# SBI Research

# GST 2.0

In the long run, there is no apparent trade off between tax reforms and consumption just as we have no trade off between growth and inflation in the long run..The GST 2.0 could unleash a consumption boost and hence higher tax revenue, lower inflation and higher growth..The revenue loss through GST rate adjustment could be more than offset by increased consumption and cess adjustments…Fiscal deficit for FY26 unlikely to be breached…Debt Market fears thus appear somewhat myopically overblown

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# Executive Summary …………….1/2

- **During the 79th Independence Day Speech, Hon'ble Prime Minister has indicated an overall reform in GST in the form of rates rationalization (GST 2.0)**
- Overall, we expect a revenue loss of~ Rs 1.1 lakh crore in Scenario-1 and ~Rs 60,000 crore in Scenario-2 per annum due to GST rationalization. **Thus, average revenue loss could come around ~Rs 85,000 crores**
    - **For FY26, it could be at Rs ~Rs 45,000 crores.. Overall headline revenue loss likely to contained with a concomitant shift in sin goods from 28 to 40%**
- In the case of India, GST collections have varied across states. Though the rationalisation of rates by the GST Council has brought down the effective weighted average GST rate from 14.4% and given the current rationalization of rates, **we believe that effective weighted average GST rate may come down to 9.5%**

## Net impact on Fiscal deficit could be non-existent / minimal

- The balance in compensation cess is around ~Rs 45,000 crores. An equivalent revenue foregone ~Rs 45,000 crores in FY26 is equally divided between states. Since the compensation cess is only for the states, thus ~ Rs 22,500 crores could be adjusted from the compensation cess in the case of a baseline scenario, leaving Rs 22,550 still in the compensation cess kitty. The remaining Rs 22,550 crores revenue foregone to centre at Rs 22,550 crores could at best add 5 bps to Centre's fiscal deficit
- In the eventuality of no adjustment in revenue loss, Rs 45,000 crores is likely to be more than compensated by the potential gain in revenue post the GST cut. **An estimated consumption boost of Rs 5.5 lakh crores with an effective tax rate applied at ~9.5%, the additional GST revenue to the Government exchequer comes to around Rs 52,000 crores, that could be equally divided between Centre and States at Rs 26,000 crores… On an average, the Centre has exceeded the projected tax revenue by Rs 2.26 trillion in the last four years**

# Executive Summary……2/2

## Net impact on CPI inflation

- Overall, we believe CPI inflation may be moderated in the range of 20 to 25 bps assuming very modest passthrough

## Net impact on consumption

- The GST 2.0 regime, while also involving an average revenue loss of Rs 85,000 crore, is estimated to have boosted consumption by Rs 1.98 lakh crore. When taken together with the tax cut, the combined impact of both measures amounts to an additional Rs 5.31 lakh crore of consumption expenditure in the economy. This translates into approximately 1.6% of GDP

# GST: Backdrop

- On 1 July 2025, the Goods and Services Tax (GST) completed eight years since its rollout. Introduced in 2017 as a major step towards economic integration, GST replaced a maze of indirect taxes with a single, unified system. It made tax compliance easier, reduced costs for businesses and allowed goods to move freely across states. By improving transparency and efficiency, GST helped lay the foundation for a stronger, more integrated economy
- **The current GST structure (GST 1.0) consists of four main rate slabs: 5%, 12%, 18% and 28%. These rates apply to most goods and services across the country**
- **In addition to the main slabs, there are three special rates: 3% on gold, silver, diamond and jewellery, 1.5% on cut and polished diamonds and 0.25% on rough diamonds**
- A GST Compensation cess is also levied on select goods such as tobacco products, aerated drinks and motor vehicles at varying rates. This cess is used to compensate states for any revenue loss resulting from the transition to the GST system
- **During the 79th Independence Day Speech, Hon’ble Prime Minister has indicated an overall reform in GST in the form of rates rationalization (GST 2.0)**

# Item wise Movement under GST 2.0:The possibilities…………….1/2

- We expect the movement of items under the following two scenarios
  - Scenario 1: We assume a 30:70 movement of 28% slab share across 40% and 18% slab
  - Scenario 2: We assume a 50:50 movement of 28% slab share across 40% and 18% slab
  - **Under both Scenario-1 and Scenario-2 items under Schedule I will rise by 92% with entire GST items in 12% slab under GST-1.0 is transferred into 5% slab**
  - **Under Scenario-1, items under Schedule III rises by 35% while under scenario-2 it rises by 25%**
- Additionally, 68 of the # of Chapter/ Heading/ Sub-Heading/ Tariff Item falls in the new 40% slab

| Expected Items Movement | | | | |
|---|---|---|---|---|
| GST-1.0 | | GST-2.0 | | |
| Schedule_central Tax | # of Chapter / Heading / Sub-heading / Tariff item | Tax Slab | Scenario-1 | Scenario-2 |
| Schedule I – 2.5% | 263 | 5% | 505 | 505 |
| Schedule II – 6% | 242 | | | |
| Schedule III – 9% | 453 | 18% | 613 | 567 |
| Schedule IV – 14% | 228 | | | |
| Schedule V – 1.5% | 18 | 3% | 18 | 18 |
| Schedule VI – 0.125% | 3 | 0.25% | 3 | 3 |
| 40% Tax Slab | | 40% | 68 | 114 |
| Note: Chapter / Heading / Sub-heading / Tariff item is based on 4 digit HS code | | | | |

