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Unravelling Goods and Services Tax in India: An Analytical Study

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Abstract

This study examines the rationale, evolution, and implementation of the Goods and Services Tax (GST) in India. It traces the transition from GST 1.0 to GST 3.0, analyzes the institutional machinery underpinning its operation, and compares India's GST framework with global counterparts. The paper highlights reforms that have shaped GST's trajectory, identifies impediments to effective implementation, and proposes a forward-looking framework to strengthen its role as a "Good and Simple Tax." Purpose The paper addresses the limitations of India's pre-GST indirect taxation system, particularly the complexities associated with the interstate movement of goods and services and the distribution of tax revenues. It demonstrates how GST has progressively resolved these challenges through successive iterations. By benchmarking India's GST against international models, the paper advances a policy framework to enhance its impact and sustainability. Design The analysis is grounded in Dalton's Theory of Public Finance and a historical overview of tax reforms in India. Following this conceptual foundation, the paper explores the evolution of GST from its inception to GST 3.0, the institutional mechanisms supporting its implementation, comparative insights from other jurisdictions, and the bottlenecks encountered in practice. It concludes with a proposed framework for ensuring the long-term effectiveness of GST. Findings The study reveals that GST has eliminated the cascading effect of taxes, simplified compliance processes, enhanced revenue buoyancy, and reinforced fiscal federalism. Originality This paper situates the origin of GST within the inadequacies of India's earlier indirect taxation regime and demonstrates how these shortcomings have been addressed. It evaluates India's GST in a comparative perspective, and contributes to the discourse by proposing a framework for the next phase of reform, GST 3.0.

Keywords: *achievements, GST 2.0, GST 3.0, GST1.0, New Framework, Taxation Reforms*

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1. Introduction

When the Goods and Services Tax (GST) was rolled out in India on July 1, 2017, it replaced a patchwork of central and state-level indirect taxes with a unified system. Before GST, businesses had to comply with multiple levies, each with its own rules and rates, which created inefficiencies and raised costs. The breakdown of the major taxes that were subsumed under GST at the Central level included Central Excise Duty (on manufacture of goods), Service Tax (on provision of services), Central Sales Tax (CST) (levied on interstate sales, collected by the Centre but shared with states), Additional Duties of Excise and Customs (including countervailing duty and special additional duty), and at the State level Taxes Replaced were Value Added Tax (VAT) (on sale of goods within the state), Entry Tax / Octroi (on goods entering a state or municipal area), Luxury Tax (on hotels, resorts, and luxury services), Entertainment Tax (on cinema tickets, shows, and events), Purchase Tax (levied on certain goods purchased by dealers), State surcharges and cesses related to supply of goods and services. By consolidating these into a single GST framework, India adopted a dual GST model, where both the Centre and the states levy GST concurrently on a common base. This reform eliminated the cascading effect of taxes, simplified compliance, and created a more integrated national market. GST today accounts for the major share of India's indirect tax revenue.

The GST introduced in India in 2017 marked a significant step toward fiscal integration, but challenges such as multiple tax slabs, compliance burdens, and litigation issues persisted. In 2025, the Government of India announced GST 2.0 reforms, designed to rationalise tax rates, simplify procedures, and provide relief to consumers (Annapoorna, 2026). This paper examines the rationale for taxation, Dalton's theory of public finance, and other defences of taxation, situating them within the framework of GST 2.0.

2. Why Taxes?

Taxation is indispensable in modern economies, serving as the primary mechanism for resource mobilisation and governance. Taxes are not merely instruments of revenue collection; they embody broader social and economic objectives.

First, taxation finances public goods and services such as infrastructure, education, healthcare, and defence, which cannot be efficiently provided through private markets. Second, taxation enables redistribution of wealth, reducing inequality by transferring resources from higher-income groups to welfare schemes.

