Economic Research | India

GST 2.0 simpler, lighter and more contemporary

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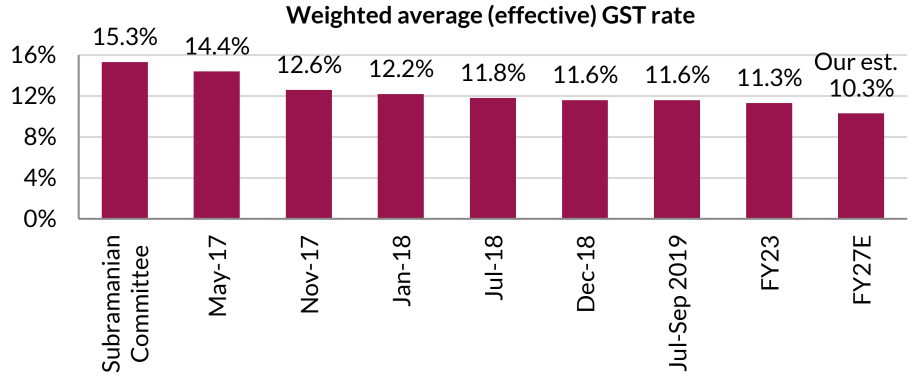
Fiscal, Growth

We see the GST Council's unanimous confirmation of GST rate simplification as a substantive growth-positive reform. It also makes the government's stance more contemporary: in today's India, small cars are not luxury goods, and branded FMCG do not warrant high rates. These changes should improve compliance, reduce disputes, and cut some working capital strain from delayed tax credits. We continue to believe that the consumption stimulus (~0.5% of GDP), is likely to be paid for by compensation cess being subsumed, improved demand and tax buoyancy, making it broadly neutral fiscally.

Exhibit 1 - GST redesign a significant structural reform: ~1pp lower effective rates



Source: Finance Ministry, RBI, GST RNR Committee, Axis Bank Research estimates

GST Council unanimously approves 2-slab structure, largely as expected

In a unanimous decision, the GST Council confirmed the discontinuation of the 12% and 28% slabs, leaving only two primary rates of 5% and 18%, plus 40% for sin/demerit goods. This was largely as expected. The new updates were i) effective date of September 22 (the first day of the festival of Navratri), which would also be the last day for all compensation cess on all products except tobacco; ii) Some items at 12% were moved to 18%: business air travel, work contracts/professional and business services; iii) FMCG from 18% to 5% (Fig 2: this had appeared in the media though: link), and several food items cut to zero; and iv) coal (earlier effectively ~40%: 5% GST + Rs400/t cess) moved to 18%: buyers now get full input credit.

Clean structure to lower compliance/litigation costs, working capital needs

We see the primary purpose as reform and simplification, even though the immediate outcome is a boost to consumption. They also make contemporary the indirect tax structure: for example, the state no longer sees a small car as a luxury, and beauty products are staples, not warranting a high rate. ~75% of total taxes are likely to be collected at the 18% rate now, but the effective rate (given exemptions/zero-rated goods) may now fall to 10%: this should improve compliance and make the overall tax burden more progressive. Several inverted duty structure problems have been corrected (Fig 4: should help with working capital, as ITC refunds were messy) and classification-related issues are being minimized (e.g. all FMCG at the same rate), ensuring predictability and reducing leakage/disputes. GST return filing has been eased: the compliance burden fell disproportionately on smaller firms.

Fiscal stimulus ~0.5pp of GDP; muted impact on government borrowing

Based on FY24 consumption patterns, and with no other changes, the government estimates ~Rs. 930bn of revenue loss over 6 months (~1.8tn over 1Y): a fiscal stimulus of ~0.5% of GDP. However, the compensation cess (off-balance-sheet for FY23-26) being subsumed into GST structure would result in additional revenues of Rs. 450bn (~0.9tn over the next 1Y). As highlighted earlier (GST reforms growth positive, but fiscally neutral), once adjusted for lower input-tax credit (ITC), revenue buoyancy from stronger demand (price cuts of 7-10%) and higher formalization, we expect almost no revenue loss to the general government.

