

# Curbing GST Evasion in India: Institutional Design, Enforcement Challenges, and Policy Responses

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## Abstract

The Goods and Services Tax (GST), introduced in India in 2017, has been hailed as one of the most significant fiscal reforms since independence. Designed to consolidate multiple indirect taxes into a unified value-added tax (VAT) system, GST sought to expand the tax base, enhance transparency, and reduce evasion through a self-enforcing input tax credit mechanism. Despite its ambitious design and integration of digital technology, tax evasion remains a persistent challenge, undermining both revenue collection and the credibility of fiscal governance.

This article examines the economics of GST evasion in the Indian context, drawing on theoretical insights, empirical evidence, and policy evaluation. It identifies three primary channels of evasion: last-mile underreporting at the retail stage, proliferation of fake invoices, and asymmetries in administrative capacity across states. The paper argues that while GST has significantly reduced opportunities for business-to-business (B2B) evasion, it has not been able to effectively address business-to-consumer (B2C) fraud, where consumers and retailers often collude in avoiding formal invoicing. Additionally, the rise of “invoice mills” has allowed firms to fraudulently claim input tax credits, leading to substantial fiscal losses estimated at nearly ₹19,690 crores in FY 2023–24. The analysis suggests that digital tools such as e-invoicing, e-way bills, and automated matching of returns have improved compliance but are insufficient in isolation. Effective deterrence depends on strengthening human capital in tax administration, fostering cooperative federalism in enforcement, and incentivizing consumers to demand receipts. Comparative experiences from Brazil, Chile, and European Union countries demonstrate the importance of blending technological innovation with robust institutional capacity.

The article concludes that the sustainability of India’s GST regime hinges on addressing persistent evasion challenges by balancing compliance costs with efficiency, harmonizing enforcement across states, and investing in the skills of tax officials. Without these reforms, India risks undermining the promise of GST as a transformative instrument for fiscal consolidation and formalization of the economy.

**Keywords:** GST, tax evasion, Indian economy, fiscal policy, digital taxation.

## 1. Introduction

The introduction of the Goods and Services Tax (GST) in India on July 1, 2017 marked a watershed moment in the country’s fiscal history. By subsuming a complex web of central and state-level indirect taxes ranging from excise duties to state VAT and octroi GST aimed to create a unified national market. The reform was not merely administrative but conceptual: it sought to shift India from a fragmented taxation structure to a modern value-added system aligned with global best practices.

Globally, over 175 countries have adopted some form of VAT or GST, with the notable exception of the United States, where sales taxes dominate. The primary advantage of VAT lies in its self-enforcing nature. By taxing value addition at every stage of production and distribution, while allowing firms to claim input tax credit (ITC) for taxes already paid, the system creates natural incentives for compliance. Buyers insist on invoices from sellers to claim credits, thereby reducing the scope for underreporting.

India’s GST was designed with these principles at its core. The digital infrastructure, comprising monthly returns, invoice matching, and e-way bills, aimed to minimize human discretion and enhance transparency. Yet, despite these design features, tax evasion continues to pose significant challenges. Reports of large-scale invoice fraud, last-mile retail evasion, and uneven enforcement across states raise critical questions about the effectiveness of the system.

This paper explores the economics of GST evasion in India through a structured analysis. It first situates GST within the broader theoretical framework of VAT systems and self-enforcement. It then examines the Indian architecture of GST and the specific channels of evasion that persist. The discussion section critically evaluates the strengths and weaknesses of ongoing reforms and draws lessons from international experiences. Finally, the conclusion offers policy recommendations for strengthening India’s fiscal capacity.

## 2. Theoretical Background: VAT and Self-Enforcement

The debate between sales tax and VAT has been central to modern tax policy. Under a sales tax regime, taxation occurs at the final point of sale to the consumer. While simple to administer, this system is vulnerable to evasion because enforcement focuses narrowly on the retail stage. VAT, in contrast, taxes value addition at each stage of production and distribution.

The self-enforcing nature of VAT arises because downstream firms demand invoices from upstream suppliers to claim ITC. For example, if a producer sells goods worth ₹100 to a wholesaler, who then sells them for ₹150 to a retailer, each stage of value addition attracts tax. If the rate is 10 percent, the producer pays ₹10, while the wholesaler pays ₹15 minus ₹10 as ITC, leaving a net liability of ₹5. The system ensures that each transaction leaves a verifiable trail, discouraging underreporting by upstream agents.

Theoretically, if compliance were perfect, VAT and sales tax would yield identical revenue. However, the compliance incentives embedded in VAT make it superior in practice. Scholars such as Pomeranz (2015) have shown that VAT significantly reduces evasion in business-to-business (B2B) transactions because of this dual reporting. Yet, the system remains vulnerable at the business-to-consumer (B2C) stage, where consumers have little incentive to demand receipts.

India's GST inherits these strengths and weaknesses. While the system has curtailed B2B evasion, it struggles with last-mile enforcement and fraudulent invoicing practices.

## 3. GST Architecture in India

The Indian GST system is notable for its reliance on digital infrastructure. Taxpayers file three main forms:

- GSTR-1: Details of outward supplies filed by sellers.
- GSTR-2A: A dynamic form reflecting ITC available to buyers based on sellers' submissions.
- GSTR-3B: Monthly return summarizing liability, ITC, and net tax due.