Third, taxation serves a regulatory function, discouraging harmful consumption through higher levies on demerit goods such as tobacco and alcohol. Finally, taxation contributes to macroeconomic stability, helping governments manage inflation, fiscal deficits, and overall economic balance (Musgrave, 1959; Kagan, 2025).

GST 2.0 reflects these principles by rationalising slabs into three categories, 5% for essentials, 18% for standard goods, and 40% for demerit goods, ensuring consumer relief while maintaining fiscal discipline (Drishti IAS, 2025).

3. Dalton's Theory of Public Finance

Economist Hugh Dalton (1922) advanced the Principle of Maximum Social Advantage, which remains foundational in public finance. Dalton argued that taxation should be levied until the marginal social sacrifice (the burden borne by taxpayers) equals the marginal social benefit (the welfare gained from public expenditure).

This equilibrium ensures that taxation neither imposes excessive burdens nor results in under-provision of public goods. Dalton emphasised fairness and equity, insisting that taxation must be distributed equitably across society. Dalton also highlighted efficiency in spending, arguing that public expenditure should maximise welfare rather than merely accumulate revenue (Dalton, 1922).

GST 2.0 embodies Dalton's principle by reducing the burden on essential goods and services, thereby lowering social sacrifice, while ensuring that revenue from higher slabs supports public welfare initiatives.

Beyond Dalton's theory, several other frameworks justify taxation:

- **Benefit Theory:** Citizens pay taxes because they directly benefit from state services such as roads, courts, and security (Wicksell, 1896; Lindahl, 1919; Scherf & Weinzierl, 2019).
- **Ability-to-Pay Principle:** Taxes should be based on individuals' capacity to pay, ensuring fairness through progressive structures (Kagan, 2025).
- **Social Contract Theory:** Taxes form part of the implicit contract between citizens and the state, legitimising governance and protection (Tengs, 2020; Gribnau & Frecknall-Hughes, 2022).
- **Keynesian Perspective:** Taxes are tools for macroeconomic management, stimulating demand during recessions or curbing inflation during booms (Keynes, 1936).

Together, these defences reinforce the legitimacy of taxation as a mechanism for balancing individual sacrifice with collective welfare.

4. Direct and Indirect Taxes and the Role of GST in Indirect Taxes

4.1. Direct Taxes

Direct taxes are levied directly on individuals and organizations based on their income, profits, or wealth. The burden of payment cannot be shifted to another party, making them progressive in nature. Examples include income tax, corporate tax, and capital gains tax. These taxes are considered equitable because they are linked to the taxpayer's ability to pay, thereby redistributing wealth and reducing inequality. However, they also involve a higher compliance burden and are more prone to evasion, requiring strong administrative mechanisms to ensure efficiency and fairness (Musgrave, 1959; Das et al., 2025).

4.2. Indirect Taxes

Indirect taxes, in contrast, are levied on the consumption of goods and services, and the burden can be shifted from producers to consumers. Examples include customs duty, excise duty, and the Goods and Services Tax (GST). These taxes are regressive in nature, as all consumers pay the same rate regardless of income, which can disproportionately affect lower-income groups. Nevertheless, they are easier to collect, cover a broad base, and encourage compliance through consumption. Indirect taxes also play a regulatory role, discouraging harmful consumption by imposing higher rates on demerit goods such as tobacco and alcohol (Wicksell, 1896; Lindahl, 1919).

4.3. Role of GST in Indirect Taxes

The Goods and Services Tax (GST), introduced in 2017 and restructured under GST 2.0 in 2025, has become the cornerstone of India's indirect tax system. GST unified multiple levies such as VAT, service tax, excise duty, and entry tax into a single national framework, thereby eliminating the cascading effect of "tax on tax." By allowing input tax credits, GST simplified compliance and improved efficiency. GST 2.0 further rationalised slabs into 5% for essentials, 18% for standard goods, and 40% for demerit goods, reducing litigation and easing compliance burdens. It also enhanced revenue buoyancy through digital compliance measures such as e-invoicing and widened coverage. Importantly, GST embodies cooperative federalism, with the GST Council ensuring that both Union and State governments participate in decision-making, balancing fiscal autonomy with national integration (Drishti IAS, 2025). According to the Central Board of Indirect Taxes and Customs (CBIC), in FY 2023-24 up to January 2024, GST contributed around 65-70% of total indirect tax collections, with the remainder coming mainly from customs duties of about 20-25% and excise on petroleum/tobacco products amounting to 10-15%.

