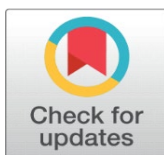


GST AND DIGITAL ECONOMY: TAXATION CHALLENGES OF E-COMMERCE AND ONLINE SERVICES

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ABSTRACT

The pace at which India's digital economy is growing, from e-commerce platforms to online services to appearing digital sectors, is both an opportunity and a regulatory challenge. The GST, introduced in 2017, was aimed at bringing indirect taxation under one roof and broadening the tax base, but its relationship with digital stays unresolved. This paper provides a critical analysis of the e-commerce and online service taxation under GST, specifically on compliance cost, cross-border service taxation, and policy vacuum. Based on secondary data sources of GST Council reports, RBI estimates, NITI Aayog studies, and international experiences, the analysis brings out immediate concerns, the ease of compliance, the perils of dual liability, and the exclusion of small sellers due to mandatory recommendations. The numbers tell the same story TCS from e-commerce was ₹13,000 crore in FY 2020–21, and close to 40 percent of foreign digital subscriptions stay out of the tax net, resulting in an annual revenue loss of ₹3,000–4,000 crore. The EU, Australia, and OECD experience also suggest that simplified compliance regimes and mandatory registration of foreign providers can help to promote parity. The paper concludes that without specific reforms, GST has the potential of excluding micro-entrepreneurs and hurting competition in the trillion-dollar Indian digital economy.

Keywords: GST, Digital, DigitalTaxation, E-Commerce, Online Services



1. INTRODUCTION

The digital economy is one of the most exciting forces defining commerce in the twenty-first century. Online marketplaces and app-based services are doing more than changing the way people consume; they are also redefining business models in every other sector. This change has occurred at a rapid pace in India, led by growing internet penetration, mobile connectivity, and consumer behavior shifts. As per the Internet and Mobile Association of India (IAMAI, 2022), the country had more than 750 million internet users, and the e-commerce market reached USD 83 billion in 2021. The Reserve Bank of India (2022) estimates that the digital economy will contribute 20 percent of the Indian GDP by 2025 and expects online retail to exceed USD 120 billion by 2026 (India Brand Equity Foundation, IBEF, 2023). However, digital services based on subscription models have seen significant momentum, and PwC (2022) suggests the Indian OTT video market will be worth USD 13 billion by 2030.

In this backdrop, 2017 saw the launch of the Goods and Services Tax (GST) as a momentous fiscal reform endeavor²⁵ seeking to work towards simplification of India's broken indirect tax architecture. GST envisaged a single, destination-based tax system that would widen the tax base, minimize cascading, and enhance compliance. It was moderately successful with traditional goods and services, but far more difficult with digital commerce! Online transactions often move between states and nations, muddy the divide between goods and services, and require intermediaries like

platforms, payment gateways, and cloud providers. These complications are at odds with the traditional descriptions and outcomes of GST.

The article engages critically with GST as it interacts with the digital economy, and in particular, e-commerce platforms and online services. IT examines whether GST has set up a level playing field for digital businesses or whether it is evenhanded or subtly opens floodgates of undue tax as well as arbitrary tax enforcement. Addressed are three aspects—sellers' and platform tax obligations, cross-border digital services taxation, and structural imbalances between small companies that have negative consequences for smaller ones. Placing India's experience against that of other countries globally, this analysis looks to bring out what has been achieved and what still needs to be done by GST for digital economy governance and suggest reforms that integrate tax modernization and inclusive digital growth.

2. LITERATURE REVIEW

The intersection of tax and the digital economy has drawn sustained scholarly interest, with discussions focusing on efficiency, fairness, and compliance. In India, official analysis highlights the gains made possible by the GST. The Ministry of Finance (2019) also argued that GST achieved improved compliance through the mandatory registration of e-commerce sellers and better revenue buoyancy given that TCS collections amounted to more than ₹13,000 crore during FY 2020-21. These findings seem to have strengthened the dominant story that GST has successfully brought digital transactions into the tax net.

However, the available individual empirical studies make this picture less straightforward. Rao (2020) did a survey of small e-commerce sellers and found that the compulsion for registration and TCS requirements led to compliance costs that would be between 3 and 5 percent of turnover being imposed on the micro-entrepreneurs (who were earlier exempt from such provisions under the earlier tax laws). Singh (2021) reported from a survey that more than 60% of SMEs faced the working capital crunch due to late receipt of refunds exceeding 30 days, which was in fact a symptom of the liquidity crunch arising out of delayed input tax credits. These studies reflect a common theme in literature: that despite targeting policy neutrality in the context of taxation reforms tend to be regressive on small firms.

