‘Double Diwali’: Rejigged rates, red tape cuts to define GST 2.0

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India’s multiple-rate Goods and Services Tax (GST) regime is set for a massive reboot with the Centre proposing to scrap the 12 per cent and 28 per cent tax slabs, switch most items facing these levies to the existing slabs of 5 per cent and 18 per cent, and introduce a new 40 per cent peak levy for sin goods.

Coming close on the heels of the 50 per cent tariff threat on Indian goods announced by the US administration, the move to fix the eight-year old indirect tax system is aimed at improving Indian producers’ cost-competitiveness, and more importantly, spurring domestic consumption to shield the economy from mounting external uncertainties.

Prime Minister Narendra Modi announced this much-awaited GST rate rationalisation reform, which corporate India believes could alter the trajectory of uneven consumption demand trends, from the ramparts of the Red Fort in his Independence Day speech, stating: “This Diwali, I am going to make it a double Diwali for you,” he said.

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Ready for a change

The current structure

GST rate (%)	Revenue collection (as a % of total mopup)
5	7
12	5
18	67
28	11

The remaining 10% comes from the compensation cess and the special concessional GST rate on precious metals, gems, jewellery, and other items

Source: Govt

Expected sectoral impact

Agriculture: Tax rate cut on farm equipment likely to boost productivity, mechanisation

Textiles, fertiliser, renewable energy: Inverted duty structure to be fixed

Automobiles: End classification dispute

Handicraft: Levies to come down

Health: Medicines, medical devices to get cheaper

India Inc sees capex, demand surge

India’s corporate leaders are betting on revival in capital spending and consumer demand after Prime Minister Narendra Modi on Friday vowed to deliver sweeping goods and services tax reforms soon.

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"We have discussed with states and we are bringing next-generation GST reforms that will reduce the tax burden across the country. Tax on items for the common man will be reduced substantially. Our MSMEs [micro, small and medium enterprises], our small entrepreneurs, will get a huge benefit. Everyday items will become very cheap and that will also give a new boost to the economy," he said.

In a statement later in the day, the finance ministry said the Centre's proposal for reforms in the indirect tax hinges on three foundational pillars — structural reforms, rate rationalisation and ease of living. The proposal, it said, has been shared with the GST Council's Group of Ministers (GoM) on rate rationalisation headed by Bihar deputy chief minister Samrat Choudhary for further deliberations.

The Centre has also proposed reducing the GST on insurance policies' premium payments for the GoM to consider, said an official, indicating a preference for a 5 per cent levy for most insurance policies.

About 99 per cent of the items facing a 12 per cent levy will be moved to the 5 per cent bracket, under the proposed formulation. Currently, about 17 per cent of all goods and services are in the 12 per cent bracket. Most service sector items will be at the 18 per cent slab, as would most white goods, that currently face a 28 per cent GST, such as television, refrigerator, washing machines and air conditioners, keeping in mind the aspirations of India's middle class.

The new 40 per cent rate, which is the levy permitted under the GST law, will apply on about five to seven sin goods, including tobacco, pan masala and online gaming. All essential commodities such as food, medicines, education and daily use items by the common man will either face a zero rate or a 5 per cent GST.

The GST Compensation Cess, levied over and above the peak rate of 28 per cent on demerit items like cigarettes and cars, is also likely to be extinguished before its present sunset date of March 31, 2026. The Cess, originally meant to be in place for five years since the GST regime's launch on July 1, 2017, to compensate State for revenue losses, was extended owing to the pandemic shock on revenues that compelled the Centre to borrow in order to pay States' dues.

In case the loans taken in lieu of shortfalls in compensation cess collections during the COVID-19 pandemic are fully paid, say by November, the government can't continue to levy the cess on demerit goods, an official said. "We are also using this an opportunity to restructure the GST rates," he noted.

"However, the overall levy on the sin goods will remain the same. Some kind of levy will be imposed over and above 40 per cent, though compensation cess will be done away with once the existing loan is fully paid back sometime in the current financial year," a government official clarified.

"We are leaving behind the legacy logic and adopting a common-sense logic in deciding which item will be in which slab. We are adopting a comprehensive approach, not a piecemeal one," the official said.

"The GST Council, when it meets next, will deliberate on the GoM's recommendations and every effort will be made to facilitate early implementation so that the intended benefits are substantially realised within the current financial year," the ministry communiqué noted. The GoM is expected to submit its report in the next few weeks. "The Centre will also closely engage with states to build a broad based consensus. A discussion and decision on the matter is expected in the next GST Council meeting in September or October," a senior government official said.

The central government expects any small revenue shortfall as a result of the rate restructuring will be more than offset by the consumption boost and higher compliance by taxpayers. However, the Centre is in no mood to assure the states of compensation in case of a revenue shortfall. "Any revenue shortfall, if at all, will be both for the Centre and the States," the official said.

"Reforms will also seek to reduce classification-related disputes (such as in food and snacks), correcting inverted duty structures in specific sectors (such as textiles and fertilisers), ensuring greater rate stability, and further enhancing the ease of doing business. These measures would strengthen key economic sectors, stimulate economic activity, and enable sectoral expansion," the finance ministry said.