5. History of Tax Reforms in India

Taxation in India has evolved through ancient, colonial, and post-independence phases. Ancient texts such as the *Arthashastra* and *Manu Smriti* mention levies on trade and agriculture, while British colonial rule institutionalised modern tax administration (Das et al., 2025). After independence, the Income Tax Act, 1961, became the cornerstone of direct taxation, supplemented by various reforms over the decades.

The Direct Taxes Committee (Wanchoo Committee, 1971) and later committees emphasised simplification, reduction of rates, and curbing evasion. Similarly, the Indirect Taxes Committee recommended rationalisation of excise and customs duties, paving the way for the eventual introduction of GST in 2017.

5.1. Reports of Direct and Indirect Taxes Committees

- **Direct Taxes Committees:** Focused on reducing corporate and personal income tax rates, broadening the tax base, and improving compliance. The Wanchoo Committee (1971) and Kelkar Task Force (2002) were particularly influential in shaping modern direct tax policy.
- **Indirect Taxes Committees:** Recommended harmonisation of excise, customs, and service taxes to create a unified market. These reports laid the foundation for GST, which

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Table 1. Taxes as a Percentage of GDP

Particular	FY 2024–25 (RE)	FY 2025–26 (BE)	FY 2026–27 (BE)
Gross Tax Revenue (₹ lakh crore)	38.5	42.7	46.1
Tax-to-GDP Ratio (%)	11.5	12.0	12.1
Direct Taxes Share (%)	54	56	57
Indirect Taxes Share (%)	46	44	43

Source: Ministry of Finance, Government of India (Union Budget 2025-26: Budget at a Glance, Receipts Budget, and Medium-Term Fiscal Policy Statement).

was implemented in 2017 and further restructured under GST 2.0 in 2025 (CBIC, 2025).

In 2025, the Government of India introduced the Income Tax Act, 2025, set to replace the Income Tax Act, 1961 from April 1, 2026. This initiative reflects the government's commitment to modernising tax architecture in line with global best practices, while balancing transparency, equity, and efficiency.

India's tax revenue is projected to reach 12% of GDP in FY 2025-26, the highest in nearly two decades, driven by robust tax buoyancy and economic formalisation (ETCFO, 2025).

Globally, tax revenue averages 13-14% of GDP in 2026, though there is wide variation:

Table 2. Comparative Tax-to-GDP Ratios Across Regions, 2026

Region/Country Group	Tax-to-GDP Ratio (%) 2026	Remarks
OECD Average	27.5	High reliance on income & social security taxes
EU (27)	28.0	Strong VAT and social contributions
USA	18.0	Lower than OECD average, reliance on income taxes
India	12.0	Rising due to GST & direct tax buoyancy
Brazil	14.5	Heavy indirect taxation
Sub-Saharan Africa (avg.)	9.0	Limited base, reliance on trade taxes
World Average	13.6	World Bank estimate

Source: Organisation for Economic Co-operation and Development (OECD, 2025); European Union Statistics (Eurostat, 2025); U.S. Congressional Budget Office (CBO, 2025); Ministry of Finance, Government of India (Union Budget 2025–26); World Bank (2025).

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6. Why GST?

