

SBI Research

GST 2.0

The rate rationalisation is likely to result in stronger revenue collections validated by historical trends with the institutional framework of fiscal federalism embedded in the Constitution guarantees status quo in State finances through revenue and tax devolution while enabling the Centre to pursue reforms simplifying tax structure reducing compliance burdens & enhancing efficiency

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- ❑ At the time of launch of the GST regime, the states were assured that a 14% increase in their annual revenue for five years of the transition period from July 1, 2017 to June 30, 2022 will be protected and also guaranteed that their revenue shortfall, if any, would be made good through a compensation cess levied on luxury goods and sin products such as liquor, cigarettes, other tobacco products, aerated water, automobiles, and coal
 - As decided by the GST Council, States have been provided a total compensation of Rs 9.14 lakh crores as compensation for protecting their tax revenues post implementation of GST for the entire transition period of five years. **This amount was almost Rs 63,265 crores (at an aggregate basis) more than the projected amount that states were expected to get from their assured 14% increase**
- ❑ We estimate that in FY26 as well, States will remain net gainers from GST collections, even under the proposed rate rationalization. This is because of the unique revenue-sharing architecture of the tax. First, GST is shared equally between the Centre and the States, with each receiving 50% of the collections. Second, under the mechanism of tax devolution, 41% of the Centre's share flows back to the States. Taken together, this means that out of every ₹100 of GST collected, states ultimately accrue nearly ₹70.5 i.e., approximately 70% of total GST revenues
 - **Our projections for FY26 indicate that states are expected to receive at least ~ Rs 10 lakh cr in SGST plus Rs 4.1 lakh crore through devolution thereby making them net gainers.** The gains accrues even when we do not take the additional consumption boost due to rate rationalization (At 9.5% effective GST rate, this translates into a revenue gain of Rs 52000 crore; Rs 26000 crore each to Centre and States)
- ❑ Evidence from earlier rounds of GST rate changes, such as those in July 2018 and October 2019, suggests that rationalization does not necessarily weaken revenue collections. Instead, the evidence points to a temporary adjustment phase followed by stronger inflows. While an immediate reduction in rates can cause a short-term dip of around 3–4% month-on-month (roughly ₹5,000 crore, or an annualized ₹60,000 crore), revenues typically rebound with sustained growth of 5–6% per month

States have received Rs 63,265 crores more in aggregate than the assured revenue in the GST regime

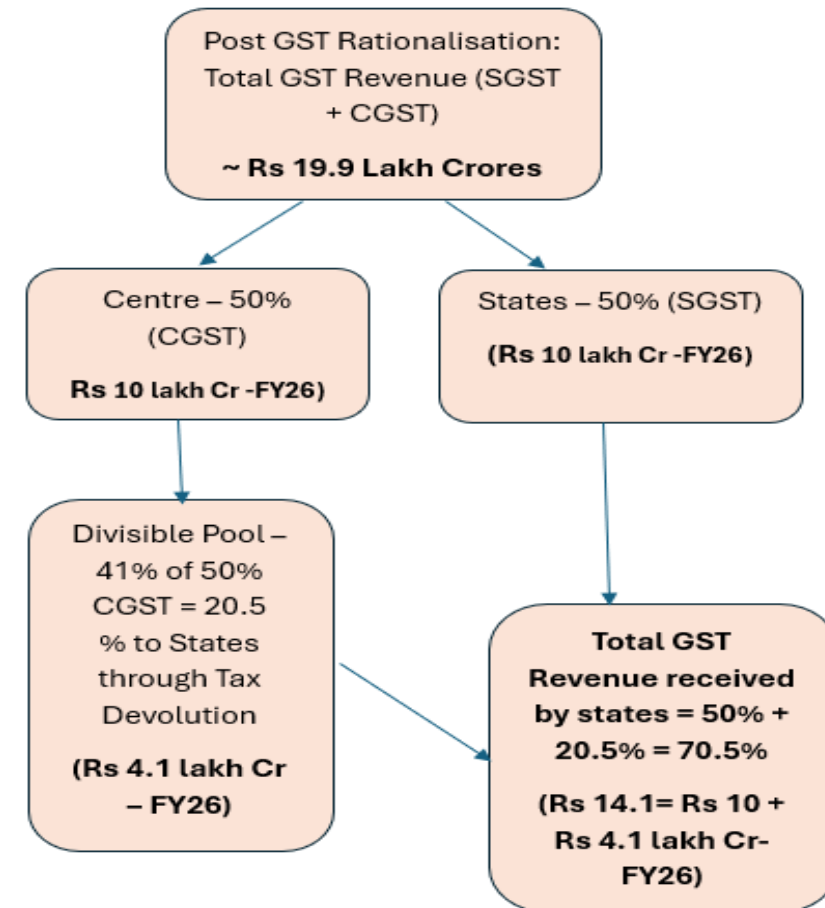
- At the time of launch of the GST regime, the states were assured that a 14% increase in their annual revenue for five years of the transition period from July 1, 2017 to June 30, 2022 will be protected and also guaranteed that their revenue shortfall, if any, would be made good through a compensation cess levied on luxury goods and sin products such as liquor, cigarettes, other tobacco products, aerated water, automobiles, and coal. The cess currently ranges from 1% to 290%
- However, due to COVID-19 the gap between protected revenue and actual revenue receipts (including reduction in cess collection) for the states had increased
- With the GST council approval, to meet such resource gap of the States, Center had borrowed and released Rs 2.69 lakh crore during pandemic to support States (Rs 1.10 lakh crore in FY21 and Rs 1.59 lakh crore in FY22)
- As decided by the GST Council, States have been provided a total compensation of Rs 9.14 lakh crores as compensation for protecting their tax revenues post implementation of GST for the entire transition period of five years. **This amount was almost Rs 63,265 crores (at an aggregate basis) more than the projected amount that states were expected to get from their assured 14% increase**

