

GST COMPLIANCE BURDEN AND WORKING CAPITAL STRESS IN INDIAN MSMEs: A SECONDARY-DATA REVIEW OF EVIDENCE AND POLICY EVOLUTION, 2017–2025

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ABSTRACT

Purpose. This paper examines the compliance burden that the Goods and Services Tax (GST) places on India's micro, small and medium enterprises (MSMEs). Its particular focus is the working capital channel: input tax credit (ITC) that is delayed or lost.

Design/methodology/approach. The study is a descriptive analytical review based on secondary data covering 2017–18 to 2025–26. It draws on four sources:

- Official GST revenue and registration data.
- Ministry of MSME and Udyam statistics.
- GST Council recommendations, up to the 56th meeting of September 2025.
- Peer-reviewed estimates of compliance cost.

The analysis uses trend and compound growth analysis, structural ratio analysis, a chronological review of compliance rules, and a parameterised illustration of working capital cost.

Findings. Gross GST collections rose from ₹11.37 lakh crore in 2020–21 to ₹22.08 lakh crore in 2024–25, a compound annual growth rate of 18.0%. Active registrations crossed 1.51 crore. The compliance burden, however, is concentrated on the smallest taxpayers:

- **Revenue concentration.** Proprietorships and partnerships make up 90.62% of taxpayers but contribute only 20.61% of GST collections.
- **Cost.** Recent unit-level estimates put the compliance cost of unincorporated enterprises at 3.28%–13.90% of turnover.
- **Working capital.** The post-2022 rules that tie ITC to supplier reporting have turned the buyer's credit into a contingent receivable. A permanent loss of ITC costs an MSME far more than a delay in receiving it.

Practical implications. The study proposes a turnover-linked safe harbour for ITC lost through supplier default, and the extension of risk-based provisional refunds. It also proposes that banks use GST return data for cash-flow-based working capital lending to MSMEs.

Originality/value. The paper brings the 2025 reforms, the latest national cost estimates and a working capital lens together in a single framework for the MSME sector.

Keywords: Goods and Services Tax, MSMEs, compliance cost, input tax credit, working capital, tax administration, India

1. INTRODUCTION

India introduced the Goods and Services Tax on 1 July 2017 through the 101st Constitutional Amendment. It replaced a cascading and fragmented system of Central and State indirect taxes with a dual, destination-based value-added tax. The reform had three stated aims:

- To create a common national market.
- To establish an unbroken chain of input tax credit.
- To widen the tax base through technology-driven compliance.

Judged on revenue and base, the reform has delivered. Gross collections reached a record ₹22.08 lakh crore in 2024–25. Active registrations grew from about 65 lakh at launch to over 1.51 crore by April 2025 (IANS, 2025).

MSMEs are central to the Indian economy. Their share of gross value added (GVA) in GDP was 31.1% in 2023–24 (Ministry of MSME, 2025b). They also account for about 45% of exports. Registrations on the Udyam Registration Portal and the Udyam Assist Platform exceeded 7.30 crore by December 2025 (Ministry of MSME, 2025c).

For these enterprises, GST is both an opportunity and a cost. Registration gives access to ITC and to buyers in the formal supply chain. Compliance, however, requires invoice-level reporting, monthly or quarterly returns, reconciliation with auto-generated credit statements, and constant adaptation to procedural change.

The international literature has consistently found that tax compliance cost is regressive: it falls more heavily, relative to size, on smaller firms (Sandford, Godwin & Hardwick, 1989; Evans, 2003; Coolidge, 2012). Value-added taxes add a second, less visible cost that comes through liquidity. A buyer's credit depends on the supplier's compliance, so supplier default is transmitted directly into the buyer's working capital.

In India this channel has been strengthened by a series of reforms:

- Restrictions on ITC under Rule 36(4) from 2019.
- Section 16(2)(aa) of the CGST Act from January 2022.
- The Invoice Management System in 2024.

For a sector that already faces a large financing gap, estimated by the International Finance Corporation at US\$397.5 billion, or about 15% of GDP (IFC, 2018), the working capital consequences of GST are a matter of financial management as much as of tax administration.