The Goods and Services Tax (GST) was introduced to unify India's fragmented indirect tax system and create a common national market. One of the strongest arguments in favor of GST is its ability to eliminate the cascading effect of taxes, where tax is levied on tax at multiple stages of production and distribution. By allowing input tax credits, GST ensures that only the value added at each stage is taxed, improving efficiency and transparency (Annapoorna, 2025).

GST also simplifies compliance by subsuming multiple levies such as VAT, excise duty, and service tax into a single framework. This reduces administrative costs and litigation, making taxation more predictable for businesses (Roy, 2025). Moreover, GST enhances revenue buoyancy by broadening the tax base and leveraging digital compliance tools such as e-invoicing. For consumers, GST 2.0 reforms in 2025 rationalised slabs, lowering rates on essentials and thereby reducing the burden on households (ClearTax, 2025).

Finally, GST strengthens fiscal federalism by involving both Union and State governments in decision-making through the GST Council, ensuring cooperative governance and equitable distribution of revenues (Drishti IAS, 2025).

Despite its advantages, GST has faced criticism and challenges. One major concern is that GST is regressive in nature, as all consumers pay the same rate regardless of income. This disproportionately affects lower-income groups, especially when essential goods are taxed at higher rates (Roy, 2025).

The implementation process has also been complex. Small businesses often struggle with compliance requirements such as invoice matching, filing multiple returns, and adapting to digital systems. Initial rollout in 2017 led to confusion, technical glitches, and increased compliance costs, particularly for micro and small enterprises (Annapoorna, 2025).

Another criticism is the inflationary impact during the transition phase. Prices of certain goods and services rose when GST was introduced, creating public dissatisfaction. Additionally, frequent changes in rates and rules have led to uncertainty, undermining the goal of simplification (ClearTax, 2025).

Finally, GST has posed challenges for state finances, as states rely heavily on compensation from the Union government. Delays in compensation payments have strained state budgets, raising concerns about fiscal autonomy (Drishti IAS, 2025).

Table 3. Comparative Table: India vs. Global GST/VAT

Country/Region	Year Introduced	Rate Range (%)	Key Features	Challenges Faced
India	2017 (GST 2.0 in 2025)	5, 18, 40	Dual GST (Union + States), GST Council	Compliance burden, state compensation delays
France (EU)	1954	20–25	First VAT system, EU harmonised	Inflationary concerns, cross-border compliance
Canada	1991	5–15	Dual GST/HST model	Provincial coordination
Australia	2000	10	Single national GST	Small business compliance costs
Singapore	1994	3–9	Gradual rate increases	Public resistance to hikes
Brazil	1960s (multiple reforms)	17–20	Complex dual GST model	Administrative complexity

Source: Ministry of Finance, Government of India (Union Budget 2025–26); Organisation for Economic Co-operation and Development (OECD, 2025); European Union Statistics (Eurostat, 2025); Government of Canada (Department of Finance, 2025); Australian Taxation Office (ATO, 2025); Inland Revenue Authority of Singapore (IRAS, 2025); Brazilian Ministry of Finance (2025).

7. GST-Type Taxes Abroad

The concept of a GST or VAT originated in France in 1954, where it was introduced as a value-added tax to replace cascading turnover taxes. Since then, it has spread widely across Europe, Asia, Africa, and Latin America. Today, more than 160 countries have adopted some form of VAT/GST, making it the most common form of indirect taxation globally (OECD, 2025).

Countries such as Canada, Australia, New Zealand, Singapore, and Malaysia use the term GST, while most European Union nations employ VAT. Despite differences in nomenclature, the principle remains the same: a tax on value addition at each stage of production and distribution, with credits for taxes paid on inputs.

