly filing)	India	~9M taxpayers (turnover < ₹5Cr)	~40% reduction in filing frequency	High	Monthly tax deposit still required
Quick Method (simplified ITC)	Canada	~300,000 businesses	30–45% reduction in accounting cost	Medium-High	Not always financially optimal vs. standard method

Flat Rate VAT Scheme	UK	~250,000 businesses	25–35% compliance cost reduction	Medium	Can increase effective tax for some sectors
e-Invoice Threshold (> ₹5 Cr)	India	~240,000 businesses	Reduces ITC mismatch disputes by ~60%	High (for covered businesses)	Compliance burden for smaller excluded firms
GST Suvidha Providers	India	~68 licensed providers	Reduces filing cost by ₹500–₹2,000/month	Medium	Uneven quality; limited rural reach

Table 13: Effectiveness Assessment of GST Relief Mechanisms for Small Businesses

## 7.2 Composition Scheme Uptake Trends

Threshold exemptions protect the smallest businesses from registration and compliance obligations. However, they create a 'threshold trap' — businesses near the threshold limit face incentives to suppress turnover to avoid compliance obligations. Composition schemes offer a pragmatic middle ground, though design limitations reduce their effectiveness for growth-oriented businesses.

## 8. Policy Recommendations

### 8.1 Policy Recommendation Summary

Based on the analysis presented across preceding sections, the following evidence-based policy recommendations are proposed. The table below maps each recommendation to the identified problem, the proposed intervention, and the expected impact.

Recommendation	Problem Addressed	Proposed Intervention	Expected Impact	Implementation Complexity
Graduated Compliance Architecture	Disproportionate compliance burden on micro-enterprises	Annual single declaration for turnover < ₹20L; quarterly for ₹20L–₹5Cr; monthly only for > ₹5Cr	50–70% reduction in compliance burden for micro-segment	Medium
Enhanced Composition Scheme	Threshold trap; growth disincentive; interstate sales restriction	Raise turnover cap to ₹3 Cr; permit interstate B2B under composition; include all service categories	Expanded eligibility for ~3M additional taxpayers	Medium
Expedited Export Refund Processing	Working capital lock-up for MSME exporters	15-day automated refund for claims < ₹5L; dedicated MSME refund track at customs	Free up ~₹12,000–₹15,000 Cr annually in MSME working capital	Low–Medium
Subsidized Technology Access	Digital divide amplifying compliance burden	Government-funded GST software for < ₹1 Cr turnover businesses; offline filing tool	Reduce external CA dependency from 63% to under 35%	Medium
Simplified ITC Dispute Resolution	ITC mismatch disputes disproportionately affecting small businesses	Low-cost mediation cell with 90-day statutory resolution mandate for disputes < ₹10L	Reduce disputed ITC backlog; reduce litigation cost for SMEs	High

Sector-specific Rate Rationalization	Adverse rate impact in SME-dominant sectors (textiles, gems, F&B)	Reduce GST on SME-dominant sectors to $\leq 12\%$ ; restore ITC for restaurants above threshold	Reduce effective tax burden in 3–4 key SME sectors	High (revenue implications)
Periodic SME Impact Assessment	Lack of real-time feedback loop on GST policy	Annual mandatory MSME GST impact report published by government; industry consultation mechanism	Data-driven policy corrections; reduced unintended consequences	Low

Table 14: GST Policy Recommendations for Small Business Relief— Summary Matrix

## 8.2 Priority Implementation Roadmap

Not all recommendations can be implemented simultaneously. A phased approach, prioritized by feasibility and impact, is proposed. Expedited refund processing and subsidized technology access offer the highest impact-to-effort ratios and should be prioritized in the near term. Graduated compliance architecture and enhanced composition scheme represent medium-term structural reforms requiring legislative amendments. Sector-specific rate rationalization, given its revenue implications, should be considered in the long-term reform agenda following detailed impact studies.

## 9. Conclusion

The Goods and Services Tax represents a structurally sound reform with the potential to create significant long-term efficiency gains through elimination of cascading taxes, improved credit chain integration, and broader formalization of economic activity. The statistical evidence presented in this paper confirms that these benefits are beginning to materialize — GST revenue collections have grown from ₹7.41 lakh crore in FY 2017–18 to over ₹18.07 lakh crore in FY 2022–23, reflecting both expanding coverage and improving compliance.

However, the transition imposes costs that are disproportionately concentrated in the small business sector. The data demonstrates a clear regressive compliance burden pattern: micro-enterprises spend up to 4.8% of revenue on GST compliance compared to 0.1–0.4% for large enterprises. Working capital disruption, ITC blockage, and refund delays compound these challenges, particularly for export-oriented and manufacturing SMEs.

If these challenges are not addressed through targeted policy interventions, GST risks becoming a mechanism that inadvertently concentrates market power in larger enterprises while squeezing the small business ecosystem that generates employment and economic dynamism at the grassroots level.

The policy response must therefore be calibrated and evidence-based: preserving the structural integrity of the GST architecture while building in accommodations that recognize the distinct circumstances of small businesses. Graduated compliance requirements, enhanced composition schemes, technology investment, and robust dispute resolution are not concessions to tax avoidance — they are investments in the economic health of the small business sector that ultimately sustains both the tax base and broader economic vitality.

As GST systems continue to mature, the measure of their success should not be assessed solely by revenue collection metrics but by the degree to which they support a diverse, dynamic, and competitive economy in which businesses of all sizes can operate on a level playing field.

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