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INDIRECT TAXATION AND ITS SOCIOECONOMIC IMPACT: A STUDY ON REGRESSIVE EFFECTS ON LOW-INCOME GROUPS

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Chapter 1: Introduction

Background and Context of Indirect Taxation:

Indirect taxation plays a pivotal role in the fiscal framework of any country, especially in developing economies like India. Unlike direct taxes, which are levied on income and profits, indirect taxes are imposed on the consumption of goods and services. These include taxes such as the Goods and Services Tax (GST), excise duties, customs duties, and value-added tax (VAT), among others. The transition to a comprehensive indirect tax regime like GST was aimed at simplifying the tax structure, enhancing compliance, and broadening the tax base. However, the nature of indirect taxation—being levied uniformly regardless of the payer's income—raises concerns about its broader economic and social implications.

Concept of Regressivity in Taxation:

A critical issue with indirect taxes is their inherently regressive nature. Regressivity in taxation implies that the tax burden falls disproportionately on the lower-income groups, as these taxes are applied at a flat rate on consumption rather than ability to pay. This means that low-income households, which spend a larger portion of their income on consumption, end up contributing a higher percentage of their income towards indirect taxes compared to high-income households. This raises significant equity concerns and necessitates a deeper exploration of how indirect taxes affect different socioeconomic strata.

Rationale for Studying Socioeconomic Impact:

Given the regressive tendencies of indirect taxes, it becomes essential to assess their socioeconomic impact. Understanding how such taxes affect household expenditure, income inequality, and access to basic goods and services is vital for designing equitable fiscal policies. This study aims to contribute to this understanding by analyzing the extent to which indirect taxation influences the financial well-being of various income groups, particularly

the economically vulnerable sections of society. The findings may offer valuable insights into policy refinements that can balance efficiency with equity.

Research Objectives and Questions:

The primary objective of this study is to examine the socioeconomic consequences of indirect taxation in India. Key research questions include: To what extent are indirect taxes regressive in the Indian context? How do they impact consumption patterns across income groups? What are the broader implications for income inequality and social welfare? The study also seeks to explore whether policy interventions, such as exemptions or differential rates, can mitigate regressive effects.

Chapter 2: Theoretical and Conceptual Framework

Principles of Tax Equity and Burden Sharing:

The foundation of any fair tax system lies in the principles of equity and burden sharing. Tax equity is broadly categorized into *horizontal equity*, which posits that individuals with similar economic capacity should bear a similar tax burden, and *vertical equity*, which advocates for greater tax responsibility from those with higher income or wealth. Burden sharing refers to the distribution of the tax load across different segments of society, with the aim of achieving social justice through fiscal policy. A tax system that ignores these principles risks reinforcing economic inequality and social exclusion.

Direct vs Indirect Taxation: Economic Theories:

Economic theory draws a fundamental distinction between direct and indirect taxes. Direct taxes, such as income tax and corporate tax, are levied on individuals or entities based on their ability to pay, and hence, are typically seen as progressive. Indirect taxes, on the other hand, are levied on goods and services and collected at the point of transaction, making them consumption-based rather than income-based. Classical and Keynesian economic theories differ in their views on the efficiency and equity of these tax types. While some argue that indirect taxes are less distortionary and encourage savings and investment, others critique them for being regressive and insensitive to income disparities.

Regressive Taxation: Meaning, Causes, and Indicators:

A regressive tax system is one where the effective tax rate decreases as the taxpayer's income increases. This occurs when low-income groups spend a larger portion of their earnings on consumption, and hence, bear a disproportionate burden of indirect taxes. Key causes of regressivity include the uniform application of tax rates on essential and luxury goods alike, lack of exemptions for basic commodities, and limited access to direct tax relief for the poor.

Indicators of regressive taxation include higher effective tax rates on the lowest income quintiles, greater post-tax income inequality, and declining disposable income among marginalized communities.

Measurement Tools for Tax Incidence and Burden:

Measuring the incidence and burden of taxation involves assessing who ultimately bears the cost of taxes—consumers, producers, or intermediaries. Tools such as *budget incidence analysis*, *computable general equilibrium (CGE) models*, and *microsimulation techniques* are commonly used for this purpose. These tools evaluate both *statutory incidence* (who is legally liable to pay) and *economic incidence* (who actually bears the financial burden). The *Suits Index* and *Gini Coefficient* are also employed to assess the progressivity or regressivity of tax systems by comparing pre- and post-tax income distributions. These instruments help quantify inequality and provide empirical evidence for policy evaluation.