Actual GST collection vs. projected Tax (Rs crore)		
All states and UT's Actual GST revenue from Jul-17 to Jun-22	A	2,635,765
Total GST Compensation to States from 1st July,2017 to 30th June 2022 (including ₹2.69* lakh crores as back-to-back loans as part of other transfer to States/UTs)	B	914,000
Actual including Cess and Loans Jul-17 to Jun-22 that the states received	C=A+B	3,549,765
Projected GST @ 14% Jul-17 to Jun-22	D	34,86,500
Actual-Projected	E=C-D	63,265

GST is an Unique Revenue sharing architecture....

- We estimate that in FY26 as well, States will remain net gainers from GST collections, even under the proposed rate rationalization. This is because of the unique revenue-sharing architecture of the tax. First, GST is shared equally between the Centre and the States, with each receiving 50% of the collections. Second, under the mechanism of tax devolution, 41% of the Centre's share flows back to the States. **Taken together, this means that out of every ₹100 of GST collected, states ultimately accrue nearly ₹70.5 i.e., approximately 70% of total GST revenues**

- This structure ensures that States are not fiscally disadvantaged by temporary moderation in revenues due to rationalization and abolition of compensation cess. **The institutional framework of fiscal federalism embedded in the Constitution guarantees this outcome, maintaining the status quo in State finances while enabling the Centre to pursue reforms that simplify the tax structure, reduce compliance burdens & enhance efficiency**



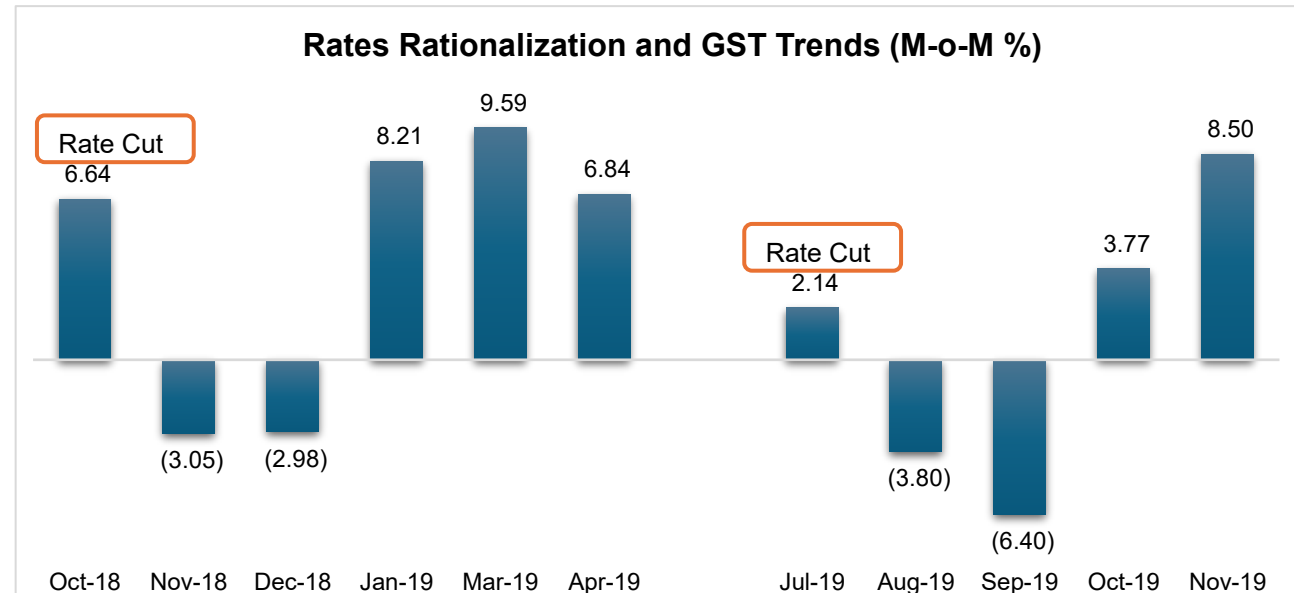
....ensure that States are always the net gainers