Global scholarship provides comparative perspectives. Auerbach (2013) emphasizes the barriers for applying VAT to cross-border demand for digital services, in particular when consumption cannot easily be attributed to a district. "We want to avoid the creation of tax no-man's lands, with double or non-taxation as a result, which are the consequence of definitional ambiguity in digital trade," Bird and Gendron (2007) point out. Attempts to address these discrepancies include the European Union's One-Stop Shop (OSS) system, where VAT reporting is centralized across the EU member says, and Australia's "Netflix tax," which requires foreign service providers to register.

In spite of these contributions, Indian literature has zones where it is deficient. First, there are few attempts to put forward a theory in the extant literature: the overwhelming majority of empirical findings are descriptive in nature and revolve around the costs of compliance or the revenue implications. Second, there is scant reflection on responsive moves, including how digital entrepreneurs devise new methods, manipulations, or adaptations of business processes under GST disturbances. Filling these gaps is crucial to know whether GST is a means towards inclusive digital formalization or whether it instead deepens structural asymmetries in the transforming economy.

3. RESEARCH METHODOLOGY

This paper is based solely on available secondary sources, by the explicit statement of such materials as shown in the rich body of government, institutional, and scholarly literature examined on GST and the digital economy. The main sources of information in this analysis are the official publications and circulars of the GST Council and the annual reports of the Ministry of Finance, which give authentic details on the legal regime and the revenue collections. Policy insights were balanced with reports by NITI Aayog on the digital economy's growth trajectory and Reserve Bank of India (RBI) data on e-commerce market size and digital transactions.

Furthermore, academic and policy papers published by the OECD and World Bank were used to frame India's experience of GST in a comparative international setting. So, the peer-reviewed articles from Economic and Political Weekly and working papers from NIPFP that came on board provided important academic perspective on the compliance cost and on the cross-border digital tax.

The method follows a thematic analysis perspective, labeling evidence into four categories: compliance duties, liquidity and repayment mechanisms, cross-border taxation, and regulatory vacuum. Where possible, numerical evidence (like TCS collections of ₹13,000 crores in FY 2020–21 and estimates from RBI over e-commerce growth) has been employed to confirm the assertions. This secondary data analysis approach provides depth of analysis and reliability through triangulation across multiple established sources.

4. GST FRAMEWORK FOR E-COMMERCE AND ONLINE SERVICES

The implementation of the Goods and Services Tax (GST) in 2017 was given to include the distributed digital economy under a single indirect tax framework. Since doing business through e-commerce or online service is different from that of conventional trade, the GST law provided various provisions specific to these modes of business to bring accountability and collect revenue. Four specific mechanisms that GST uses to interact with the digital economy are TCS (tax collected at source), mandatory registration, place of supply rules, and RCM (reverse charge mechanism).

As per the TCS provisions, e-commerce companies must deduct 1 percent of the payment made to suppliers and deposit it with the government. While it makes tax tracking more transparent and checks tax leakages, it leads to liquidity issues for small sellers, who have to wait to recover TCS credits before taking home their full earnings. TCS collections in FY 2020–21 stood at around ₹13,000 crore based on GST Council (2021), highlighting its fiscal significance and the effect on seller cash flow.

Compulsory registration is mandated as well. In contrast to businesses that run offline, those who do business online do not get the benefit of dispensation of ₹20 lakh turnover. Even micro-entrepreneurs need to register if they want to sell anything online. Although the legislation broadened the tax base, participation has been discouraged among small businesses, most of which are incapable of doing monthly filing.

It is also more complex for digital trade with respect to the rules on place of supply. For digital services such as cloud storage or online subscriptions, the tax is applied based on the location where those services are used. Although sunglasses are conceptually consistent with destination-based taxation, enforcement is challenging, as it is hard to enforce when consumers, for example, rely on cross-border payment gateways or VPNs, which can make their location unclear.