This paper takes stock of these developments using secondary data and the published evidence. It asks three questions:

1. How has the GST base and revenue evolved, and how is the compliance burden distributed?
2. What does the best available evidence say about the size of GST compliance cost for small enterprises?
3. Through which channels, particularly working capital, do the post-2022 procedural reforms affect MSMEs, and what policy and banking responses follow?

The paper is organised as follows:

- Section 2 reviews the literature, and Section 3 identifies the gap and states the objectives.

- Section 4 describes the methodology, and Section 5 presents the analysis.
- Sections 6 and 7 set out the findings and suggestions, and Sections 8 and 9 cover the limitations and conclusion.

2. REVIEW OF LITERATURE

2.1 Concept and measurement of compliance cost

Sandford, Godwin and Hardwick (1989) defined tax compliance cost as the cost taxpayers incur in meeting the requirements of a tax system, beyond the tax itself. They separated it into three components:

- **Time cost:** the hours of the owner and staff.
- **Monetary cost:** fees paid to advisers, and spending on software and equipment.
- **Psychological cost:** the stress and uncertainty caused by tax obligations.

Tran-Nam, Evans, Walpole and Ritchie (2000) refined this framework. They distinguished gross compliance cost from net compliance cost, which is gross cost less the cash-flow and managerial benefits of compliance. They also set out the methodological standards for measuring compliance cost through surveys.

2.2 International evidence: regressivity and the VAT burden

Evans (2003) reviewed compliance cost studies across many countries and found that the burden on businesses is consistently regressive. Lignier and Evans (2012) documented the continued rise in compliance cost for Australian small businesses despite repeated simplification programmes.

Coolidge (2012) summarised World Bank compliance cost surveys in developing countries. Small firms, the survey found, bear a disproportionate share of the cost, and procedural complexity matters more than tax rates. Yilmaz and Coolidge (2013) found that e-filing reduces compliance cost only when the underlying procedures are also simplified.

Evidence on value-added taxes specifically points the same way:

- **Bangladesh.** Faridy, Copp, Freudenberg and Sarker (2014) linked VAT complexity and compliance cost to non-compliance among SMEs.
- **Malaysia.** Sapiei et al. (2017) reported significant start-up and recurring GST compliance cost for SMEs.
- **Developing countries.** Smulders and Evans (2017) reviewed ways to mitigate VAT compliance cost. They identified registration thresholds, simplified schemes and less frequent filing as the main levers.
- **Firm size.** Eichfelder and Hechtner (2018) showed that cost burdens fall sharply as firms grow larger. They also showed that self-reported cost estimates need careful treatment.

On the design side, Keen and Mintz (2004) derived the optimal VAT threshold as a trade-off between the revenue forgone and the compliance and administrative costs saved. Bird and Gendron (2007) cautioned that VAT administration in developing countries often transfers the cost of enforcement onto small taxpayers through documentation and credit-matching requirements.

2.3 Indian evidence

Indian research on compliance cost is limited. Chattopadhyay and Das-Gupta (2002) found that the compliance cost of personal income tax was regressive. Vishnuhadevi (2021) reviewed the evidence on VAT administrative and compliance cost and noted that there were very few Indian estimates.

Mukherjee and Rao (2019) examined the factors that determine whether enterprises register under State VAT. They found that compliance burden and informality are closely linked. Mukherjee and Badola (2022) used unit-level NSSO data to estimate VAT compliance cost for unincorporated enterprises before GST.

The most direct evidence for the GST period is Mukherjee and Badola (2026). They draw on unit-level data from the NSSO Annual Survey of Unincorporated Sector Enterprises (ASUSE) 2022–23, and report three main findings:

- Only 2.41% of the sample enterprises are registered under GST.
- Registered enterprises incur compliance cost of between 3.28% and 13.90% of annual turnover.
- That is equivalent to between 4.64% and 19.71% of annual operating expenses.

Policy documents form the other strand of the Indian literature. The Thirteenth Finance Commission's Task Force on GST (2009) and the Report on the Revenue Neutral Rate (Ministry of Finance, 2015) set out the design logic of GST. Soon after GST was introduced, the World Bank (2018) observed that India's GST had one of the highest standard rates and was among the more complex systems of the 115 countries it compared. It flagged compliance cost as a concern for small firms.

