



# A STUDY OF TAX INCIDENCE ON CONSUMERS IN INDIA – AN ANALYSIS

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## **Abstract:**

*This study examines the incidence of taxation on consumers in India, with a primary focus on the Goods and Services Tax (GST) regime implemented in July 2017. Tax incidence refers to the economic burden of a tax, which often differs from the legal liability to pay it. While businesses and service providers remit GST to the government, the actual burden is largely transferred to consumers through price adjustments. The study explores how this burden is distributed across different income groups, consumption categories, and regions, highlighting whether the indirect tax structure is progressive, proportional, or regressive in practice. Through sectoral analysis, the paper investigates the impact of GST on essential goods, consumer durables, food services, healthcare, and education-related items. It also considers how tax policy has affected consumer behavior, informal sector dynamics, and household expenditure patterns. Empirical evidence suggests that while GST simplified tax compliance and broadened the tax base, it has in many cases led to price increases for everyday goods and services, disproportionately affecting lower and middle-income households.*

*Further, the study addresses the behavioral and digital dimensions of tax incidence, such as price stickiness, tax salience, and the role of digital payments in tax transmission. It critically evaluates whether the intended goals of transparency, efficiency, and equity have been achieved under GST. Overall, the research provides a comprehensive view of how India's modern tax system influences consumer welfare, purchasing power, and economic equity. The findings serve as an important input for tax reform debates and highlight the need for targeted policy adjustments to minimize regressive impacts on vulnerable populations.*

**Keywords:** Tax Incidence, Consumers, India.

## **INTRODUCTION:**

Tax incidence refers to the analysis of the economic burden of a tax—that is, who actually pays the tax in terms of reduced income or increased prices, regardless of who legally remits it to the government. It distinguishes between the statutory incidence (who is legally responsible to pay the tax) and the economic incidence (who ultimately bears the cost). In many cases, the individual or business that pays the tax to the government can shift the burden onto others through changes in prices, wages, or returns. For instance, although a business may be required to collect and submit Goods and Services Tax (GST), it may shift the tax burden to consumers by

raising product prices. Similarly, taxes on labor or capital may be shifted to employees (through lower wages) or consumers (through higher prices), depending on the elasticity of supply and demand in each market.

In India, indirect taxes like GST are typically passed on to consumers, making them the primary bearers of such taxes. By contrast, direct taxes (such as income tax) fall more squarely on the person or entity who earns the income. The concept of tax incidence is vital for evaluating fairness in taxation policy. A tax may appear equitable on paper but could have regressive effects if lower-income groups bear a larger proportion of the burden relative to their income.

## **OBJECTIVE OF THE STUDY:**

This study examines the incidence of taxation on consumers in India.

## **RESEARCH METHODOLOGY:**

This study is based on secondary sources of data such as articles, books, journals, research papers, websites and other sources.

## **A STUDY OF TAX INCIDENCE ON CONSUMERS IN INDIA**

Tax incidence refers to who ultimately bears the economic burden of a tax. In India, the Goods and Services Tax (GST), introduced on 1 July 2017, was designed as a destination-based, multi-stage VAT mechanism, subsuming a host of indirect taxes. Though businesses remit GST, economists agree that the end consumer bears almost the entire burden—a hallmark of indirect taxation.

### **Structure of GST and Slab Impact**

GST operates across five slabs: 0%, 5%, 12%, 18%, and 28%, with additional cesses on select luxury items and vehicles. Essential food items generally fall in 0–5%, while consumer durables, services, and luxury goods occupy higher brackets.

### **Theoretical Incidence by Income Group**

An IMF study (2018) estimated that effective GST incidence is relatively progressive: the lowest consumption quintile bears an average rate of 9%, rising to around 10.5% for the top quintile, when including indirect input taxes on exempt goods. Thus, according to the IMF, GST isn't strongly regressive in consumption-based terms.