Lastly, RCM compliances also remove the onus of paying GST on imported digital services from the supplier to the consumer or recipient (B2C) in India. While these measures are effective in relation to B2B, enforcement will be difficult in the B2C sphere (people signing up to foreign OTTs, for example), leaving domestic players at a competitive disadvantage.

Overview In conclusion, although the GST regime has succeeded in formally bringing the digital economy into the tax net, the nature of its provisions imposes a heavier burden on the smaller players, which raises an important question for the government on the equity, inclusivity, and sustainability of the digital economy of India.

5. COMPLIANCE OBSTACLES IN THE E-COMMERCE INDUSTRY

While GST has set up a common taxation structure for digital commerce, implementation has proven to be a significant compliance burden for the e-commerce industry. These impediments are driven by complex reporting requirements, restrictive registration requirements, and insufficient working capital, which have a disparate impact on the micro and small sellers. There are four key issues: onerous tax liability adding up, exclusion of small sellers, curbs in input tax credit, and unreasonable load of TCS-

5.1. MULTIPLE TAX LIABILITIES

Reconciliation of their own GST filings with details uploaded by e-commerce operators is among the common issues faced by sellers. Even slight errors in invoices, shipping information, or return orders can lead to mismatches, which in turn will delay the availability of ITC. As per a report by the Federation of Indian Chambers of Commerce & Industry (FICCI, 2021), 65% of e-commerce sellers grappled with reconciliation disputes on a quarterly basis. For small companies that do not have the resources for professional accounting representation, these battles simply mean delays in payment and higher compliance costs.

5.2. SMALL SELLER EXCLUSION

GST exemptions for e-commerce sellers Unlike offline trade, e-commerce sellers cannot receive help from the common turnover exemption of ₹20 lakh under GST.T. Mandatory registration rules bring even micro-entrepreneurs into the tax net. This is a broadening of the tax net, but does it not disincentivize small-time craftsmen, local traders, home-based small entrepreneurs, and start-ups from coming online? According to the All-India Online Vendors Association (2020), approximately 30% of the micro-sellers that were onboarded to platforms such as Amazon and Flipkart exited them within the first two years of the implementation of GST and on account of compliance costs. This exclusion is contrary to the government's wider digital inclusion agenda and limits diversity in online marketplaces.

5.3. INPUT TAX CREDIT RESTRICTIONS

ITC, the key feature of GST that promises to remove the cascading effect of taxes, has created a few challenges for e-commerce sellers. Regular discrepancies in credits claimed and those confirmed by the Goods and Services Tax Network are one of the reasons for the delay. In one study conducted by the Indian Council for Research on International Economic Relations (ICRIER) (2021), 70% of small online sellers experienced refund-related delays in excess of 30 days. For enterprises that work on narrow margins, blocked ITC reduces working capital and stifles reinvestment in inventory or marketing efforts.

5.4. TCS BURDEN

The platform is also needed to deduct 1 percent tax at the source while making payment to the seller under the TCS (Tax Collection at Source) provision. This helps to control transactions but reduces liquidity for sellers in the short term. A 1% discount on a low-margin category like books or handcrafts or consumer electronics is massive. According to GST Council data (2021), TCS generated from e-commerce platforms added approximately ₹13,000 crore in the kitty in FY 2020-2021. This is a lot of money, but it is not liquidity that is really being left available to small businesses, who do not have ready access to low-cost credit. Such gaps are even causing the sellers to indulge in rampant borrowing at high interest rates, which adds to the operating risk.

6. THE TAXATION OF THE ONLINE ECONOMY: ISSUES AND INCENTIVES

The collection of GSTS on online services is the most complicated issue in the mechanics of the new indirect tax system in the country. The difference happens in this: digital goods are non-physical due to their borderless nature and usually "consumable" on a worldwide platform. Video streaming, cloud computing, online gaming, cryptocurrency exchanges and gig companies are now major parts of the economy, but the GST is not really fit for them. While there are provisions such as place of supply rules and the reverse charge mechanism (RCM), there are gaps. These concerns fall into four large heads i.e., complexity of place of supply rules, administrative ease of enforcement of reverse charge, new growing trends in digital economy and likelihood of double taxation and arbitrariness due to system errors.

