



GST

LEVERAGING DIGITAL GOVERNANCE FOR INCLUSIVE ECONOMIC GROWTH: GST REFORMS AND FISCAL FEDERALISM IN TAMIL NADU

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DIGITAL GOVERNANCE AND TAX COMPLIANCE: OPPORTUNITIES AND CHALLENGES FOR SMALL TAXPAYERS IN INDIA



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Abstract

The digitisation of tax administration in India represents a fundamental shift in the relationship between the state and small taxpayers. This paper examines the opportunities and challenges presented by digital governance in taxation for Micro, Small, and Medium Enterprises (MSMEs) in the Indian context. Based on government reports, academic research, and industry analyses from 2023 to 2026, the paper presents that initiatives such as the Goods and Services Tax Network (GSTN), faceless assessments, and e-invoicing have enhanced transparency and compliance, their effectiveness is constrained by persistent infrastructural deficits, digital literacy gaps, and trust-related challenges among small taxpayers. The paper concludes with policy recommendations for developing inclusive digital tax systems that balance technological advancement with accessibility for all segments of the taxpayer population.

Keywords: *Digital Governance, Tax Compliance, MSMEs, GST, India, Tax Administration*

1. Introduction

The global transition toward digital tax administration characterised by real-time data integration, automated compliance, and reduced human interface has profound implications for small taxpayers. In India, this transformation has been particularly significant following the implementation of the Goods and Services Tax (GST) in 2017 and the subsequent development of the Goods and Services Tax Network (GSTN) as a comprehensive digital infrastructure for tax compliance (Gupta, 2024). Micro, Small, and Medium Enterprises (MSMEs) constitute a critical segment of the Indian economy, contributing approximately 30% to the Gross Domestic Product (GDP) and employing over 110 million persons (Ministry of MSME, 2025). However, this sector has historically faced challenges in tax compliance due to limited administrative capacity, high compliance costs, and partial operation within the informal economy (Sharma & Kumar, 2025).

This Paper Addresses the Research Question

How does digital governance shape tax compliance opportunities and challenges for small taxpayers in India?

1.1 Objectives:

- To examine the key digital initiatives in Indian tax administration
- To analyse the opportunities these initiatives present for MSMEs
- To identify the persistent challenges that limit their effectiveness.

2. Literature Review

2.1 Theoretical Framework: Digital Governance in Taxation

Digital governance in taxation refers to the integration of information and communication technologies into tax administration processes, enabling real-time data capture, automated compliance verification, and reduced physical interface between taxpayers and authorities (Chattopadhyay & Das, 2024). The OECD's concept of "Tax Administration 3.0" envisions tax systems seamlessly embedded within the natural systems taxpayers use in their daily operations, moving from periodic, retrospective compliance to real-time, proactive engagement (Rao, 2025).

2.2 The Indian Context: Evolution of Digital Tax Administration

India's journey toward digital tax administration began with the partial automation of income tax processes in the early 2000s but accelerated dramatically with the introduction of GST in 2017. The GSTN represents one of the world's most ambitious tax technology projects, creating a unified digital platform for registration, return filing, payment, and compliance verification (Garg & Mittal, 2024).

Key initiatives include:

- **E-invoicing:** Mandatory for businesses with turnover above specified thresholds, enabling real-time reporting of business-to-business transactions and automated reconciliation (Central Board of Indirect Taxes and Customs [CBIC], 2025)
- **Faceless Assessment:** Elimination of physical interface between taxpayers and assessing officers, with cases allocated randomly through algorithms (Income Tax Department, 2025)
- **Pre-filled Returns:** Automated population of return forms with data available from third-party sources, reducing manual entry requirements (Mehta, 2024)
- **QRMP Scheme:** Quarterly filing and monthly payment options for small taxpayers with turnover up to Rs.5 crore, reducing compliance frequency (CBIC, 2024)

2.3 MSMEs and Tax Compliance: Existing Research

Research on MSME tax compliance in India has identified several persistent challenges. Sharma and Kumar (2025) found that compliance costs for small businesses remain disproportionately high despite digitisation, with time spent on tax matters averaging 8-10 hours per month for businesses with limited accounting infrastructure. Gupta (2024) noted that while large businesses have internal capacity to adapt to digital systems, micro-enterprises often rely on external tax professionals, creating dependency and additional costs.