The architecture creates multiple layers of verification. If a seller underreports sales in GSTR-1, the buyer will not see corresponding ITC in GSTR-2A, prompting reconciliation. Similarly, mismatches between GSTR-1 and GSTR-3B flag potential evasion.

Additional mechanisms include:

- E-Way Bill System: Mandatory for transporting goods above ₹50,000 in value across states, providing traceability.
- Tax Collected at Source (TCS): E-commerce platforms must collect and remit 1 percent tax, reducing scope for underreporting in online sales.
- E-Invoicing: Validation of B2B invoices through the Invoice Registration Portal (IRP) to prevent duplication and fraud.

- Consumer Incentive Schemes: Initiatives such as Mera Bill Mera Adhikar (2023) encourage consumers to upload invoices, with winners receiving rewards.

Despite these innovations, loopholes persist. Evasion at the retail stage, proliferation of fake invoices, and disparities in state-level enforcement remain significant obstacles.

## 4. Channels of GST Evasion in India

### 4.1 Retail Evasion (Last-Mile Underreporting)

The Achilles heel of VAT systems is evasion at the consumer end. Retailers can underreport sales because consumers do not require ITC. In India, anecdotal evidence suggests widespread issuance of informal receipts, colloquially termed “kacha bills.”

Studies confirm this vulnerability. Pomeranz (2015) showed that VAT systems reduce B2B evasion but not B2C fraud. Similarly, Naritomi (2019) found that incentivizing consumers in Brazil to demand receipts led to a 21 percent increase in reported sales and 9 percent rise in tax revenue. In India, the government's invoice-incentive schemes are modeled on such experiments, though their effectiveness is still being evaluated.

### 4.2 Fake Invoices and “Invoice Mills”

Another major source of evasion is the use of fake invoices to inflate input claims. “Invoice mills” are entities created solely to issue fraudulent invoices and vanish before detection. The scale of the problem is substantial: in FY 2023–24 alone, fake credits worth nearly ₹19,690 crores were unearthed.

To counter this, authorities have introduced Aadhaar verification for new registrants, biometric checks, and cross-linking of GST data with other databases such as electricity consumption and income tax records. However, enforcement remains uneven, and resource constraints limit the effectiveness of these measures.

### 4.3 Administrative Capacity and Central Asymmetries

GST is unique in being administered jointly by the Centre and the states. Firms with turnovers below ₹5 crores are divided between the two in a 9:1 ratio, while larger firms are shared equally. However, state capacity varies widely. Wealthier states like Maharashtra and Karnataka have developed advanced digital infrastructure, while others continue to rely heavily on central systems.

Human capital gaps exacerbate the problem. Some states lack dedicated tax cadres and depend on deputed officials with limited expertise. Without well-trained officers, data-driven enforcement becomes difficult, undermining the potential of digital tools.

## 5. Comparative Perspectives

The persistence of GST evasion in India raises important policy questions. First, while digital innovations have improved transparency, they cannot substitute for institutional capacity. Technology reduces clerical errors

and creates paper trails, but it requires skilled human interpretation to identify anomalies and pursue enforcement.

Second, compliance costs remain a concern, especially for small and medium enterprises (SMEs). The complexity of multiple filings, e-invoicing requirements, and penalties for delays can strain liquidity-constrained firms. Policymakers must balance strict enforcement with ease of doing business.

International comparisons offer useful insights. Brazil's consumer-incentive schemes demonstrate the power of aligning citizen behavior with compliance. Chile has successfully integrated e-invoicing across sectors, reducing fraud. The European Union's experience highlights the importance of cross-border cooperation in VAT enforcement. India can adapt these lessons by deepening consumer engagement and enhancing federal coordination.

## 6. Policy Implications

Based on the analysis, three policy priorities emerge:

1. **Strengthening Human Capital:** Training tax officers in data analytics, forensic accounting, and digital investigation is essential. Without skilled personnel, technology cannot achieve its intended impact.
2. **Consumer-Centric Approaches:** Expanding schemes like Mera Bill Mera Adhikar can empower consumers to act as watchdogs. Linking receipts to tax rebates or digital wallets may provide stronger incentives.
3. **Federal Harmonization:** Variations in enforcement across states undermine the cooperative spirit of GST. Uniform standards, capacity-building programs, and greater resource sharing are required.

## 7. Conclusion

India's GST reform was a bold experiment in modernizing taxation, with an ambitious goal of reducing evasion and formalizing the economy. While significant progress has been made particularly in leveraging digital platforms for compliance—persistent challenges remain. Retail-level evasion, proliferation of fake invoices, and uneven enforcement across states continue to erode revenues.

The success of GST cannot rest on technology alone. It requires a balanced approach that combines digital innovations with institutional strengthening, consumer participation with business-friendly compliance, and federal cooperation with uniform enforcement standards.

Ultimately, the credibility of GST as a transformative reform depends on addressing these challenges head-on. By investing in human capital, harmonizing enforcement practices, and incentivizing consumer participation, India

can move closer to realizing the full potential of GST as a cornerstone of fiscal governance in the 21st century.

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