

Goods and Services Tax: Radical Shift in India's Indirect Tax System

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Abstract

The rollout of the Goods and Services Tax (GST) on July 1, 2017, constitutes the most significant structural fiscal reform in India's post-independence history. Built upon the foundational philosophy of "One Nation, One Tax, One Market," GST sought to integrate a fragmented, multi-layered indirect tax framework into a singular, destination-based value-added tax system. This conceptual research article provides an early-stage academic analysis of this structural shift, pulling from academic journals, institutional whitepapers, and official public data available up to April 2018.

The study contrasts the pre-existing regime—hampered by the compounding cascading tax effect, non-vatable inter-state fiscal barriers, and administrative overlap—with the newly enacted dual-GST architecture (comprising CGST, SGST, and IGST). It evaluates the macro-economic motivations behind the reform, its immediate operational benefits, and the severe teething implementation challenges that characterized its first three quarters of operation. Preliminary data up to April 2018 indicates that while the technology-driven framework, managed by the Goods and Services Tax Network (GSTN), drastically expanded the formalization of the economy and eased long-haul logistics, it simultaneously induced severe working capital crunches for small industries due to frozen input tax credit refunds and systemic software instabilities. The paper concludes with targeted policy interventions relevant to the stabilization environment of early 2018.

Keywords: Goods and Services Tax (GST), Indirect Tax Reform, Cascading Effect, Input Tax Credit (ITC), GSTN, Fiscal Federalism.

I. INTRODUCTION

Prior to July 2017, India's domestic commerce was heavily constrained by its own internal borders. The country was divided into independent state-level tax jurisdictions that actively penalized the cross-border movement of goods and services (Vertex, 2018). The passage of the 101st Constitutional Amendment Act in 2016 paved the way for a radical restructuring of this paradigm, culminating in the nationwide launch of the Goods and Services Tax (GST) on July 1, 2017 (GST Council, 2017). By subsuming a wide array of separate central and state indirect levies, the reform established a uniform, multi-stage value-added tax collected at the point of final consumption rather than the point of production or origin.

As a structural shift, the implementation of GST completely altered corporate supply chain dynamics, pricing strategies, and statutory accounting compliance (KPMG International, 2018). Evaluating the state of the Indian economy up to April 2018 reveals an environment defined by intense structural transition. The long-term promises of a unified national market and a broader tax base came into immediate conflict with short-term operational challenges. These included an unstable IT framework, changing compliance rules, and liquidity bottlenecks for small-scale sectors (Garg, 2017; KPMG International, 2018). This paper explores the structural shifts, early successes, and teething problems observed during the initial implementation phase of this historic reform.

Review of Literature

The conceptual journey toward a unified value-added tax framework in India has been meticulously documented across decades of public policy deliberations. The foundational critiques of India's multi-point sales taxation date back to the Taxation Enquiry Commission (1953–54), which argued that compounding tax structures insulated production supply chains from market efficiency and led to arbitrary consumer price inflation (Vertex, 2018). The systemic shift toward an input credit-based value-added framework began with the introduction of the Modified Value Added Tax (MODVAT) in 1986, which was later scaled across state jurisdictions as the State Value Added Tax (VAT) in 2005 (Garg, 2017). Despite these iterative improvements, academic consensus leading up to the 2017 reform highlighted that the pre-existing framework was fundamentally incomplete. It failed to systematically bridge the taxation of goods with services and was unable to eliminate inter-state fiscal blockades (Paripex, 2018).

Early academic appraisals published immediately following the July 1, 2017 rollout categorized the tax as a massive, paradigm-shifting fiscal stabilizer. Rupa (2017) conducted a comprehensive baseline assessment of the new architecture, noting that its primary achievement lay in the structural simplification of domestic

trade. By dismantling overlapping local statutes, the initial design successfully laid the groundwork for enhanced ease of doing business across fractured regional markets. This perspective was expanded by Lourdunathan and Xavier (2017), whose contemporary exploratory study on early prospects and implementation bottlenecks concluded that GST would distribute the country's indirect tax burden more equitably between the manufacturing and service sectors. However, their findings also flagged early warnings regarding severe logistical disruptions within micro-dependent sectors, notably FMCG, real estate, and seasonal food processing networks.

As the implementation entered its second quarter in late 2017, the macro-economic lens shifted toward pricing behavior, inflation indexing, and compliance dynamics. Kumar et al. (2017) investigated the immediate impacts of variable tax slabs on consumer product pricing. While their research validated the long-term deflationary properties of eliminating the cascading "tax-on-tax" layer, it simultaneously revealed short-term pricing anomalies. They observed that retail market players frequently delayed passing on the benefits of lower input costs to end-consumers—a trend that intensified public anxieties over the multi-tiered tax slabs.