6.1. PLACE OF SUPPLY COMPLEXITIES

GST is derived from the principle of destination-based tax. Yet, the location of service provision is controversial in the virtual realm. Consumers typically use VPNs, foreign app stores or international gateways to hide their true location. For instance, if an Indian citizen is paying for an American cloud service on an international card, they can potentially escape GST completely. Thirty percent of B2C digital transactions are not taxable in global sense because of misreporting of location (OECD, 2021). In India, 18% of big-city internet users there rely on services provided by international intermediaries for whom these gaps in enforcement might apply, the researchers concluded.

6.2. REVERSE CHARGE ENFORCEMENT

The counter-charge principle, in reference to the consumer having to pay the tax where a consumer imports digital services, can be effectively implemented in a B2B context, but it is impossible to apply in a business-to-consumer (B2C)

context. A lot of Indians who subscribe to services like Netflix, Spotify or Apple TV have not been paying the GST. A PwC India (2022) report has put the evasion of GST at 40% of cross-border digital subscriptions consumed in India and pegged annual revenue loss at ₹3,000 -4,000 crore. Domestic services, however, are struck to the letter, unfair competition. As an example, Indian player Disney+ Hotstar charges 18% goods and services tax on subscriptions while international competition could still be even partially untaxed.

6.3. EMERGING DIGITAL MODELS

It does not help that fast-growing digital industries make the taxation worse. The Indian online gaming market reached USD 2.6 billion in 2022 and is expected to grow to approximately USD 8.6 billion by 2027 (KPMG, 2022). The confusion arises from difference of opinion within the GST Council on whether to levy 18 per cent or 28 per cent tax on gaming services. Likewise, the gig economy with 7.7 million workers, to which 20 billion INR have been added (NITI Aayog, 2022) struggles with veritable fog on who is responsible to pay the GST, platforms, or workers? Now we have added a wrinkle to the already inadequate system, and that is cryptocurrency. Despite the law that requires 30 per cent taxes on virtual assets, there are no rules on how the GST treats crypto transactions, creating regulatory vacuum of a sector that was worth \$5.3 billion in India in 2021 (Chain lysis, 2022).

6.4. RISKS OF DOUBLE TAXATION

Cross-border services are either double taxed or not taxed. So, services availed from a US-incorporated cloud services provider may now potentially have to pay GST in both India and US's digital service tax at the same time. Should the compliance costs in such a market exceed 5% of the amount of the transaction, it is possible that the growth of SMEs may also be stifled." (World Bank, 2020). In India, FICCI (2021) surveys have found that Double Taxation disputes were seen by small IT service exporters (approximately 55.0%) in the course of providing sales out of their country which imply higher cost of compliance and loss of competitiveness.

7. INTERNATIONAL PERSPECTIVES AND COMPARATIVE LESSONS

Taxing the digital economy has presented numerous challenges around the world, but some countries have found innovative solutions that offer interesting lessons for India. One particular model, the European Union (EU) One-Stop Shop (OSS), sets a strikingly good example of how this may be achieved. As of 2021, OSS enables non-resident digital service providers to register in one EU country and give a single VAT return that encompasses sales in all countries of the EU. This cuts much of the cost of administration and provides for predictable collection of revenue. The Chinese Belarusian Sino-Belarus Industrial Park wants to be the "one-stop shop" for Chinese investment into European infrastructure too. Here is the EU model: Centralizing compliance burdens on business while improving tax enforcement.

Australia and New Zealand have been at the forefront of attempts to apply the so-called "Netflix tax" to foreign digital service providers, imposing obligations on them to register and collect GST on their supplies to local consumers. For example, in Australia, the 2017 changes yielded more than AUD 1.1 billion in GST collections from offshore platforms between 2017 and 2018 (Australian Taxation Office, 2021). New Zealand had similar success, according to Inland Revenue (2020), where the foreign supplier GST collection was NZD 440 million above first forecasts in the first three years. These are illustrations of how requiring foreign provider registration ensures a level playing field and removes the possibility of schemes affecting consumer prices.

The 2021 OECD guidelines expand on these by prioritizing destination-based taxation provisions and compulsory registration of non-resident suppliers. What is critical is that, as the OECD points out, in districts where enforcement capability is low, revenue loss from cross-border digital services is at risk of developing into 10-15% of potential GST/VAT take. In a country like India, where overseas providers highly dominate the OTT and app-based subscription market, such reforms might plug large holes.