The adoption of GST/VAT abroad was driven by the need to simplify indirect taxation by replacing multiple overlapping levies, ensure neutrality by taxing consumption rather than production, improve compliance through input tax credits and invoice-based systems, and boost revenue efficiency by broadening the tax base. Canada introduced GST in 1991, replacing a hidden manufacturers' sales tax. Australia adopted GST in 2000, after extensive political debate and consensus-building. Similarly, Singapore introduced GST in 1994 at a modest rate of 3%, gradually increasing it to balance fiscal needs with consumer welfare. Despite its advantages, countries faced significant challenges when implementing GST/VAT such as political resistance, administrative complexity, compliance burden, inflationary concerns and federal coordination. Australia's GST rollout in 2000 faced criticism from small businesses over compliance costs, while Malaysia's GST (2015) was repealed in 2018 due to political backlash, replaced by a Sales and Service Tax (SST).

Globally, GST/VAT has become a cornerstone of indirect taxation. It accounts for 20-30% of total tax revenue in OECD countries, reflecting its efficiency and broad base (OECD, 2025). The system's reliance on digital compliance and invoice-based credits has also made it a model for modern tax administration.

8. Why was GST 2.0 Introduced?

GST 1.0, launched in 2017, unified India's indirect tax system but left unresolved issues such as multiple slabs, inverted duty structures, and compliance burdens for small businesses. By 2025, the four-slab structure (5%, 12%, 18%, 28% plus cess) had become complex, leading to frequent classification disputes and litigation. GST 2.0 was introduced in September 2025 to rationalise rates, simplify compliance, and align India's tax system with global best practices (Insights Editor, 2025; Annapoorna, 2026).

The government outlined three pillars for GST 2.0 reforms:

1. **Structural Reforms:** Simplify the tax framework by reducing slabs to 5%, 18%, and 40%.
2. **Rate Rationalisation:** Correct inverted duty structures and lower rates on essentials such as packaged food, electronics, and insurance.
3. **Ease of Doing Business:** Reduce compliance costs, empower MSMEs, and encourage investment through digital facilitation and fewer disputes (Annapoorna, 2026).

GST 2.0 also aimed to prioritise long-term growth over short-term revenue maximisation, reflecting a strategic shift in India's fiscal policy (Insights Editor, 2025). It had fewer slabs, reduced classification disputes and litigation, provided consumer relief, enhanced micro, small, and medium enterprises, ensured revenue stability, and led to global alignment. However, issues concerning state compensation, compliance burden, inflationary risks, political sensitivity, and regressive concerns remained.

9. Mechanism of GST in India

GST in India is administered by the GST Council, a constitutional body established under Article 279A of the Constitution, as amended by the 101st Amendment Act, 2016. It is composed of the Union Finance Minister (Chairperson), the Union Minister of State for Finance, and the Finance Ministers of all States and Union Territories. Its functions include deciding tax rates, exemptions, and thresholds, resolving disputes between the Centre and States, and recommending changes in laws and procedures. Decisions require a three-fourths majority, and the centre has one-third voting weight; States collectively hold two-thirds. It ensures uniformity, cooperative federalism, and smooth functioning of GST across India.

The states' perspectives on GST functioning have been positive. GST has created a unified market, reducing trade barriers, and compensation mechanisms initially assured states of revenue stability. However, the states have voiced some concerns ranging from revenue dependence, autonomy, to compliance burden.

The International Parallels of the GST council in India comprise European Union (EU) VAT Committee, ensuring uniform rules while allowing rate flexibility. The Canadian, Australian, and New Zealand mechanisms are similar, centrally administered, but revenue is distributed to states/territories, requiring intergovernmental agreements. Thus, India's GST Council is comparable to international models, but its federal, consensus-driven structure is more complex than most, reflecting India's diverse polity.