## …Overall Revenue Loss due to such GST Rejig could be at Rs 85,000 crores /0.24% of GDP per annum…For FY26, it could be at Rs ~Rs 45,000 crores.. Overall revenue loss likely to contained further with a concomitant shift in sin goods from 28 to 40% ….2/2

- In the current GST structure (GST 1.0), the majority of revenue share is come from goods having GST rate of 18% followed by goods having GST rate of 28%
- With the scrapping of 28% rate and shifting of items to 12% as well as to 40% bucket leads to Rs 60,000 crores- Rs 1.1 lakh crores revenue loss
- **Overall, we expect a revenue loss of~ Rs 1.1 lakh crore in Scenario-1 and ~Rs 60,000 crore in Scenario-2 per annum due to GST rationalization. Thus, average revenue loss is at Rs 85,000 crores**

### Scenario 1: We assume a 30:70 movement of 28% slab share across 40% and 18% slab

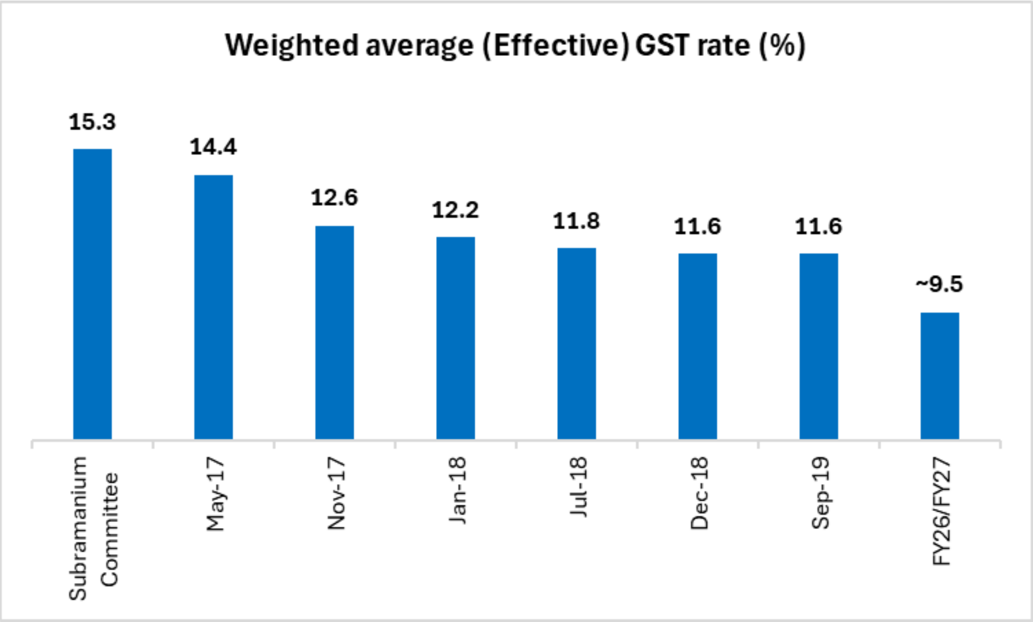
| Arithmetic of GST 2.0 | | | | | |
|---|---|---|---|---|---|
| GST 1.0 | | GST 2.0 | | Revenue Loss/Gain | |
| Rates | Share (%) | Rates | Share (%) | Share | Rs lakh crore |
| 5% | 6% | 5% | 11% | -2.9% | -0.7 |
| 12% | 5% | - | - | - | - |
| 18% | 74% | 18% | 84% | - | - |
| 28% | 15% | - | - | -3.6% | -0.9 |
| - | - | 40% | 5% | 2.1% | 0.5 |
| **Overall Revenue Loss** | | | | | **-1.1** |
| Source: SBI Research | | | | | |