## **SECTORAL IMPACT ON CONSUMERS**

**Food & Household Essentials:** Staples like rice, wheat, curd, milk powder, and spices are taxed at 0–5%, offering relief to the poorest. Yet pre-packaged food was brought under 5% GST in July 2022, raising expenditure 3–5% for a typical middle-class household.

**Personal Care, Toiletries & Cosmetics:** Items such as hair oil, toothpaste, soaps, detergents and cosmetics were previously taxed at 28% but reduced to 18% under GST—short of total relief but still a net reduction. Nonetheless, these are everyday items disproportionately purchased by lower income consumers.

**Consumer Durables & Appliances:** Electronics and appliances (TVs, fridges, mobile phones, mixers, etc.) moved from extremely high pre-GST effective rates (~31%) down to 18%, significantly lowering the upfront cost for consumers.

**Telecom, Insurance and Banking Services:** Service sectors such as telecom and insurance saw GST rates rise from ~15% up to 18%, pushing costs higher for consumers without additional benefits.

**Restaurants, Dining & Food Delivery:** Restaurant bills used to incur service tax (~6%) plus VAT (~12.5%), totaling ~18.5%. GST consolidated at 5% for non-AC and AC restaurants (without ITC), reducing costs. However, food delivery services initially taxed at 18% triggered calls for reduction to 5%.

**Real Estate & Housing:** Under-construction residential units attract 12% GST (compared to prior ~5.5% VAT + service tax), leading to rising housing costs for purchasers. Ready-to-move flats are often exempt, depending on law interpretations.

**Auto & Motor Vehicles:** Cars under GST face 28% plus cess (1–15%), meaning small cars (~28 + 1%) and luxury vehicles (~28 + 15%) are relatively high-taxed, raising consumer prices compared to pre-GST era.

**Health & Sanitary Supplies:** Sanitary napkins taxed at 12% by mid-2018 sparked criticism due to hygiene concerns among low-income women. Healthcare services remain largely exempt, but many inputs are taxed, pushing insurance premiums (18%) higher, impacting middle-class families.

## GOVERNMENT DISCOURSE & POLITICAL DEBATE

Officials such as Finance Minister Nirmala Sitharaman argue that GST provided relief—pointing to reductions from ~28% to 18% on everyday items like soap, detergents, toothpaste, makeup, etc.. Critics counter that GST on educational items (uniforms, books) at 18% burdens the poor and is globally unusual. Recent GST Council discussions include possible abolition of the 12% slab, shifting items into 5%, contingent on simplifying tax structure and easing consumer burden .

## WELFARE AND DISTRIBUTIONAL CONSIDERATIONS

While GST simplifies collections and enhances transparency, its regressive implications can disproportionately affect lower-income and informal households who spend larger shares of income on taxed goods and services. Female-headed households may bear higher burden per data from regional studies in West Bengal.

## **IMPACT OF TAX INCIDENCE ON THE INFORMAL SECTOR AND UNORGANIZED LABOR MARKETS**

The informal sector forms the backbone of India's labor market, employing nearly 80–85% of the workforce, especially in urban service, manufacturing, and rural agrarian zones. Traditionally, these sectors operated outside the formal tax net, dealing in cash and avoiding registration under VAT or service tax regimes. However, with the introduction of GST and digitization efforts, indirect tax exposure of informal consumers has increased, both directly and through market linkages with formal entities.

Informal workers—daily wage earners, street vendors, domestic helpers—do not directly file GST returns or pay income tax, but their consumption patterns are heavily taxed. For example, a street vendor purchasing soap, oil, or basic packaged foods pays GST embedded in the retail price, despite being outside the formal economy. Similarly, they face price pass-throughs from formalized supply chains, as even small unregistered firms are indirectly impacted when purchasing taxed inputs or services. Moreover, the informal sector's inability to claim Input Tax Credit (ITC) places them at a structural disadvantage. Registered entities can offset tax paid on inputs, but unregistered entities cannot, which leads to higher prices being passed down the supply chain to consumers. As informal firms operate on razor-thin margins, the embedded tax in final retail prices is disproportionately higher for their largely low-income consumer base.