The relationship between formalisation and digitisation has also been examined. Chattopadhyay and Das (2024) argue that digital payment systems and GST reporting are gradually bringing previously informal economic activity into the tax net, though complete formalisation remains distant.

3. Opportunities: The Promise of Digital Governance

3.1 Reduced Compliance Burden

Digital governance has demonstrably reduced certain compliance burdens for small taxpayers. The introduction of the Quarterly Return Filing and Monthly Payment (QRMP) scheme in 2020 allowed businesses with turnover up to Rs. 5 crore to file returns quarterly while paying taxes monthly, reducing filing frequency by 67% (CBIC, 2024). The facility to file NIL returns via SMS eliminated the need for login and form submission for businesses with no taxable activity in a given period.

Empirical evidence suggests that these measures have had measurable impact. A study by the National Institute of Public Finance and Policy (NIPFP, 2025) found that average time spent on GST compliance for small taxpayers decreased from 12 hours per month in 2018 to 7 hours per month in 2024, though significant variation exists based on digital literacy and access to professional support.

3.2 Enhanced Transparency and Predictability

The faceless assessment system introduced for income tax in 2020 and progressively extended has reduced opportunities for discretion and corruption in tax administration (Income Tax Department, 2025). For small taxpayers, this means greater predictability in interactions with tax authorities. Cases are assigned algorithmically based on risk parameters, and communications occur through designated portals, creating documented trails that protect taxpayer interests.

The Engineering Export Promotion Council (2025) has recommended extending this faceless approach to GST audits, arguing it would "eliminate biases and inefficiencies traditionally associated with manual audits" (p. 12).

3.3 Financial Inclusion Through Data Visibility

Perhaps the most transformative opportunity lies in the secondary use of tax data for financial inclusion. GST return data provides a verifiable transaction history that financial institutions can use for credit assessment (Reserve Bank of India [RBI], 2025). Through the Account Aggregator framework introduced by RBI, taxpayers can consent to sharing their GST data with banks and non-banking financial companies, enabling credit access without traditional collateral requirements.

As Rao (2025) observes, "GST data has become a form of financial identity for small businesses, enabling access to formal credit that was previously unavailable to enterprises lacking audited financial statements" (p. 45). Data from the RBI (2025) indicates that loans disbursed to MSMEs based on GST data crossed ₹50,000 crore in 2024-25, demonstrating the practical significance of this development.

3.4 Wider Tax Base and Economic Formalisation

Digital governance has contributed to expanding the tax base and formalising economic activity. GST registrations increased from approximately 1.2 million at implementation in 2017 to over 14 million by March 2025 (CBIC, 2025). While not all

registered businesses file regularly, the expansion of the registered base represents significant progress in economic formalisation.

Chattopadhyay and Das (2024) argue that the combination of GST reporting and UPI payment trails is creating "data visibility" even for enterprises that remain legally informal, potentially easing eventual formalisation by reducing information asymmetry between businesses and the state.

4. Challenges: The Persistence of Barriers

4.1 Infrastructural Deficits

Despite significant progress in digital infrastructure, substantial disparities persist across Indian states and regions. The Ministry of Electronics and Information Technology (MeitY, 2025) reports that while urban areas have 4G coverage exceeding 95%, rural connectivity remains inconsistent, with approximately 15% of villages experiencing regular network disruptions.

For small taxpayers in these areas, online compliance becomes disproportionately difficult. A survey of MSMEs in Bihar and Uttar Pradesh conducted by the Federation of Indian Micro and Small Enterprises (FISME, 2025) found that 42% of respondents cited internet connectivity as a major barrier to timely tax compliance, with many relying on urban-based intermediaries for basic filings.

4.2 Digital Literacy and Skills Gap

Infrastructure alone does not ensure effective digital governance. The skill requirements for digital tax compliance extend beyond basic internet usage to include understanding of tax concepts, data entry accuracy, and ability to interpret system-generated notices (Sharma & Kumar, 2025).

Research by the National Sample Survey Office (NSSO, 2024) indicates that only 23% of MSME owners in India possess basic digital literacy, defined as ability to independently complete online forms and navigate government portals. This skills gap creates dependency on tax professionals and intermediaries, increasing compliance costs and reducing the direct benefits of digitisation.