Parallely, studies focused on institutional tax administration emphasized the critical role of structural transparency. Nayyar and Singh (2017) evaluated the transparency gains achieved by replacing traditional physical audit trails with automated digital ledgers. Their comparative analysis indicated that while a unified portal could significantly expand national revenue mobilization by reducing leakages at state borders, its ultimate success remained entirely dependent on removing technical and procedural barriers for small-scale taxpayers.

By early 2018, corporate field surveys and structural impact evaluations began documenting empirical friction within corporate and industrial networks. Whitepapers released by institutions like KPMG International (2018) captured real-time transitional anxiety across major industrial clusters. Their diagnostic metrics highlighted that while large enterprise supply chains adjusted quickly by consolidating regional warehouses, smaller business groups faced sharp financial distress due to the administrative overhead of tracking multi-part digital filings.

Furthermore, thematic reviews of the early implementation phase by organizations such as the Vidhi Centre for Legal Policy (2018) pointed out that the frequent legislative interventions, rate adjustments, and compliance extensions enacted by the GST Council—while necessary to address system bugs—unintentionally created an environment of regulatory fluidity that complicated compliance for traditional, non-digitized retail sectors.

Research Gap

While macroeconomic research leading up to mid-2017 focused extensively on the theoretical modeling, projected GDP expansions, and long-term compliance elasticities of a clean GST architecture, there is a distinct gap in synthesized literature capturing the actual operational realities of the transition period immediately following its launch. Most available academic evaluations up to April 2018 treated the tax as an isolated policy event rather than an iterative process of legislative adjustment. Furthermore, limited conceptual research explicitly mapped how the digital infrastructure constraints of the centralized portal directly impacted the short-term working capital management of downstream supply chains. This paper addresses this gap by capturing the state of the Indian indirect tax ecosystem exactly at the close of its first financial transition window in April 2018.

Objectives

- To systematically map the structural differences between the pre-GST multi-tiered tax architecture and the unified dual-GST model.
- To identify the systemic socio-economic vulnerabilities and fiscal challenges that necessitated this structural tax overhaul.
- To analyse the real-world operational benefits and implementation blockades experienced by industry stakeholders up to April 2018.

Existing Background of India's Indirect Tax Regime and its Challenges

The pre-GST indirect tax infrastructure was fundamentally fractured, split between manufacturing-stage levies managed by the Central Government and sales-stage levies managed by the individual states (Paripex, 2018). The Union Government possessed the constitutional mandate to levy Central Excise Duty on manufacturing, Service Tax on commercial provisions, and Additional Customs Duties (CVD/SAD) at international entry points (Paripex, 2018). Conversely, State Governments exercised sovereign fiscal jurisdiction over internal trade through State Value Added Tax (VAT), Entry Tax, Octroi, Luxury Tax, and Entertainment Tax (GST Council, 2017).

This fragmented arrangement generated three major operational challenges:

1. The Cascading "Tax-on-Tax" Phenomenon

Because central levies could not be offset against state-level distribution levies, the input tax credit mechanism broke down at the state border (Vertex, 2018). For example, Central Excise Duty paid by a manufacturer became an embedded component of the raw asset cost when state VAT was computed at the retail level. This compounding of taxes over the supply chain artificially inflated production costs and penalized the end-consumer.

2. Fiscal Barriers and Central Sales Tax (CST)

Inter-state trade was subject to a non-vatable Central Sales Tax (CST) collected by the exporting state (Paripex, 2018). Because cross-border buyers could not claim a tax credit for CST paid, corporations structured their physical supply networks around tax avoidance rather than logistical efficiency. This led to the proliferation of small, inefficient regional warehouses in nearly every state of operation simply to avoid interstate trade liabilities (Garg, 2017).

3. Overlapping Jurisdictions and Compliance Overhead

Firms dealing in composite transactions—where goods and services were bundled together, such as software licensing or restaurant catering—were continuously exposed to double taxation. They were forced to comply with both Central Service Tax and State VAT assessments simultaneously, while navigating dozens of distinct state compliance timelines (KPMG International, 2018).

Need for GST in India

The strategic necessity to transition to a Goods and Services Tax was driven by the urgent need to clean up the domestic economy. First, eliminating the cascading tax effect was vital to improving the price competitiveness of Indian manufacturing in global markets and accelerating the "Make in India" initiative (GST Council, 2017). Second, the government required an automated, invoice-matched transaction framework to reduce cash-based parallel economies and curb tax evasion (Paripex, 2018). Finally, removing inter-state checkpoints was critical to modernizing national logistics, cutting down transit times for commercial freight, and lowering the high logistics costs built into Indian commodities (Garg, 2017).