Our projections for FY26 indicate that States remain Net gainers even after post GST rate rationalization. States are expected to receive **at least** ~ Rs 10 lakh cr in SGST plus Rs 4.1 lakh crore through devolution thereby making them net gainers. **The gains accrues even when we do not take the additional consumption boost due to rate rationalization** (At 9.5% effective GST rate, this translates into a revenue gain of Rs 52000 crore; Rs 26000 crore each to Centre and States)...when included the gains are even higher... Thus, even under the conservative scenario of only revenue loss and no gain, states emerge as net gainers....

States' total GST Revenue (Rs crore)			
States	Expected State wise GST Collection (FY26) (1)	FY26 Post Rate Rationalization (P) (2)	Change (2-1)
Andhra Pradesh	35863	52622	16759
Arunachal Pradesh	1462	8738	7276
Assam	13659	26613	12953
Bihar	22622	64273	41651
Chhattisgarh	20248	34357	14109
Goa	4416	6014	1598
Gujarat	74088	88491	14403
Haryana	88357	92884	4526
Himachal Pradesh	9293	12730	3437
Jharkhand	18972	32667	13695
Karnataka	99137	114240	15103
Kerala	24786	32758	7972
Madhya Pradesh	35019	67527	32508
Maharashtra	183907	210066	26159
Manipur	889	3854	2965
Meghalaya	2213	5389	3176
Mizoram	741	2812	2071
Nagaland	926	3282	2356
Odisha	26552	45302	18751
Punjab	26699	34182	7483
Rajasthan	45611	70565	24954
Sikkim	4024	5631	1607
Tamil Nadu	72309	89200	16892
Telangana	42075	50779	8705
Tripura	1358	4290	2932
Uttar Pradesh	85689	159977	74287
Uttarakhand	14466	19095	4630
West Bengal	41118	72272	31154
Total	996500	1410610	414110
Source: SBI Research; P: SBI Projections			

GST post rates Rationalization always results in higher revenue per se

- Evidence from earlier rounds of GST rate changes, such as those in July 2018 and October 2019, suggests that rationalization does not necessarily weaken revenue collections. **Instead, the evidence points to a temporary adjustment phase followed by stronger inflows. While an immediate reduction in rates can cause a short-term dip of around 3–4% month-on-month (roughly ₹5,000 crore, or an annualized ₹60,000 crore), revenues typically rebound with sustained growth of 5–6% per month**
- In past episodes, this dynamics is translated into additional revenues of nearly ₹1 trillion. **Importantly, rationalisation should be seen less as a short-lived stimulus to demand and more as a structural measure that simplifies the tax system, reduces compliance burdens, and enhances voluntary compliance, thereby widening the tax base.** In this broader sense, the Hon'ble PM's vision of a streamlined GST framework is best understood as a step towards long-term revenue buoyancy and greater efficiency in the economy



The GST council will discuss several important matters including rationalization of tax rates, ease of compliance and restructuring of cess etc but we believe the following issues should be addressed

- ❑ With loans taken by the Centre to pay compensation cess to states getting recouped and fully repaid by November-December. As per our estimate around Rs 50,000 crore surplus will be in the compensation fund, we believe this amount could be used to compensate states for revenue loss due to rate rationalization
- ❑ The council should think about a plan to include Petroleum, Electricity and Aviation Turbin Fuel under GST over the medium term
- ❑ **To promote ease of 'living', Government should use technology to speed-up and ease GST registration process and implement pre-filled returns, thus reducing manual intervention and eliminate mis-matches, while refunds could be processed in a faster and more automated manner**
- ❑ The inverted tax structure (IDS), when GST rate on inputs are higher than output, in GST has many implications for business, particularly regarding the 'refund of input tax credit (ITC)'. In otherwards, if the rate on tax on inputs (say solar panels@18%), is higher than outputs (Say, Green electricity @0%), business continue to face the issue of accumulated ITC. Though, under GST law has the provision to refund the unutilized ITC but this unnecessarily burden businesses with higher tax cost, which lead to increase in prices for consumers. This issue may also be addressed

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