Chapter 3: Structure of Indirect Taxes in India

Overview of Major Indirect Taxes (GST, Customs, Excise):

India's indirect tax system has undergone a significant transformation over the years, with the introduction of the Goods and Services Tax (GST) in 2017 being a landmark reform. Prior to GST, the indirect tax landscape included a range of levies such as central excise duty, service tax, value-added tax (VAT), and entry tax, often leading to tax cascading and compliance burdens. Post-GST, most of these taxes were subsumed under a unified structure, aimed at simplifying tax administration and creating a common national market. However, certain levies such as customs duties—charged on imports and exports—and excise duties—still applicable on petroleum and tobacco products—continue to exist outside the GST framework. Together, these taxes form the backbone of indirect revenue collection in India.

GST Framework and Rate Categories:

The GST structure in India is a dual model comprising Central GST (CGST), State GST (SGST), and Integrated GST (IGST) for inter-state transactions. It follows a multi-tier rate system with slabs of 0%, 5%, 12%, 18%, and 28%, depending on the nature of goods and services. Essential items like fresh food and public transportation are either exempt or taxed at the lower end, while luxury goods and sin goods (such as tobacco and aerated drinks) attract the highest rates, often accompanied by a cess. Despite this structure aiming to maintain a balance between revenue needs and equity, the sheer number of rate categories and frequent changes have raised concerns about complexity and transparency in implementation.

Consumption Patterns of Income Groups in India:

The impact of indirect taxation, particularly GST, varies significantly across income groups due to differences in consumption behavior. Lower-income households tend to allocate a larger share of their income toward food, fuel, and basic necessities, many of which are taxed under the GST regime. In contrast, higher-income groups spend more on services, durables, and luxury items, which may be taxed at higher rates but constitute a smaller proportion of their total income. As a result, even a nominal tax on basic goods can disproportionately burden poorer households, reinforcing the regressive nature of indirect taxation.

Understanding these consumption patterns is crucial for assessing the fairness of the current tax structure.

Exemptions and Concessions: Are They Equitable?

To address concerns of regressivity, the Indian tax system incorporates exemptions and concessions for essential goods and services. Items like unprocessed food, public health services, and basic education are zero-rated or exempt under GST. While these measures aim to protect the poor, their effectiveness in promoting equity is mixed. Many exemptions are poorly targeted and may benefit higher-income groups as well. Moreover, the lack of uniform criteria for concessions and frequent policy changes have led to ambiguities and administrative inefficiencies. A critical analysis is necessary to determine whether these relief mechanisms are truly progressive or simply dilute the tax base without achieving the intended social outcomes.

CHAPTER 4

Essential goods and services form the backbone of any society which are especially targeted towards socially and economically vulnerable groups. Imposition of Indirect taxes as result consumes a large share of limited earning of low income household. A significant portion of low-income households' earnings goes toward essential consumption. When indirect taxes like GST push up the prices of basic goods and services, these families face a higher financial burden. In contrast, wealthier households have more flexibility to adjust their spending, while poor families have limited options as their expenditures are already focused on necessities.

A significant difference in household earnings across income levels in India is brought to light by Azim University's 2019–2024 report. In 2023, PLFS data highlighted a striking

contrast: a 6.6% income increase for richer households compared to a modest 0.42% for the poorest. Lower income groups invest a significant portion of their earnings on taxed items, as a result of which their financial burden accelerates, making it harder for them to access basic needs like food, medical care, and education. In comparison, more affluent families are better positioned to set aside money for savings and investments, which lessens their overall tax impact. This inequality deepens the wealth gap and obstructs efforts toward building a fairer and more balanced economy.

Numerous studies highlight that VAT and GST systems can exacerbate gender inequality by disproportionately burdening women, particularly those in lower-income households. As UN Women (2015) points out, women often spend a larger share of their income on taxable goods for household and child care needs, making them more vulnerable to consumption-based taxes.