GST vs. Older Indirect Tax Regime

The structural transition introduced on July 1, 2017, shifted the tax base from an **origin-based, multi-point model** to a **destination-based, single-point consumption tax** levied across continuous value-addition stages (GST Council, 2017; Paripex, 2018).

Feature Vector	Pre-GST Taxation Infrastructure	Goods and Services Tax (GST) Framework
Taxation Basis	Origin-based; levied at the point of manufacture or sale location (Paripex, 2018).	Destination-based; levied at the final point of consumption (Paripex, 2018).
Tax Unification	Highly fragmented across distinct Central and State statutes (Paripex, 2018).	Unified into a dual architecture: CGST + SGST for intra-state, and IGST for inter-state trade (Paripex, 2018).

Input Tax Credit (ITC)	Broken flow; central levies could not offset state distribution levies (Vertex, 2018).	Continuous flow across the value chain, covering both goods and services seamlessly (Paripex, 2018).
Cross-Border Trade	Subject to non-vatable Central Sales Tax (CST) and local entry checkpoints (Vertex, 2018).	Subject to integrated GST (IGST) with digital tracking via the E-Way Bill system (ClearTax, 2018).
Compliance System	Manual or fragmented across standalone state VAT portals (Paripex, 2018).	Consolidated, automated IT framework handled through the centralized GSTN portal (KPMG International, 2018).

Benefits of GST

Observations gathered during the initial three quarters of execution highlighted clear structural gains for the macroeconomic system:

- **Removal of Fiscal Borders:** The abolition of inter-state border checkpoints and octroi collection centers immediately cut freight transit times across key industrial corridors, significantly improving long-haul transport efficiency (GST Council, 2017).
- **Supply Chain Optimization:** Companies began dismantling redundant, small-scale regional distribution nodes. They transitioned toward larger, consolidated fulfillment centers chosen for geographic proximity to target markets rather than tax minimization strategies (Garg, 2017).
- **Expansion of the Formal Tax Base:** The mandatory requirement for invoice matching between buyers and sellers to unlock Input Tax Credits created a strong economic incentive for informal firms to register under the formal tax net. This led to millions of new taxpayer registrations within the first nine months of implementation (KPMG International, 2018).

Possible Challenges in Implementation

Despite its long-term benefits, the transition to GST was highly complex, and several operational challenges emerged during its initial rollout through early 2018 (Garg, 2017; KPMG International, 2018):

System Instability within the GSTN

The Goods and Services Tax Network (GSTN), designed to process billions of invoices simultaneously, suffered from recurrent technical crashes, delayed error logs, and slow spreadsheet updates as filing deadlines approached (KPMG International, 2018). This forced the GST Council to frequently extend filing

windows and temporarily suspend complex matching returns like GSTR-2 and GSTR-3 to prevent widespread compliance failures (Vertex, 2018).

Capital Liquidity Pressures on Exporters

Under the initial GST framework, exporters were required to pay IGST on raw material imports up front and claim refunds later. Delays in refund processing through early 2018 tied up significant working capital, straining operations for small-scale exporters (KPMG International, 2018).

High Compliance Costs for MSMEs

Unlike large corporations with dedicated IT infrastructure, smaller firms struggled to adapt to monthly multi-part digital filings (GSTR-1, GSTR-3B) and navigate complex, evolving tax slabs (Paripex, 2018). This heavy administrative and financial burden triggered a temporary slowdown in industrial output across small-business clusters during the 2017–18 fiscal year.

The Staggered E-Way Bill Launch

The implementation of the E-Way Bill system—intended to digitize transit tracking—suffered a severe technical breakdown during its initial attempt in February 2018 due to server overloads. This forced a complete deferral, with the system finally being reintroduced in a staggered manner for inter-state movement on April 1, 2018 (ClearTax, 2018).

II. CONCLUSION

The implementation of the Goods and Services Tax in India marks a profound shift away from archaic, origin-based taxation toward a unified, digital-first economic framework (GST Council, 2017; Paripex, 2018). Data and policy records up to April 2018 reveal that while the foundational architecture successfully eliminated the cascading tax effect and streamlined national logistics, it also created real transitional disruptions (Paripex, 2018).

The early challenges—such as IT bottlenecks within the GSTN portal, working capital strains from delayed input tax credit refunds, and regulatory uncertainties—reflect the immense scale of reforming a highly diverse economy (KPMG International, 2018). Addressing these short-term issues required sustained policy interventions from the GST Council, including upgrading technical infrastructure, streamlining refund processes, and simplifying compliance requirements for small businesses to unlock the long-term structural benefits of this historic reform (KPMG International, 2018).

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