GST compliance burdens have also indirectly affected consumer welfare in these sectors. Several micro and small enterprises (MSMEs) faced working capital shortages due to input credit delays and upfront tax payments, which in turn led to higher retail prices. For example, a small tailoring unit buying cloth or threads from GST-registered wholesalers cannot claim credit but still pays the full tax, which it eventually loads into garment prices. The end consumer, often another low-income individual, bears this incidence. Thus, the interplay between indirect tax policy and the informal economy reveals a deeply regressive effect, whereby unorganized consumers and workers, despite not being taxpayers themselves, contribute significantly to the indirect tax pool. Policymakers must consider targeted interventions such as lower slabs for goods consumed in informal settings, or simplified registration and ITC claims for very small businesses.

### **BEHAVIORAL RESPONSES AND PRICE STICKINESS IN TAX INCIDENCE TRANSMISSION**

While tax incidence is typically analyzed in structural economic terms—based on elasticity, market structure, or legal tax assignment—behavioral economics introduces new dimensions to how taxes are perceived and experienced by consumers. Notably, price stickiness, framing effects, and psychological pricing all influence the actual impact of taxes on consumer welfare. One prominent behavioral factor is tax salience—how visible or noticeable a tax is to consumers. When taxes are embedded within a product's price (as with GST on packaged goods), consumers may not register the exact tax burden they are bearing. This contrasts with older VAT bills or restaurant service charges, where multiple components were listed separately, triggering stronger consumer resistance. GST's structure allows businesses to advertise tax-inclusive pricing, which obscures the true incidence for most casual buyers, especially those with low financial literacy.

Second, price stickiness refers to the tendency of businesses not to reduce prices immediately after tax cuts. For instance, when GST rates on electronics were reduced from 28% to 18%, many retailers kept the end price unchanged for weeks or months, absorbing the difference as profit. Consumers thus did not feel immediate relief. Conversely, when rates are increased, businesses promptly pass on the cost. This asymmetric transmission effectively shifts the entire burden of tax hikes to consumers while blunting the benefits of cuts—a form of non-neutral tax incidence. Additionally, framing effects affect how consumers perceive tax-inclusive pricing. A good priced at ₹99 (tax included) is more appealing than ₹84 plus 18% GST, even though the total may be the same or less. Retailers use this psychological trick to prevent consumer resistance, ensuring tax burden is smoothly transferred. This strategy is particularly effective in FMCG and apparel retailing, where volume-driven purchases override rational price dissection.

Moreover, Indian consumers' responses to tax changes are moderated by social norms and local trust structures. When community kirana stores explain price hikes citing GST changes, many consumers accept them, even when the rate revision might not apply to the product. This information asymmetry and trust-based negotiation create environments where even non-taxed items may see tax-induced price inflation, again transferring unintended burdens to consumers. Therefore, tax incidence must be viewed not only through economic rigidity but also through the lens of behavioral psychology. Tax policies aiming to reduce burden on consumers should be accompanied by mandated transparency norms, such as digital receipts with GST breakups, clear signage on tax-exempt goods, and consumer education campaigns to improve tax literacy.

## **DIGITAL PAYMENT ECOSYSTEMS AND THEIR ROLE IN SHAPING TAX INCIDENCE**

One of the indirect yet profound effects of GST has been the acceleration of digital payment adoption across India. As GST compliance and filings are intrinsically digital, vendors and small businesses have increasingly adopted online invoicing, e-invoicing, and digital payment methods. This shift has had dual implications for tax incidence on consumers.

