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GST RATE RATIONALIZATION: A CRITICAL EVALUATION OF THE LATEST AMENDMENTS (GST 2.0 REFORMS) AND THEIR IMPACT ON DIFFERENT SECTORS

(Adv). Chirag Mahesh Chandan
Assistant Professor, Department of Accounting and Finance, Don Bosco College, Kurla (W), Maharashtra, India.

ABSTARCT

The recent Goods and Services Tax (GST) rate rationalization, resulting from the 56th GST Council meeting (late 2025), represents a pivotal move to simplify India's indirect tax structure. The core amendment involves streamlining the previous multi-tier system into a dominant two-tier architecture: a Merit Rate of 5% for essentials and a Standard Rate of 18% for most goods and services, alongside a restricted 40% De-Merit Rate. The primary objectives are to reduce compliance burdens, correct persistent inverted duty structures, and stimulate consumption demand. Critically, the reform has a positive, yet uneven, sectoral impact. The FMCG and Common Consumer sectors gain significantly, with numerous daily-use items, including personal care products and processed foods, moving from the 12%/18% slabs to the 5% rate, directly boosting affordability. The Automobile and Consumer Durables sectors receive a stimulus as most items previously under the 28% slab (e.g., small cars, cement, ACs) are now taxed at 18%, encouraging capital expenditure. Crucially, the correction of the inverted duty structure in the Textile and Fertiliser industries by standardizing inputs at 5% unlocks working capital and enhances global competitiveness. However, challenges remain, notably the short-term fiscal risk from rate cuts and potential price increases for specific services moving up to the 18% slab. Ultimate success hinges on sustained revenue buoyancy and rigorous anti-profiteering enforcement.

Keywords: *GST Rate Rationalization, Two-Tier Structure, Sectoral Impact, Fiscal Risk, 56th GST Council.*

INTRODUCTION

The Goods and Services Tax (GST), implemented in 2017, was heralded as India’s most significant indirect tax reform, designed to unify the national market and eliminate the cascading effect of multiple levies. Over its operational tenure, the tax structure evolved, leading to a proliferation of rates (Nil, 0.25%, 3%, 5%, 12%, 18%, 28%), which introduced complexity, increased compliance friction, and fueled classification-related litigation. Recognizing these structural shortcomings, the 56th GST Council meeting in late 2025 unveiled the most comprehensive set of amendments since inception, collectively termed GST 2.0. These reforms are underpinned by a critical rate rationalization strategy, which pivots the system from a four-tiered structure to a simplified, dominant two-tier architecture featuring a Merit Rate of 5% for essential goods and a Standard Rate of 18% for the majority of other goods and services. A selective De-Merit Rate of 40% has been introduced for specific sin and luxury items to safeguard revenue and address social objectives. This introductory analysis sets the context for a critical evaluation of these latest amendments, focusing on their stated goals, the mechanisms of change, and their anticipated differential impact across India’s diverse economic sectors.

The primary policy objectives driving this rationalization are multifaceted. First, the move aims to enhance Ease of Doing Business (EoDB) by reducing the complexity inherent in classifying millions of goods and services across numerous slabs, thereby mitigating audit and compliance burdens for taxpayers, particularly MSMEs. Second, it seeks to promote equity and affordability by shifting a vast number of consumer essentials, from processed foods and personal care items to medical supplies and educational materials, from the higher 12% and 18% slabs down to the 5% or Nil rate. Third, the rationalization targets a long-standing structural anomaly: the inverted duty structure. By reducing the tax on inputs for key industries like Textiles (Man-Made Fibre/Yarn) and Fertilisers to 5%, the reform seeks to unlock crucial working capital tied up in accumulated Input Tax Credit (ITC), thereby enhancing the global competitiveness of domestic manufacturers. Finally, a significant objective is to stimulate consumption-led economic growth; the substantial reduction of GST on aspirational goods, notably the shift of almost 90% of items from the 28% slab (including cement, small cars, motorcycles ≤ 350cc, and white goods) to the 18% Standard Rate, is strategically timed to boost festive demand and overall market activity.