10. Why GST 3.0?

While GST 2.0 (2025) rationalised slabs and simplified compliance, challenges remain. States continue to express concerns about fiscal autonomy and compensation, small businesses still face

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Table 4. Comparative Evolution of GST in India

Feature	GST 1.0 (2017)	GST 2.0 (2025)	GST 3.0 (Proposed)
Tax Slabs	5%, 12%, 18%, 28% + cess	Rationalised to 5%, 18%, 40%	Possible 2 slabs with equity adjustments
Structure	Dual GST (CGST + SGST + IGST)	Same dual model, simplified classification	Strengthened federal balance, revised compensation mechanism
Compliance	GSTN portal, multiple returns, invoice matching	Simplified filing, e-invoicing, reduced litigation	AI-driven compliance, blockchain-based invoice tracking
Consumer Relief	Lower rates on essentials, but confusion on classification	Essentials further reduced, insurance and food relief	Targeted subsidies or direct transfers linked to GST collections
Business Impact	Unified market, but high compliance burden for MSMEs	MSME-friendly reforms, reduced compliance costs	Seamless digital integration, one-click compliance for small firms
Revenue Performance	Initial volatility, later buoyancy	Steady growth, collections crossed ₹1.9 lakh crore/month	Broader base, green levies, digital tax integration
Global Alignment	Inspired by VAT/GST abroad, but complex slabs	Rationalised closer to OECD models	Harmonisation with OECD digital tax rules, sustainability focus
Challenges	Technical glitches, frequent rate changes, state compensation delays	Regressive concerns, fiscal autonomy issues, inflationary risks	Balancing equity with simplicity, political resistance to reforms

Source: Ministry of Finance, Government of India, Union Budget 2017-18; Union Budget 2025-26; Goods and Services Tax Council Reports 2017–2025; OECD Consumption Tax Trends, 2025.

compliance burdens, and the regressive nature of consumption-based taxation persists. Moreover, global trends in digital taxation, sustainability, and equity demand further innovation. GST 3.0 would therefore be introduced to deepen reforms, align with international best practices, and address structural gaps in India's tax system. GST 3.0 should aim to:

1. **Enhance Equity:** Introduce targeted relief for low-income households, possibly through differentiated rates or direct transfers linked to GST collections.
2. **Digital Integration:** Expand e-invoicing, blockchain-based compliance, and AI-driven fraud detection to reduce evasion.
3. **Green Taxation:** Integrate environmental levies within GST to discourage carbon-intensive consumption and promote sustainability.
4. **Fiscal Federalism:** Strengthen state participation by revising compensation mechanisms and ensuring predictable revenue-sharing.
5. **Global Alignment:** Harmonise India's GST with OECD digital tax frameworks and cross-border VAT/GST rules to facilitate trade.

GST 3.0 should be consumer-centric, business-friendly, ensure revenue stability, and Global Competitive. It may face political resistance, an increase in implementation costs, and induce the fear of inflationary risks. Balancing equity-focused differentiation with the goal of simplification may be difficult.

We now provide a comparative evaluation table showing the evolution from GST 1.0 to GST 2.0 to GST 3.0

It is apparent from Table 4 that while GST 1.0 achieved unification and reduced cascading but struggled with complexity and compliance; GST 2.0 simplified slabs, empowered MSMEs, and boosted revenue, but concerns about regressivity and state autonomy persisted. GST 3.0 should focus on equity, digitalisation, sustainability, and federal balance, making India's GST globally competitive and socially inclusive.

11. Conclusion

The introduction of GST is a transformative initiative, challenging the old framework of taxation in India as a source of revenue to align it to achieve the national objectives of Viksit Bharat - Growth with Equity. It is one strategic step to align the Indian taxation system with the global taxation systems. It has made doing business in India easy and is customer-friendly. The digitization has substantially reduced its operational complexities. Over and above, it has led to a greater harmony in center-state financial relations. However, questions remain about the impact of GST on capital formation, stock market investments, foreign investments, and its inclusivity. Can GST help India in becoming a manufacturing hub and internationalization of Indian stock market? Will recent GST cut adversely impact fiscal legroom? Will GST 3.0 revive the animal spirit and spur private investments which has been lagging during post-COVID years? How GST reforms will fuel the growth engine through its impact on Aam Aadmi, particularly the middle and neo middle class?

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