



Impact of Digital GST Compliance on Financial Inclusion in India

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Abstract : This paper emphasizes various positive and negative impacts of implementing GST through digital technology and the role of digital compliance systems introduced under the GST and their impact on tax administration and financial inclusion. Using a qualitative approach based on secondary data from government reports, policy documents and existing literature, the study reviews key digital mechanisms such as online registration, e-invoicing, electronic return filing, and the e-way bill system. The findings suggest that GST digital compliance has improved transparency, strengthened tax monitoring and increased the efficiency of tax collection. The integration of GST with digital payment platforms, including Unified Payments Interface (UPI), mobile wallets and net banking, has also encouraged businesses to adopt digital financial practices and maintain electronic transaction records. These records support financial inclusion by helping financial institutions assess creditworthiness and expand access to financial services for small businesses.

Index Terms- GST, Digital Tax Compliance, Financial Inclusion, Digitalization -

INTRODUCTION

Background (Evolution of Taxation in India): The Indian taxation system has evolved over time due to historical and economic changes. The introduction of the Goods and Services Tax (GST) is a major reform aimed at simplifying taxes, improving efficiency and promoting interstate trade. In ancient and medieval India, taxes mainly included land revenue, trade tolls, customs duties and taxes on artisans and merchants under empires such as the Maurya Empire, Gupta Empire and Mughal Empire.

During British rule, the British East India Company introduced systems like the Permanent Settlement, Ryotwari System and Mahalwari System, along with taxes on goods and trade. After independence, reforms such as the Income Tax Act 1961 and Value Added Tax modernized the system. These developments eventually led to the implementation of GST as a comprehensive tax reform (1).

Need for tax reforms: A tax is a **compulsory financial charge** imposed by the government on individuals or property owners. In India, the power to levy taxes is defined by the Constitution of India, which provides the legal framework for the country's taxation system. Taxes are mandatory contributions collected under laws passed by the legislature or Parliament. India follows a **three-tier taxation system** consisting of the central government, state governments and local government bodies. Taxes shaped the relationship between the state and its people. For farmers, artisans, and traders, taxation affected how much of their income or produce they could keep, while for rulers it provided resources to maintain armies, build infrastructure, and support religion and culture. Thus, taxation has been not only a financial system but also a tool of governance, social control, and redistribution (2).

Before the introduction of the **Goods and Services Tax (GST)**, India's tax system was complex, with many indirect taxes imposed by central and state governments. Businesses had to follow different tax rules, maintain separate records and file multiple returns, which increased compliance costs, especially for small and medium enterprises. The fragmented tax structure also hindered interstate trade and economic integration. Different tax rates and procedures across states made business operations

difficult and raised costs. Additionally, the lack of a unified tax system reduced the global competitiveness of Indian companies by discouraging investment and slowing industrial growth (3).

Importance: Payment systems around the world have changed rapidly in recent years. Surveys by central banks show that the use of cash is decreasing, while consumers are increasingly choosing digital payments. This shift is mainly due to government policies, technological progress, and continuous innovation. In addition, the COVID-19 pandemic also played a major role in increasing non-cash payments globally. During the pandemic, many people moved from cash to digital payments because shops were closed, cash was less available, and people wanted to avoid physical contact. As a result, the use of digital payment methods such as cards and online transfers grew quickly during and after the pandemic. Therefore, the pandemic acted as a catalyst for the rapid growth of digital transactions (4). What started as a convenient option later became a necessity and is now a common payment behavior.

In line with the growth of digital payments in India, the indirect tax system was restructured with the introduction of the Goods and Services Tax (GST), which replaced taxes like service tax and VAT with a single tax structure. GST requires online return filing, digital invoices, and electronic records, pushing businesses to adopt digital platforms. The growing use of Unified Payments Interface (UPI), net banking, mobile wallets, and card payments for tax payments and transactions has increased digital payment adoption. This supports the government's aim of a cashless economy and financial inclusion (5). In this digitalization of tax administration has improved transparency, reduced tax evasion and made tax compliance easier for taxpayers. Small businesses are a major part of India's economy and contribute significantly to employment and GDP, so their adoption of digital tax systems is important for the success of GST reforms (6).

RESEARCH OBJECTIVE

To examine the digital compliance systems introduced under GST through literature review.

METHODOLOGY

This study uses a **qualitative** and **secondary data** analysis approach:

- Policy and regulatory reviews: Examination of GST digital compliance changes from notifications, government reports and scholarly analyses.

GST DIGITAL COMPLIANCE SYSTEMS IN INDIA

GST has introduced several digital systems to simplify tax administration and improve compliance. Registration under GST is completely online, allowing businesses and professionals to register digitally and obtain a GSTIN for reporting taxes. Tax returns are also filed through digital forms which reduces paperwork compared to the pre-GST system (7). Another important feature is e-invoicing, where businesses above a specified turnover limit must generate invoices through a digital portal. These invoices are automatically sent to the GST Network (GSTN) and integrated into return systems, which improves accuracy and reduces manual errors. In addition, the e-way bill system, introduced in 2018, enables the online generation of travel documents for goods above a certain value, helping authorities track the movement of goods and reduce tax evasion. Furthermore, digital compliance rating systems and data analytics, including AI tools, are being developed to encourage higher compliance and strengthen the credibility of digital tax records (8).

DIGITAL COMPLIANCE AND FINANCIAL INCLUSION

The digital GST system improves transaction visibility by creating verifiable records of business activities, which financial institutions can use to assess creditworthiness. Its integration with banking and digital payment systems streamlines tax payments and generates reliable financial data that can support lending decisions (9). Additionally, the requirement for digital registration and compliance creates a digital footprint for informal businesses, helping them enter the formal economy and gain better access to bank accounts and credit, thereby promoting financial inclusion.