The situation is particularly acute for micro-enterprises. As Garg and Mittal (2024) note, "The one-person business that characterises much of India's informal economy lacks both the time and capability to develop in-house tax expertise, making them perpetual outsiders in the digital compliance ecosystem" (p. 78).

4.3 Trust and Perceived Surveillance

Technology alone cannot build trust in tax administration. If digital systems are perceived primarily as surveillance mechanisms designed to detect and penalise non-compliance, small taxpayers may rationally respond by maintaining partial informality or under-reporting (Mehta, 2024). The plan emphasises the need for "people-focused governance" that reduces adversarial approaches and encourages voluntary compliance through demonstrated benefits rather than punitive measures.

4.4 Complexity and Frequent Changes

Despite simplification efforts, the GST system remains complex for many small taxpayers. Rate changes, form revisions, and procedural updates occur frequently, requiring constant adaptation (Gupta, 2024). For businesses without dedicated compliance staff, keeping pace with these changes is challenging.

FISME (2025) survey data indicates that 67% of small taxpayers find it difficult to stay updated with compliance requirements, and 54% have faced penalties or notices due to unintentional errors arising from system complexity.

4.5 Cost of Compliance

While digitisation has reduced certain costs, it has introduced others. Hardware requirements, internet expenses, and professional fees for tax consultants remain significant for small businesses. The NIPFP (2025) study estimates that the average annual compliance cost for a small taxpayer (turnup below Rs.1.5 crore) is approximately Rs.12,000, representing 0.8% of turnover proportionally higher than for larger businesses.

5. Policy Recommendations

5.1 Infrastructural Investment and Last-Mile Connectivity

Addressing infrastructural disparities requires targeted investment in rural and remote connectivity. MeitY (2025) recommends extending the BharatNet project to ensure reliable broadband access in all villages, with priority for areas with significant MSME concentration. Mobile-based compliance solutions optimised for low-bandwidth environments should be developed and promoted.

5.2 Capability Building and Digital Literacy

The shift from compliance-focused training to capability-building initiatives is essential. The Ministry of MSME (2025) has proposed establishing GST Seva Kendras in all district headquarters, providing in-person support for digital compliance. Partnerships with industry associations for peer learning and mentorship programs can supplement formal training.

Educational content should be available in regional languages and designed for varying literacy levels, recognising the diversity of the MSME sector.

5.3 Simplification and Stability

Reducing system complexity and ensuring stability in compliance requirements would significantly benefit small taxpayers. Garg and Mittal (2024) recommend a "compliance moratorium" for micro-enterprises, with simplified filing requirements and reduced penalties for unintentional errors. The introduction of a presumptive taxation scheme for small GST taxpayers, similar to Section 44AD of the Income Tax Act, could further reduce compliance burdens.

5.4 Incentivising Visibility

Linking digital visibility to tangible benefits can encourage voluntary compliance.

Recommendations:

- Faster refund processing for digitally compliant businesses (CBIC, 2025)
- Preferential interest rates on MUDRA loans for businesses with clean GST records (RBI, 2025)
- Priority in public procurement for MSMEs with consistent digital compliance (Ministry of MSME, 2025)

5.5 Data Protection and Trust-Building

Clear legal frameworks for data protection and usage are essential to maintaining taxpayer trust. The proposed Digital Personal Data Protection Act provides a foundation, but specific safeguards for tax data may be necessary (Rao, 2025). Transparency about data usage, consent-based sharing protocols, and robust security measures can address privacy concerns.

6. Conclusion

India's digital transformation in tax administration represents significant progress in building a modern, efficient, and transparent system. For small taxpayers, this transformation offers genuine opportunities: reduced compliance burdens, enhanced predictability, and access to formal credit through data visibility. The expansion of the taxpayer base and gradual formalisation of economic activity demonstrate the potential of digital governance to reshape the relationship between the state and small businesses.

However, these opportunities are not uniformly accessible. Infrastructural deficits, digital literacy gaps, trust concerns, and system complexity continue to constrain the benefits of digitisation for significant segments of the MSME sector. The challenge ahead is not technological but institutional: ensuring that the powerful digital infrastructure India has built serves all taxpayers equally.

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