2.4 Synthesis

The literature establishes three points:

1. Compliance cost is real, measurable and regressive.
2. Credit-matching regimes shift the risk of supplier default onto buyers.
3. Recent Indian unit-level estimates place GST compliance cost at a multiple of typical MSME net margins.

What the literature does not yet do is connect the post-2022 rules on ITC to MSME working capital and financing.

3. RESEARCH GAP AND OBJECTIVES

3.1 Research gap

Dimension	State of the literature	Contribution of this paper
Cost focus	Time and monetary cost; liquidity cost rarely treated	Working capital cost of ITC treated as a separate channel
Period	Mostly transition years (2017–2020)	Covers the reforms up to the 56th GST Council meeting (September 2025)
Evidence base	Small, local perception surveys	Synthesis of official data and peer-reviewed national estimates
Audience	Tax administration	Links tax administration to MSME finance and bank lending

3.2 Objectives

1. To analyse the growth and structure of the GST revenue and taxpayer base from 2017–18 to 2024–25.
2. To assess how the compliance burden is distributed between taxpayer segments, and what the gap in MSME formalisation looks like.
3. To review the evidence on how large GST compliance cost is for small enterprises.
4. To trace how the GST compliance rules evolved, and how each change affects MSMEs.
5. To examine the working capital implications of the rules that tie ITC to supplier reporting.
6. To recommend measures for policymakers, lenders, practitioners and MSMEs.

4. RESEARCH METHODOLOGY

4.1 Research design

The study uses a descriptive-analytical design based entirely on secondary data and published research. No primary data were collected.

4.2 Data sources

Data	Source	Period
Gross GST collections; active registrations by category	GSTN and Ministry of Finance data released for the eighth anniversary of GST (as reported by IANS, 2025)	2020–21 to 2024–25; registrations as of 30 April 2025
Taxpayer composition by constitution; registration and compliance cost of unincorporated enterprises	Mukherjee & Badola (2026), using NSSO ASUSE 2022–23 and GSTN data as of 30 June 2024	2022–23 / 2024
MSME share of GVA; Udyam registrations; classification limits	Ministry of MSME (2025a, 2025b, 2025c)	2023–24 to December 2025
MSME credit gap	IFC (2018)	2017 data
Compliance rule changes	CGST Act and Rules, 2017 (as amended); GST Council (2025)	July 2017 to September 2025

4.3 Tools of analysis

The analysis uses five tools:

1. **Trend analysis.** Year-on-year growth in gross collections.
2. **Compound annual growth rate (CAGR):**

$$CAGR = \left(\frac{V_{\text{end}}}{V_{\text{start}}} \right)^{1/n} - 1$$
3. **Structural ratio analysis.** Shares of the taxpayer base and of revenue, and a revenue-per-taxpayer concentration ratio.
4. **Chronological review of compliance rules.** Each major change is classified by the cost channel it affects: time, money or working capital.
5. **Parameterised illustration of working capital cost.** The annual cost of ITC that is blocked or lost is modelled as:

$$WCC = (B \times r \times \frac{d}{365}) + L$$

The terms are defined as follows:

Term	Meaning
B	ITC temporarily blocked
r	Cost of working capital
d	Average number of days the credit is blocked
L	ITC permanently lost, for example where the supplier never files

The parameters are assumptions chosen for illustration and are stated explicitly. They are not estimates.

5. ANALYSIS AND DISCUSSION

5.1 Growth of GST revenue

Gross GST collections almost doubled in four years, from ₹11.37 lakh crore in 2020–21 to ₹22.08 lakh crore in 2024–25. That is a CAGR of 18.0%, but annual growth slowed in each successive year (Table 1).