On one hand, digital payments promote tax transparency and reduce evasion, which ideally broadens the tax base and should allow for lower tax rates. As more businesses enter the formal system, the need for high indirect tax rates to compensate for a narrow base may decline. This theoretically benefits consumers, who would pay less due to efficiency gains. On the other hand, the integration of digital infrastructure into taxation has introduced hidden costs. For example, merchants using payment apps or card readers often pay a Merchant Discount Rate (MDR), which is sometimes indirectly added to product prices—raising the effective cost for consumers. While UPI transactions are generally free, other modes like credit cards or wallets carry small surcharges that impact consumer pricing subtly but consistently. Furthermore, digital receipts make the tax component more visible, sometimes prompting consumers to question pricing or change consumption habits. In particular, middle-class consumers have become more sensitive to tax lines shown in e-commerce bills, food delivery app summaries, and mobile recharge invoices. This has led to changes in consumer behavior such as:

- Choosing restaurants with inclusive billing policies.

- Avoiding services with high GST (like premium OTT plans).
- Preferring bundled deals with tax absorbed by vendors.

Another dimension is consumer segmentation via digital platforms, which allows businesses to implement price discrimination more effectively. GST burden can thus be distributed unequally among users based on purchasing behavior and app usage. For instance, the same product may be sold tax-inclusively to some users and with added tax to others, depending on location or promotional eligibility. This practice subtly shifts incidence and complicates efforts to measure tax fairness. Moreover, GST compliance rules tied to digital payment tracking have prompted micro and small vendors to limit high-value sales or avoid bulk transactions, fearing audits or penalties. The reduced flow of such goods affects low-income consumers in local markets, who may have previously relied on bulk buying for discounts. Consequently, digitization, while promoting long-term transparency, has near-term cost implications for bottom-of-the-pyramid consumers.

### COMPARATIVE PERSPECTIVES: PRE-GST VS POST-GST

- Pre-GST indirect taxes included cascading VAT, excise, service tax, cess, octroi, etc.—leading to greater cumulative tax burden on consumers. GST rationalized these into unified VAT with credit system, eliminating much of cascading tax effect.
- Most consumer-durables and household goods saw tax cuts—e.g., electronics moved from ~31.3% to 18%.
- But services like telecom and insurance went up, and new categories like pre-packaged food, sanitary pads, and education support items were included, raising burden for certain groups.

### POLICY CHALLENGES & RECOMMENDATIONS

1. **Slab Rationalization:** Moving to fewer slabs (0%, 5%, 12% or 18%) can simplify compliance and reduce arbitrary burden.
2. **Targeted Exemptions/Rebates:** Essential items used by poor may need zero or minimal rates; GST credits or rebates might offset regressivity—particularly on food, education, health.
3. **Behavioral Interventions:** “Invoice Incentive Scheme” (Mera Bill Mera Adhikaar) promotes billing culture, improving transparency and formalization.
4. **Compensation Mechanisms:** States were promised compensation post-GST implementation for revenue losses, but delays have sparked criticism.
5. **Expand Coverage:** Bringing more small unregistered vendors into composition or regular scheme ensures fair sharing and reduces tax evasion

## CONCLUSION:

This study reveals that while the Goods and Services Tax (GST) was introduced with the goals of simplification, transparency, and efficiency, its real-world impact on consumers is complex and multifaceted. Though the GST system replaced a fragmented tax regime and reduced cascading effects, it also led to increased prices on several goods and services, particularly those consumed by low- and middle-income households. The incidence of GST falls predominantly on consumers, as businesses largely shift the burden through higher prices. Essential goods are taxed at lower rates, but items like sanitary products, packaged food, education supplies, and health insurance continue to attract significant tax, raising equity concerns. The informal sector, digital payment systems, and consumer behavior further complicate how the tax burden is transmitted. Despite improvements in compliance and revenue collection, the current tax structure has shown signs of regressivity, especially in the absence of targeted relief measures. To ensure a more equitable distribution of tax burdens, there is a need for slab rationalization, improved tax transparency, and protective measures for vulnerable groups.

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