### Scenario 2: We assume a 50:50 movement of 28% slab share across 40% and 18% slab

| Arithmetic of GST 2.0 | | | | | |
|---|---|---|---|---|---|
| GST 1.0 | | GST 2.0 | | Revenue Loss/Gain | |
| Rates | Share (%) | Rates | Share (%) | Share | Rs lakh crore |
| 5% | 6% | 5% | 11% | -2.9% | -0.7 |
| 12% | 5% | - | - | - | - |
| 18% | 74% | 18% | 82% | - | - |
| 28% | 15% | - | - | -2.7% | -0.7 |
| - | - | 40% | 7% | 3.2% | 0.8 |
| **Overall Revenue Loss** | | | | | **-0.6** |
| Source: SBI Research | | | | | |

# Effective weighted average GST rate could be at a 9.5% post GST rate rationalization

- In the case of India, GST collections have varied across states. Though the rationalisation of rates by the GST Council has brought down the effective weighted average GST rate from 14.4% at the time of inception to 11.6% in Sep’19; enhanced buoyancy has been achieved by widening the tax base and removing distortions
- Given the current rationalization of rates, we believe that effective weighted average GST rate may come down to 9.5%




~We have estimated weighted average GST rate for FY27 using weighted average of expected GST tax rate with number of items in the particular bucket as weight of the tax bracket

# Compensation Cess….Funding the Gap

- At the time of launching the GST regime, the law assured states a 14% increase in their annual revenue for five years of the transition period from July 1, 2017 to June 30, 2022, 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.
- **GST Compensation Cess is levied by the GST (Compensation to States Act) 2017, which aimed to compensate the States for loss of revenue arising due to the implementation of GST on 01 July 2017 for a period of 5-years (till 30 June 2022). The cess ranges from 1% to 290%**
- Due to COVID-19..so the gap between protected revenue and actual revenue receipts (including reduction in cess collection) for the sates had increased
- **With the GST council approval, to meet such resource gap of the States, Center has borrowed and released Rs 2.69 lakh crore during pandemic to support States (Rs 1,10,208 crore in FY21 and Rs 1.59,000 crore in FY22)**
- Further, with the GST council consent, the GST compensation cess was, however, extended from June 30, 2022 till March 31, 2026, only to retire debts taken on behalf of states to meet the revenue shortfall during the Covid period. **While states have no claims for compensation from July 1, 2022, the cess continues till March 31, 2026 to service the back-to-back loans released to states when compensation cess collection fell in 2020 and 2021 because of a slump in economic activity due to the pandemic**

# ~Rs 45,000 crore Surplus likely in GST Compensation Fund as on March 2026

- As decided by the GST Council, States have been provided a total compensation of Rs 9.35 lakh crores (**including ₹2.69* lakh crores as back-to-back loans as part of other transfer to States/UTs, & including AP compensation of Rs 19,021 crore**) as compensation for protecting their tax revenues post implementation of GST for the entire transition period of five years i.e., from 1st July,2017 to 30th June, 2022
- **While Cess collected Rs 10.3 lakh crore during FY18-FY26 (BE). So, after repayment of loans and interest, the Compensation Fund will have cess surplus of ~ Rs 45,581 crore..It may be noted that the compensation cess is only for the States and the Centre only facilitates it…**
- The GST council, which is expected to meet in September 2025 and discuss several important matters including rationalization of tax rates, ease of compliance and restructuring of cess etc
- As utilization of surplus requires the Council's approval, so we expect this surplus will be use as compensation for the revenue loss due to rationalization tax rates in the rest of FY
- As the cess will reduce, the impact on 'Sin Goods', due to increase in tax rates to 40% from 28%, will have limited impact

**GST Compensation Cess: Collection & Distribution among States/UTs (Rs crore)**

| | | |
|---|---|---|
| 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, & including AP compensation of Rs 19,021 crore) | A | 9,35,021 |
| Total GST Compensation Cess Collection | B | 10,31,055 |
| Interest on Loans of Rs 2.69 lakh crore (approx) | C | 50,452 |
| **Net Funds in Compensation Fund after Paying Loans & Interest** | **D (=B-A-C)** | **45,581** |

Source: Union Budget Document, Answer to Lok Sabha Q No. 22, 05 Feb 2024, SBI Research

* Rs 2.5 lakh crores excluding union territories

**Borrowing for providing Back-To-back Loan to States/UTs During the year 2020-21 and 2021-22 to meet GST Compensation Shortfall**

| | Maturity date | FY21 | FY22 |
|---|---|---|---|
| 5.22% Government Stock 2025 | 15.06.2025 | 6000 | |
| 4.48% Government Stock 2023 | 02.11.2023 | 55104 | |
| 5.15% Government Stock 2025 | 09.11.2025 | 49104 | |
| 5.63% Government Stock 2026 | 12.04.2026 | | 136000 |
| 4.26% Government Stock 2023 | 17.05.2023 | | 23000 |
| **Sub-Total** | | **110208** | **159000** |
| **Grand-Total** | | | **269208** |