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Exhibit 2 - Changes to the 28% slab

Category	Items	Changes in tax levies
Motor vehicles	Two-wheelers Small cars and compact SUVs Large cars and SUVs Commercial vehicles Three-wheelers	**Items moved to 18%:** Diesel vehicles<1800cc Petrol vehicles<1200cc Motorcycles<350cc Three-wheelers **Items moved to 40%:** Diesel vehicles>1800cc Petrol vehicles>1200cc Motorcycles>350cc Racing cars
Aerated drinks and beverages	Carbonated drinks; Aerated waters; Caffeinated drinks	Moved to 40%
Cement		Moved to 18% slab
Sin goods*	Pan masala; Cigarettes and tobacco Bidis	Moved to 40% only Bidis moved to 18%
Household appliances	White goods: ACs, dishwashers, TV sets>32 inches, monitors, projectors	Moved to 18%
Luxury goods	Yachts; Personal use aircrafts Revolvers and pistols; Smoking pipes	Moved to 40%
Lottery and gambling	Casinos, horse races	Moved to 40%
Other machinery	Electric accumulators; Furl dispensing pumps Spark and compression ignition internal combustion engines	Moved to 18%

Source: 56th GST Council (link), Axis Bank Research

*Note: *Pan Masala, gutkha, cigarettes, chewing tobacco products like zarda, unmanufactured tobacco and bidi will continue at the existing rates of GST and compensation cess till loan and interest payment obligations under the compensation cess account are completely discharged.*

Exhibit 3 - Changes to the 18% tax slab

Category	Items	Changes in tax levies
FMCG goods	Chocolates Hair oil Shampoo Soaps Oral care Biscuits Mineral water	Most items moved to 5% tax slab (incl. sugar confectionaries, cocoa, chocolates, malt, corn flakes, coffee extracts, soups and broths, ice creams, mineral water, plant-based drinks, soaps, tooth brush, shaving cream, hair oil, talcum powder)
Non-alcoholic beverages	HS codes 22029100, 220299	Moved to 40%
Medical instruments	Thermometers Instruments and apparatus	Moved to 5%
Fertlizer inputs	Sulphuric acid Nitric acid Ammonia	Moved to 5%
Tractor inputs	Tyres, Agriculture diesel engine Bumpers, brakes, gearboxes etc.	Moved to 5%
Footwear	Footwear>Rs. 1,000	Threshold value changed to Rs. 2,500
Services	Education Health Insurance Telecom	Life and health insurance (individual and not group policies) are now tax exempted Some beauty/physical well-being services moved to 5%
Fuels	Coal and lignite	Moved to 18% vs. 5% earlier

Source: 56th GST Council (link), Axis Bank Research

Exhibit 4 - Inverted duty structure largely resolved

Category	Inverted duty structure (old)
Apparel	Finished fabrics and clothing at 5%/12% while the inputs were at 12%/18%
Footwear	Finished footwear at 12%/18% while the inputs were at 18%
Tractors	Tractors taxed at 12% while the components were at 18%
Fertilizers	Fertilizers at 5% while the inputs were at 12-18%
Pharmaceuticals	Final drugs at 5%/12% while the APIs and intermediaries were at 18%
Vegetable Oils	Edible oils at 5% vs the inputs at 12-18%
Apparel	Finished fabrics and clothing at 5%/12% while the inputs were at 12%/18%
Footwear	Finished footwear at 12%/18% while the inputs were at 18%

Source: 56th GST Council (link), Axis Bank Research

Exhibit 5 - International comparison of VAT/GST rates

Country	Standard VAT/GST rates	Reduced rates
India	**5%/18%**	**Multiple rates**
Australia	10%	Nil
Belgium	21%	Nil/6%/12%
Canada	5%	Nil
France	20%	2.1%/5.5%/10%
Germany	19%	Nil/7%
Israel	17%	Nil
Japan	10%	8%
South Korea	10%	Nil
Mexico	16%	Nil
New Zealand	15%	Nil
Poland	23%	Nil/5%/8%
Switzerland	8.1%	Nil/2.6%/3.8%
UK	20%	Nil/5%
OECD unweighted average	**19.3%**	

Source: OECD Report (link); Axis Bank Research

Exhibit 6 - GST and other taxes collected on coal (Effective rate was ~40% so far)

Category	FY25 payments break-up by Coal India (Rs cr)
Royalty	15359
DMF	4623
NMET	308
GST	**4553**
Compensation cess	**30410**
Cess on Coal	2107
Others	3654
Total	**61014**

Source: Coal India Annual Report (link); Axis Bank Research

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