Table 1: Gross GST collections, 2020–21 to 2024–25

Year	Gross collection (₹ lakh crore)	Year-on-year growth (%)	Average monthly collection (₹ lakh crore)*
2020–21	11.37	—	0.95
2021–22	14.83	30.4	1.24
2022–23	18.08	21.9	1.51
2023–24	20.18	11.6	1.68
2024–25	22.08	9.4	1.84
CAGR, 2020–21 to 2024–25		18.0	

*Source: GSTN/Ministry of Finance data as reported by IANS (2025) and Free Press Journal (2025). *Computed by the author as the annual figure divided by 12.*

Two points stand out:

- **The 18.0% CAGR is flattered by a low base.** Collections in 2020–21 were depressed by the pandemic.
- **Growth has since fallen to about the growth of nominal GDP.** The figure for 2024–25 is 9.4%. This suggests that the gains from widening the base and from tighter enforcement, much of which came through ITC matching, have largely been realised.

Further revenue growth must now come from economic growth rather than from enforcement. That makes the cost of compliance for the remaining marginal taxpayers, who are mostly small, a more important policy variable than before.

5.2 Structure of the taxpayer base

Table 2: Active GST registrations by category (30 April 2025)

Category	Registrations	Share of total (%)
Normal taxpayers	1.32 crore	87.4
Composition taxpayers	14.86 lakh	9.8
Tax Deductors at Source (TDS)	3.71 lakh	2.5
Total active registrations	1.51 crore	100.0*

*Source: IANS (2025). *Shares computed by the author; the remaining 0.3% is other categories.*

Only about one taxpayer in ten uses the composition scheme. Its turnover limit is ₹1.5 crore for most States, and enterprises in it cannot pass on ITC to buyers. The great majority of MSME registrants are therefore in the regular scheme. They are subject to the full invoice-reporting and reconciliation regime.

5.3 Concentration of revenue and of the compliance burden

Table 3: Share of taxpayers and of GST collections by constitution (30 June 2024)

Constitution	Share of taxpayers (%)	Share of GST collection (%)	Revenue share ÷ taxpayer share
Proprietorships and partnership firms	90.62	20.61	0.23
All other forms (companies, LLPs, others)	9.38	79.39	8.46

Source: Mukherjee & Badola (2026); the last column and the "all other" row are computed by the author.

The average taxpayer outside the proprietorship and partnership segment contributes about **37 times** the revenue of the average proprietorship or partnership taxpayer ($8.46 \div 0.23$). Compliance obligations, however, do not scale with revenue. Monthly or quarterly returns, reconciliation with GSTR-2B and responses to notices impose a largely fixed cost on every regular taxpayer.

The result is a structural mismatch. About nine in ten taxpayers, mostly MSMEs, bear the fixed costs of the system while contributing about one-fifth of its revenue. This is the mechanism behind the regressivity documented in the literature.

5.4 The formalisation gap

Udyam and Udyam Assist registrations exceeded 7.30 crore by December 2025 (Ministry of MSME, 2025c). Active GST registrations, which also include large enterprises, were about 1.51 crore. The two populations are not identical. Even so, the comparison shows that at most about one in five registered MSMEs can be part of the GST credit chain.

Unit-level data confirm this. Only 2.41% of unincorporated enterprises in the ASUSE 2022–23 sample were registered under GST (Mukherjee & Badola, 2026). Much of this non-registration is lawful, because the threshold is ₹40 lakh for goods and ₹20 lakh for services in most States. But it has a cost for registered MSMEs: purchases from unregistered suppliers break the credit chain.

5.5 Size of the compliance cost

The best available national estimate places the GST compliance cost of registered unincorporated enterprises at between 3.28% and 13.90% of turnover. That is between 4.64% and 19.71% of operating expenses (Mukherjee & Badola, 2026).

The lower bound alone is comparable to the net margin of many trading MSMEs. These estimates are also consistent with the international finding that VAT compliance cost is highest, as a proportion of turnover, for the smallest firms (Evans, 2003; Coolidge, 2012; Eichfelder & Hechtner, 2018). The Indian figures appear to sit at the upper end of the international range.