# Impact on Inflation could be at least 20-25 basis points on headline inflation numbers

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- Since the GST rate of essential items (food, cloth, etc.) is expected to decline from 12% to 5%, the CPI inflation in this category may also come down by 10-15 bps after considering a 60% pass through effect on food items
- Apart from this, the rationalization of GST rates of services also leads to another 5-10 bps reduction in CPI inflation on other goods and service items, considering a 25% pass through effect
- Overall, we believe CPI inflation may be moderated in the range of 20 to 25 bps

**GST tax rates revision Impact on CPI**

| Major items | Impact on CPI (bps) | Pass throug impact on CPI in FY26 (bps) |
|---|---|---|
| Food and textiles goods | 20-25 | 10-15 |
| House hold items and sports good | 2-3 | 0.5-1 |
| Electronics goods | 2-3 | 0.5-1 |
| Service items | 20-25 | 5-10 |
| **Overall Inflation** | **45 to 55** | **20 to 25** |

# GST Consumption boost could be around 0.6%

- To evaluate the demand-side impact of the Rs 85,000 crore GST revenue shortfall in FY25, we model it as an effective reduction in indirect taxes borne by households and firms. A decline in GST collections effectively lowers the tax wedge, thereby increasing disposable purchasing power. Using the Keynesian tax multiplier framework, this can be translated into a measurable stimulus to aggregate demand
- The mechanics operate in two stages. In the first round, households spend a fraction of the tax cut equal to their marginal propensity to consume (MPC). With MPC = 0.7, the initial consumption injection equals Rs70,000 crore. This direct spending increase sets off further induced rounds of consumption.
- The total effect is captured by the tax multiplier:

$$\Delta y = \frac{-C}{1 - C}\,\Delta T$$

- **The tax multiplier is estimated to be 2.33 (Since $\Delta T$ is negative) .Thus, the total increase in aggregate demand is ₹1.98 lakh crore**
- This amounts to **a 0.6% increase in GDP**. For every rupee of lost GST revenue translates into higher household purchasing power, which  propagates strongly through the economy before considering potential leakages through imports

# Combined stimulus might spur consumption of Rs 5.31 lakh crore….

- The measures introduced in FY26 have yielded a measurable uplift in household demand by channeling foregone revenues into private consumption. **The income tax rate cut, which led to a revenue loss of ₹1 lakh crore has effectively enhanced household disposable incomes. This measure translated into an additional ₹3.33 lakh crore of consumer spending**

- The GST 2.0 regime, while also involving an average revenue loss of Rs 85000 crore, is estimated to have boosted consumption by **Rs 1.98 lakh crore.** When taken together, the **combined impact of both measures** amounts to an additional **Rs 5.31 lakh crore of consumption expenditure** in the economy. This translates into approximately **1.6% of GDP**

- Such an effect highlights the importance of carefully calibrated tax policy in stimulating domestic demand. It also illustrates that while direct tax cuts support household incomes, broad-based indirect tax reforms like GST 2.0 may exert a deeper and more immediate impact on consumption dynamics

- **The government has, therefore, incurred revenue losses on both the direct tax side through income tax cuts and the indirect tax side through GST 2.0 adjustments. Yet, these foregone revenues could effectively translate into greater household purchasing power, and the combined stimulus from both channels has provided a timely and meaningful support to aggregate demand**

# Impact on Fiscal Deficit could be minimal / nonexistent in FY26…

- Since the overall annual revenue loss is ~Rs 1.1 lakh crore/ Scenario1 and ~ Rs 60,000 in Scenario 2, for rest of the fiscal (Oct-Mar), the loss would be around ~ Rs 45,000 crore
- In the normal scenario, such a revenue loss could have a 10 basis point on fiscal deficit. However, such an impact could be mitigated
  - The balance in compensation cess is around ~Rs 45,000 crores. An equivalent revenue foregone in FY26 is equally divided between states. Since the compensation cess is only for the states, thus ~ Rs 22,500 crores could be adjusted from the compensation cess in the case of a baseline scenario, leaving Rs 22,550 still in the compensation cess kitty. **The remaining Rs 22,550 crores revenue foregone to centre at Rs 22,550 crores could at best add 5 bps to Centre's fiscal deficit**
  - In the eventuality of no adjustment in revenue loss, Rs 45,000 crores is likely to be more than compensated by the potential gain in revenue post the GST cut. An estimated consumption boost of Rs 5.5 lakh crores with an effective tax rate applied at ~9.5%, the additional GST revenue to the Government exchequer comes to around Rs 52,000 crores, that could be equally divided between Centre and States at Rs 26,000 crores…**On an average, the Centre has exceeded the projected tax revenue by Rs 2.26 trillion in the last four years**
  - The net impact on fiscal deficit thus could be minimal / nonexistent


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