The comparative evidence therefore shows that India's equal-equal approach, a natural notion of administrability, carries the risk of not only burdening the small domestic firms further but also ending up under-collecting from foreign players. The adoption of global best standards would give India an opportunity to improve not just its fiscal situation but also to level up the digital playing field in its market.

8. IMPACT ON BUSINESS AND CONSUMERS

8.1. BUSINESS IMPACT

For a big MNC platform player like Amazon, Flipkart, or Netflix, they find the compliance under GST very manageable by comparison, using the benefits of the scale of their operations, their own legal counsel, and the fact that they have had to deal with such systems in multiple countries across the globe. Such firms can spread the costs of compliance over many volumes and thus have insignificant impact per transaction. But these obligations vary hugely for SMEs.

According to a FICCI survey (2021), 62% of small e-commerce sellers saw GST compliance as a big hurdle in scaling operations, and when quizzed, 58% said TCS deductions severely strained their liquidity. Likewise, an ICRIER survey (2021) showed that the refunds for about 70 percent of SMEs got stuck for more than 30 days, which implied that they are short of working capital and cannot invest in inventory or marketing. This leads to a structural discrepancy—larger companies can still grow, while small and medium-sized enterprises (SMEs) must tread water or are put off digital market access.

The All-India Online Vendors Association (2020) said that about 30% of micro-sellers left platforms such as Amazon and Flipkart in the first two years of imposing GST due to the compliance burden. Such attrition diminishes the variety and number of products and sellers online, which narrows consumer choice and undermines the inclusiveness of e-commerce.

8.2. CONSUMER IMPACT

Businesses' actions about GST indirectly influence the consumer's experience. To a similar effect, SMEs faced with an upward spiral of compliance costs often send these costs to consumers through increased product prices. For instance, the increase in compliance cost was estimated as 2–3% of turnover for small sellers (Rao, 2020), thereby increasing the retail prices in the competitive categories such as books, handicrafts, consumer electronics, etc.

Meanwhile, the lax implementation of GST over foreign digital providers leads to price discrepancies. PwC India (2022) also found that 40% of international OTT and digital subscriptions in India are still not taxed, which provides global platforms an implicit 18% price advantage (the GST rate) compared to domestic platforms. This makes Indian players such as Zee5 or Hotstar less competitive despite being in the same market. The outcome could mean cheaper foreign services in the short run for consumers but less domestic innovation and fewer local alternatives eventually.

8.3. MARKET DISTORTIONS

Market concentration figures bear out this trend. In 2022, the Indian e-commerce market was dominated by Amazon and Flipkart, which had a combined market share of about 65%, followed by over 10% for the smaller domestic players (Red Seer, 2022). Netflix, Amazon Prime, and Disney+ Hotstar collectively accounted for over 70% of the OTT services market share (KPMG, 2022). The heavy compliance costs that local companies face in conjunction with the lopsided enforcement of foreign providers ease this kind of concentration, further diminishing market competition.

9. POLICY REFORMS AND CONCLUSIONS

The Indian experience proves that although GST has helped to bring digital businesses within the tax net, in the shorter term its architecture has been patchy and onerous for smaller players. A number of focused reforms might enhance its effectiveness.

It would bring back the exemption thresholds for micro-sellers to induce the artisans, home-based entrepreneurs, and local traders, who have stopped using online platforms due to compliance costs. A report by the All-India Online Vendors Association (2020) shows that approximately 30% of small fishers exited the e-commerce platforms after the introduction of GST, highlighting the necessity of relief measures.

Simplified compliance via the single filing and payment interface akin to the EU's OSS would save on duplication and costs. According to the European Commission (2022), OSS produced €17 billion in VAT collection in its first year, which proves its effectiveness.

Compulsory registration of foreign digital service providers, like Australia's so-called "Netflix tax," would plug the gap left by untaxed subscriptions. PwC (2022) calculates that India is losing ₹3,000–₹4,000 crore every year due to such gaps.

Clear norms for emerging sectors like gaming, cryptocurrency, and gig platforms are also needed; India's online gaming market alone is estimated at \$8.6 billion by 2027 (KPMG, 2022).

Finally, while the GST is a revolution in indirect taxation, it requires complementary reforms that address asymmetries and promote inclusivity; otherwise, it might end up featuring large platforms and foreign providers on one side and India's SMEs and innovators on the other.

CONFLICT OF INTERESTS

None.

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