5.6 How the compliance rules evolved, 2017–2025

Table 4: Major GST compliance changes and their effect on MSMEs

Period	Change	Main cost channel affected	Net effect on MSMEs
Jul 2017	Launch; GSTR-3B adopted as a summary return; invoice matching through GSTR-2/3 deferred	Time	↑ Learning and transition cost
Oct 2019 – Jan 2021	Rule 36(4): ITC on invoices not reported by the supplier capped at 20%, then 10%, then 5%	Working capital	↑ Buyer exposed to supplier non-reporting
Jan 2021	QRMP scheme for taxpayers with turnover up to ₹5 crore	Time	↓ Fewer returns, though monthly payment continues
Jan 2022	Section 16(2)(aa): ITC only if the invoice appears in GSTR-2B	Working capital	↑↑ Credit becomes contingent on the supplier
Aug 2023	E-invoicing threshold lowered to ₹5 crore	Money, time	↑ For small and medium firms: system and software cost
Oct 2024	Invoice Management System (accept, reject or keep pending each supplier invoice)	Time, working capital	↑ Time; ↓ disputes, if used actively
Nov 2024	Section 128A: waiver of interest and penalty on certain demands for 2017–18 to 2019–20	Money	↓ Settles legacy disputes
Jul 2025	Auto-populated liability in GSTR-3B locked; returns time-barred after three years	Time	↑ Errors must be corrected at source
Sep 2025	56th GST Council: rates rationalised into two main slabs (5% and 18%); 90% provisional refunds for inverted duty structure; simplified registration for low-risk applicants; GSTAT operationalised	Money, working capital	↓ Fewer classification disputes; faster refunds

Source: Compiled by the author from the CGST Act and Rules, 2017 (as amended), and GST Council (2025).

The pattern in Table 4 is clear. Between 2019 and 2024, reforms aimed at preventing revenue leakage moved the burden of supplier compliance onto buyers through the working capital channel. The 2025 package is the first set of measures directed mainly at reducing cost: fewer rate slabs, faster refunds, quicker registration, and an operational appellate tribunal. Even so, none of these measures addresses the ITC a buyer loses when a supplier defaults.

5.7 The working capital channel: an illustration

Consider a micro manufacturer, defined by its turnover as micro under the classification limits revised in 2025 (Ministry of MSME, 2025a), with the following assumed profile:

Assumption	Value
Annual turnover	₹2 crore
Taxable purchases	₹1.40 crore at 18% GST
Annual ITC	₹25.20 lakh
Cost of working capital	12% a year

Table 5: Illustrative annual cost of ITC disruption

Scenario	Assumption	Annual cost (₹)	As % of turnover
A. Moderate delay	10% of ITC delayed by 90 days	7,457	0.04
B. Severe delay	25% of ITC delayed by 180 days	37,282	0.19
C. Permanent loss	5% of ITC never recovered	1,26,000	0.63

Source: Author's computation using $WCC = B \times r \times d/365 + L$. All parameters are illustrative.

The illustration yields a finding that matters for policy. **A permanent loss of ITC costs an MSME an order of magnitude more than a delay in receiving it.** Losing just 5% of credit costs about 17 times as much as a moderate delay. At a net margin of 5%–8%, a loss equal to 0.63% of turnover would wipe out roughly 8%–13% of annual profit.

Because of Section 16(2)(aa), it is exactly this permanent-loss risk that the buyer now carries for the supplier's default. That risk falls on a sector which, according to the IFC (2018), already faces a credit gap of about 15% of GDP.

6. MAJOR FINDINGS

- Revenue has grown, and the gains from enforcement are largely realised.** Gross GST collections grew at a CAGR of 18.0% between 2020–21 and 2024–25, reaching ₹22.08 lakh crore. Annual growth, however, slowed from 30.4% to 9.4%.
- The compliance burden is concentrated where the revenue is not.** Proprietorships and partnerships make up 90.62% of taxpayers but contribute 20.61% of collections. Revenue per taxpayer in the remaining segment is about 37 times higher, while compliance obligations are largely fixed.
- Formalisation is shallow.** At most about one in five Udyam-registered MSMEs can be part of the GST credit chain. Only 2.41% of unincorporated enterprises are registered under GST.
- Compliance cost is high and regressive.** National unit-level estimates put it at 3.28%–13.90% of turnover for unincorporated enterprises. That is at the upper end of international evidence and comparable to typical MSME net margins.
- Reforms between 2019 and 2024 shifted risk onto buyers through working capital.** Rule 36(4), Section 16(2)(aa) and the Invoice Management System made a buyer's ITC contingent on the supplier's compliance.
- For MSMEs, permanent loss of ITC is the dominant liquidity risk.** In the illustration, losing 5% of ITC costs about 17 times as much as a moderate delay in receiving it. The 2025 reforms improved refunds and registration but did not address this risk.

