Tariff-led headwinds may dent govt revenues in FY26

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The government's revenue collection in 2025-26 (FY26) is likely to be affected if there is an economic slowdown in India, triggered by the mounting global headwinds following American President Donald Trump's sweeping reciprocal tariffs.

Upasna Bhardwaj, chief economist at Kotak Mahindra Bank, in a research note on Tuesday said she expected a tax shortfall of around ₹1 trillion in FY26, given the downside risks to growth.

Economists say the increase in cooking gas prices and the special additional excise duty on fuel products on Monday, appear to be preemptive steps by the government to cushion a potential shortfall in revenue. Bhardwaj said the revenue shortfall "could be offset with lower spend from the ₹62,000 crore budgeted for AI (artificial intelligence) and R&D (research and development) schemes, ₹30,000 crore from the excise duty hike of ₹2/litre on petrol and diesel, and a large upside" to the Reserve Bank of India) dividend.

According to Icra estimates, the ₹2 per litre increase in special additional excise duty on petrol and diesel is expected to garner ₹35,000 crore this year, while the reduction in under-recoveries in domestic liquefied petroleum gas is pegged at ₹10,000 crore.

Moreover, since the tax hike has been through the instrument of special additional excise duty and not the basic excise duty, the central government will not need to share these surplus revenues with the states.

Economists have projected the growth impact of slowdown in exports on India to be up to 50 basis points in FY26. The Economic Survey had projected GDP growth in the range of 6.3 per cent to 6.8 per cent for this year.

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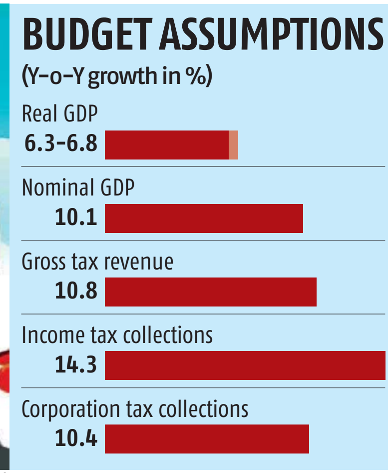

The Budget has assumed nominal growth in gross domestic product (GDP) at 10.1 per cent, with gross tax revenues expected to rise 10.8 per cent. Income-tax collection is estimated to grow 14.3 per cent, while corporation tax collection is projected to grow 10.4 per cent in this financial year.

Sakshi Gupta, principal economist, HDFC Bank, said a slowdown in domestic growth in FY26 due to external headwinds could weigh on both direct and indirect tax collection, and put pressure on the fiscal deficit. "If real GDP growth slows materially from levels close to 6.5 per cent, both nominal GDP and tax growth are estimated to be lower than budgeted," she noted.

Gaura Sen Gupta, chief economist at IDFC First Bank, said the increase in special additional excise duty would balance some risk to direct-tax collection.

"The income tax estimate was on the optimistic side. Moreover, given the slowdown in urban wage growth and decline in equity markets, there is likely to be a downside risk to direct-tax collection," she added.

Aditi Nayar, chief economist at Icra, said the prevailing uncertainties could impact various aspects of India's FY26 macros, and a persistence of this might seep into revenue collection vis-a-vis the budgeted targets. "While excise duty collection would be buffered after the recent increase announced by the government, it is possible that a squeeze in margins in some sectors could affect corporation-tax collection," she added.

However, Madan Sabnavis, chief economist at Bank of Baroda, said economic slowdown in extreme cases could lower real GDP growth by 20 basis points and it was unlikely to affect tax collection in the aggregate.

"The SME (small and medium enterprises) segment is more likely to be affected and their profits are not high enough to affect revenue," he added.