Indirect taxes such as VAT and GST are often considered neutral because they are levied on consumption rather than income. However, in reality, they can have regressive and gendered effects, disproportionately impacting women, especially those from lower-income groups. Women tend to spend a greater proportion of their income on household necessities, food, healthcare, and childcare — goods and services that are frequently taxed. In contrast, men may spend more on goods that are either tax-exempt or subject to lower rates. Moreover, in many societies, women earn less due to the gender pay gap and are more likely to work in the informal sector, which means they pay a higher percentage of their limited income in taxes compared to men. Tax systems that ignore these social and economic inequalities can deepen gender disparities. Additionally, many tax policies do not exempt or provide concessions on essential sanitary and reproductive health products, adding to the tax burden on women. Feminist economists argue that without gender-sensitive tax reforms, indirect taxation reinforces economic injustice. Recognizing this, some countries have taken steps to implement gender-responsive budgeting and tax exemptions for gender-specific essentials like menstrual hygiene products. Therefore, to ensure tax justice, policymakers must analyze and reform indirect tax systems through a gender equity lens.

In conclusion, while Value Added Tax (VAT) and Goods and Services Tax (GST) have proven to be efficient revenue-generating tools across countries, their regressive nature raises significant equity concerns. Evidence from global tax systems—such as those in Canada,

Australia, and New Zealand—illustrates how indirect taxation disproportionately affects low-income groups, particularly women, who spend a larger share of their income on essential, taxable goods. Although many nations have taken steps to harmonize tax structures and exempt basic commodities to address regressivity, there remains a pressing need for gender-sensitive and equity-focused tax reforms. Countries must balance the goals of fiscal efficiency with social justice by adopting progressive measures like zero-rating essential goods, introducing targeted subsidies, and implementing gender-responsive budgeting. A reimagined tax policy that integrates inclusivity, fairness, and economic growth is essential to ensuring that indirect taxes do not exacerbate existing inequalities but instead contribute to equitable development worldwide.

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Chapter 5 : Comparative International Experience

VAT/GST are considered as an indirect tax widely accepted indirect tax approach throughout the world which aim at eliminating cascading taxes (tax on tax) that existed in older tax structure ., which makes the system rigid . Introduction of GST result in more transparent and accountable collection process and a positive approach to words indirect tax. However they are several demerits toward this approach there for aggressive nature making the low income groups of a more and more it is better to address this concern by looking to various strategies and male major approaches which is followed over by different countries.

CANADA

In case of Canada value added tax commonly known as GST as introduced on January 1, 1991 is governed through Excise Tax Act. Federal GST rate in Canada is about 5% applied to goods and services. Also, Tax are not applied to the services that are Zero-rated . Mentioned 5 provinces therefore, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island - harmonized their sales tax with PST (provincial sales tax) into GST and impose a single unified HST(Harmonized Sales Tax) which includes the 5% of GST. In Quebec , Canada's largest central province both GST and QST levied and further regulated by the provincial government. Other provinces retain their own separate Provincial Sales Tax (PST) in addition to the federal GST.

Further analysis by Statistics Canada reveals that a significant proportion of GST Credit recipients are not classified as low-income, indicating potential inefficiencies in targeting. Specifically, only about 25% of families receiving the credit were in low-income brackets, suggesting that the credit could be better focused to assist those most in need .

Recent policy developments have aimed to enhance the effectiveness of the GST Credit. For example, the 2024 federal budget proposed increasing the credit amounts to provide greater assistance to low- and modest-income Canadians. A single individual without children could receive up to \$496 annually, while a family of four could receive up to \$992. Additionally, a temporary doubling of the GST Credit was implemented for six months in fall 2022 to address rising living costs .

In conclusion, while Canada's GST system incorporates mechanisms like the GST Credit to address its regressive nature, challenges remain in fully mitigating the disproportionate impact on lower-income households. Ongoing assessments and policy adjustments are essential to enhance the equity of the tax system and ensure that support measures effectively reach those who need them most.

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AUSTRALIA

In case of Australia GST is imposed at the rate of 10% which is further added to the sale price and paid of by the consumer at the time of purchase. Introduced on July 1, 2000, it replaced the previous federal wholesale sales tax system and aimed to simplify the tax structure by consolidating various state and territory taxes .