7. SUGGESTIONS

7.1 For the GST Council and CBIC

- **Safe harbour for supplier default.** Allow micro and small buyers to retain ITC for a fixed period, such as two return cycles, where the supplier has failed to report the invoice. The buyer would need to hold the tax invoice and proof of payment through banking channels. Recovery would be pursued first from the defaulting supplier.
- **Extend risk-based provisional sanction.** Apply the 90% provisional mechanism adopted for refunds to genuine ITC disputes of low-risk MSMEs.
- **Make the composition and QRMP schemes more attractive.** Review the composition threshold and allow composition dealers a limited, optional route to pass on credit. This would reduce their exclusion from B2B supply chains.
- **Stable change calendar.** Publish procedural changes on fixed dates twice a year, with transition windows, except where an urgent anti-evasion measure is needed.

7.2 For banks and financial institutions

- **Cash-flow lending based on GST data.** Use GST return data, shared with the borrower's consent, to assess working capital limits for MSMEs and monitor them. This would reduce reliance on collateral.
- **ITC-backed working capital.** Design short-term facilities secured on ITC reflected in GSTR-2B, or on pending refunds, to bridge timing gaps.
- **Financing receivables.** Promote the TReDS platform and supply-chain finance alongside GST compliance. Delayed payments and blocked credit compound each other's strain on working capital.

7.3 For tax practitioners and professional bodies

- **Supplier compliance monitoring.** Use the Invoice Management System and the filing status of suppliers on the GST portal to offer screening and monitoring of supplier compliance as a routine service.
- **Low-cost compliance packages.** Offer bundled compliance services for micro enterprises in Tier-2 and Tier-3 districts, through MSME facilitation centres and District Industries Centres.

7.4 For MSMEs

- **Screen suppliers.** Check suppliers' GST filing records before onboarding them.
- **Pay through banks.** Pay suppliers through banking channels, so there is a record if ITC is ever disputed.
- **Reconcile monthly.** Use accounting software that reconciles with GSTR-2B every month.

8. LIMITATIONS AND SCOPE FOR FURTHER RESEARCH

The study has the following limitations:

- **Secondary data only.** No primary data were collected. Findings depend on the accuracy and coverage of official releases and published estimates.
- **Different populations.** Udyam and GST registrations cover different populations, so the formalisation ratio in Section 5.4 is an upper-bound indicator, not a precise rate.

- **Narrow cost estimates.** The compliance cost estimates come from unincorporated enterprises and do not cover incorporated MSMEs.
- **Illustrative parameters.** The working capital illustration uses assumed parameters. It shows orders of magnitude, not observed costs.

Future research could take four directions:

- A primary survey of MSMEs in Tier-2 districts to measure, in rupee terms, the ITC delayed and the ITC permanently lost.
- Panel data from GSTN, if made available for research, to trace how supplier default spreads through supply chains.
- An evaluation of the 2025 reforms once a full year of data is available.
- A study of whether lending based on GST data improves MSMEs' access to credit and reduces defaults.

CONCLUSION

GST has delivered on revenue and on widening the tax base. Collections doubled to ₹22.08 lakh crore and registrations exceeded 1.51 crore. Its costs, however, fall unevenly. About nine in ten taxpayers, mostly proprietorships and partnerships, bear largely fixed compliance obligations while contributing about one-fifth of revenue, and their compliance cost may run from 3% to 14% of turnover.

The reforms of 2019–2024 sought to prevent revenue leakage. In doing so they shifted the risk of supplier default onto buyers, through the working capital channel. For an MSME, permanent loss of input tax credit, not delay, is the most damaging consequence. The 2025 reforms are a welcome turn towards facilitation, but they leave this risk unaddressed.

The priority now is a safe harbour for small buyers exposed to supplier default, combined with lending that recognises GST data as evidence of cash flow. Together these would align GST administration with the financial reality of India's MSMEs.

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