CHALLENGES AND LIMITATIONS

The taxation system is rapidly changing with the growth of digital technologies. Governments are adapting tax policies to address the expanding digital economy, where many businesses operate online without a physical presence. This creates challenges in determining how and where such companies should be taxed. A major issue in digital taxation is **jurisdiction**. Since digital transactions easily cross national borders, it becomes difficult to identify which country has the right to tax the income, often resulting in complex and overlapping tax regulations (10).

Despite its benefits, the digital GST system faces several challenges. Limited internet access and low digital literacy can prevent some taxpayers from effectively using online compliance systems. In addition, GST procedures are sometimes viewed as complex, leading some small traders to avoid digital payments due to fear of compliance issues (11). Moreover, small and informal businesses may face barriers such as compliance costs and technological requirements, which can make participation in the GST system difficult.

Positive and Negative Impacts of GST Digital Compliance on Financial Inclusion in India



Source: Self

POSITIVE: GST digital compliance has contributed positively to financial inclusion in India. Digital systems create transparent records of business transactions, which help reduce tax evasion, improve accountability and also can reduce long-term costs through automation (6). GST registration also encourages informal businesses to enter the formal economy (12). Digital tax records help banks assess creditworthiness, making it easier for small businesses to access loans and other financial services. Systems such as the **GST Network (GSTN)** help businesses maintain proper financial records and integrate tax payments with digital banking platforms (13). GST has helped more MSMEs become part of the formal economy and register under the tax system. The new tax system has made business activities clearer and more transparent. MSMEs can now reach bigger markets more easily. Better transparency has increased the trust and reliability of these businesses (14). Overall, these developments promote digital literacy, better financial management, and wider access to financial services.

Digital payments increase tax revenues through two main channels: higher economic activity and improved tax compliance. Digitalization promotes financial inclusion and formalization, bringing more individuals and businesses into the formal economy. This leads to increased consumption, investment, and taxable income.

Additionally, digital transactions create a traceable record, reducing tax evasion and the scope for underreporting. Since transactions are monitored by financial institutions and shared with tax authorities, it becomes easier to verify actual sales and income. The awareness of such monitoring further discourages tax evasion, ultimately leading to higher tax revenue (15).

NEGATIVE: The benefits of digital compliance are not equally experienced by all, especially MSMEs. They face issues like low digital skills, lack of proper technology, and high costs of GST software. These problems lead to compliance fatigue and reduce their participation in the formal economy. Moreover, technical issues, frequent changes in rules, and complex return filing increase the workload and create inefficiencies in the system (16). GST digital compliance also presents certain challenges that may limit financial inclusion. Limited internet access and weak digital infrastructure create a digital divide, especially in rural areas. Many small traders lack the digital skills needed for online registration, return filing, and e-invoicing (17). Complex procedures and frequent regulatory changes can discourage small businesses from participating. In addition, compliance may increase costs due to the need for accountants or software. Some informal businesses avoid registration due to strict documentation requirements, while fear of tax scrutiny and dependence on digital systems like the GST Network (GSTN) can also create difficulties (18), a high compliance costs for small businesses and vendors and relatively high taxes on some essential commodities. Additionally, small and medium enterprises face challenges in adopting and maintaining digital infrastructure due to its high cost.

FINDINGS

The study shows that the digital compliance systems introduced under the Goods and Services Tax (GST) have significantly improved tax administration by increasing transparency, efficiency and digital record-keeping. The implementation of online GST registration, electronic return filing, e-invoicing and the e-way bill system has reduced paperwork and enhanced the accuracy of

tax reporting. These digital systems have also strengthened the monitoring of business transactions and helped reduce tax evasion. The review of GST collection trends from FY 2017–18 to FY 2024–25 indicates an overall increase in revenue, suggesting improved tax compliance and broader participation in the tax system. The integration of GST with digital payment platforms such as Unified Payments Interface (UPI), mobile wallets and net banking has further encouraged businesses to adopt digital financial practices.

The findings also indicate that GST digital compliance supports financial inclusion by generating reliable digital transaction records that financial institutions can use to evaluate creditworthiness. This digital footprint enables small and informal businesses to enter the formal financial system and gain better access to banking services and credit. Study also identifies certain challenges that limit the inclusive impact of GST digital compliance. Limited internet connectivity, low digital literacy, and complex compliance procedures create difficulties for many small traders and informal businesses. Additionally, compliance costs related to accounting services, software adoption, and technological infrastructure may place a financial burden on small and medium enterprises, which can discourage full participation in the digital tax system.

CONCLUSION

The study concludes that digital compliance under the Goods and Services Tax (GST) has significantly modernized India's tax administration and promoted the adoption of digital financial systems. Features such as online registration, e-invoicing and digital return filing have improved transparency, reduced tax evasion and increased the efficiency of tax collection. The integration of GST with digital payment platforms has also supported the growth of the digital economy and strengthened financial inclusion by creating reliable financial records for businesses.

However, the benefits are not equally experienced by all businesses. Small and informal enterprises often face challenges such as limited digital literacy, poor internet access, and higher compliance costs. Therefore, improving digital infrastructure, simplifying procedures and providing training support are necessary to ensure broader participation. Overall, while GST digital compliance has positively influenced financial inclusion and tax transparency in India, continued policy support is needed to ensure that small businesses are not left behind in the digital transformation process.

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