While GST is inherently regressive, affecting lower-income individuals more significantly, Australia employs several measures to alleviate this: 1. Exemptions and Concessions: As mentioned, essential goods and services are GST-free or input-taxed, reducing the tax burden on necessities. 2. Welfare Adjustments: At the time of GST introduction, the government increased welfare payments to offset the impact on low-income earners. 3. Progressive Income Tax System: Australia's income tax system is progressive, which helps balance the overall tax.

Certain goods and services are exempt from GST, such as basic food, some education courses, and certain medical services. Some supplies, like financial services and residential rent, are input-taxed, meaning GST is not charged, and input tax credits cannot be claimed.

Australia's GST system, with its uniform rate of 10%, reflects a broad-based, consumption-oriented tax model that simplifies compliance and administration. However, like many indirect taxes, it has been critiqued for its regressive nature, disproportionately impacting lower-income households that spend a greater share of their income on taxable goods and services. To mitigate this, Australia exempts or zero-rates essential items such as basic food, healthcare, and education. Furthermore, the revenue from GST is redistributed among states to support equity and regional development. While the structure is relatively efficient and transparent, continuous evaluation and targeted reforms remain essential to balance revenue generation with fairness, especially in protecting vulnerable populations from undue tax burdens.

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NEW ZEALAND

Introduced in 1986, New Zealand's GST is a value-added tax applied uniformly at a single rate of 15% on nearly all goods and services, with very few exemptions or zero-rated items, thus making it administratively simple and economically neutral. This system avoids the complexities and loopholes associated with multiple rates and extensive exemptions found in many other countries. The tax is collected by businesses and administered by the Inland Revenue Department, which ensures compliance and transparency. Although GST is often considered regressive—since low-income households spend a higher proportion of their income on consumption—New Zealand addresses this issue not by altering GST rates, but by compensating through a progressive income tax system and targeted social transfers.

Academic economists also point out that the single-rate GST encourages compliance and minimizes economic distortions. International bodies like the IMF have acknowledged New Zealand's GST structure as an ideal standard, noting that minimal exemptions contribute to higher revenue productivity and fairness. New Zealand's example illustrates that a broad-based GST, combined with well-targeted social spending, can achieve both administrative simplicity and social equity.

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Chapter 6

India's current indirect tax regime, is a greater significant milestone with the introduction of goods and service tax (GST), which came into effect on first July 2017 as governed by GST council headed by the union finance minister replacing the reject taxes earlier levied by central and state government in India such as CVD (Additional Customs Duty) , SAD (Special Additional Duty), VAT (Value Added Tax) ,etc. Therefore coming up at 'One Slogan ' - ONE NATION , ONE TAX, as a foundational principle unifying multiple indirect tax for the single tax system. GST has different tax rate for different goods and services (0% , 5% , 12% , 18%, , 25%), this results and complex rate structured finding it difficult for the businesses to rely on which rate applies, further undermine the flexibility of being a comprehensive tax.

The indirect tax burden on low income group remain a major concern as highlighted by NIPEP (National Institute of Public Finance and Policy), household as a part of low income group allocate around 65% of their income to consumption, on the other hand, wealthier sections of the households disburse around 40% of their earning. Given that low income group bear a disproportionately tax burden like GST. Although GST structured for uniform and neutral application it resulted regressive in effect. Further affecting consumers from the corners of low income group making it less fair for those who already struggle financially. Therefore rate rationalisation in India's indirect tax system especially and the GST is justified on the ground of efficiency simplicity and equity. Targeted subsidies on essential goods and services are crucial for the neutralization filling of unfair gaps. DBTs (Direct Benefit Transfer), launched in 2013 as a supportive aid for beneficiaries by government of India, such as PAHAL (for LPG Subsidy) , MNREGA (wage payments), etc., which aim to prevent corruption and other detrimental actions.

As per the reports presented by government DPT has saved rupees 2.7 lakh crore by eliminating impersonated and replicated beneficiaries. Nearly, 4.2 crore fake ration cards were eliminated resulted in the saving of approximately 1.35 lakh crore accounting for nearly 50% of the total DBT enabled savings.

Efficient tax administration is fundamental for the implementation of tax policies and for making taxpayers aware about the transparent application of law as a part of allocation of tax

and revenues. Further understanding among low income groups as a part of their obligation fosters credibility of the system.

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