The critical evaluation of these amendments, however, must extend beyond the intended benefits to address potential challenges. While the FMCG and Automobile sectors are positioned as clear beneficiaries of lower final prices, the complete abolition of the 12% slab introduces a paradoxical risk: certain services and intermediate goods previously taxed at 12% may default to the 18% Standard Rate, potentially increasing costs in specific segments. Furthermore, the ambitious rate cuts pose a potential short-term fiscal risk to government revenues, making the successful implementation of compensatory measures—such as the high 40% de-merit tax and improved tax buoyancy from enhanced compliance—paramount. The uneven impact is also visible in sectors like Insurance, where the exemption of individual life and health premiums from GST, while socially beneficial, could disrupt the ITC chain for insurers, potentially raising their operational costs. This paper will therefore provide a granular, sector-by-sector analysis of these changes to critically assess the trade-offs between simplification, equity, and fiscal sustainability.

OBJECTIVES

1) To Evaluate the Effectiveness of Structural Simplification on Compliance.
2) To Quantify the Impact on Inverted Duty Structures (IDS) and Manufacturing Competitiveness.
3) To Analyze the Differential Price and Demand Elasticity Across Consumer Segments.
4) To Critically Assess the Fiscal Sustainability and Revenue Impact on States.
5) To Map the Uneven Sectoral Trade-Offs and Unintended Consequences.

LITERATURE REVIEW:

1. Nilanjan Ghosh (Observer Research Foundation - ORF)

Ghosh (2025) emphasizes the macroeconomic impulse of the rationalization, viewing it as a pivotal step towards a simpler, growth-oriented tax regime. He argues that the move to prune the multiple slabs, particularly the abolition of the 12% and 28% rates, directly addresses four sources of inefficiency: classification disputes, high compliance costs for small enterprises, distortion of consumption choices, and administrative friction. Ghosh asserts that by reducing the tax burden on essentials and high-volume consumer goods (moving many from 28% to 18%), the reform directly boosts household disposable incomes and sustains India's consumption-led growth model, which also has a positive correlation with poverty reduction metrics.

2. Jayashree Parthasarathy (Tax Partner, EY India)

Parthasarathy (2025) provides a deep, sector-specific focus on the Real Estate and Construction industry. She highlights the positive impetus provided by rate reductions on key inputs, such as cement (down from 28% to 18%) and select construction materials (e.g., sand-lime bricks down from 12% to 5%). Her critical evaluation notes that while these changes can ease input costs and promote affordable housing, the final benefit to apartment buyers remains contingent on the developer's procurement strategy and their ability to pass on the savings. She also points out a potential negative trade-off: the rate increase on specific Works Contracts (e.g., government projects with high earthwork content) from 12% to 18%, which could raise costs in the infrastructure segment.

3. Suresh Nair (Tax Partner, EY India)

Nair (2025) focuses on the dramatic changes in the Pharma and Healthcare sector. He documents the significant social benefit derived from the GST rate reduction on all drugs and medicines (from 12% to 5%) and the complete exemption (NIL rate) of 36 critical life-saving drugs used for ailments like cancer and rare diseases. However, his critical assessment introduces a crucial challenge: the reduction of the output tax rate (to 5%) on medicines intensifies the inverted duty structure (IDS) problem for pharmaceutical manufacturers. This inversion leads to higher accumulation of unutilized Input Tax Credit (ITC), potentially straining working capital and necessitating urgent structural amendments to the refund mechanism.

4. Himanshu Srivastava & Subroto Bose (Baker Tilly ASA India LLP)

Srivastava and Bose (2025) provide a broad-based analysis of the GST 2.0 implications for key industrial sectors. They confirm the success in correcting the Inverted Duty Structure in the Textile Industry by aligning rates on Man-Made Fibre/Yarn to 5%, which is vital for competitiveness. Their critical insight lies in the short-term transitional challenges faced by the supply chain. They argue that dealers and distributors holding significant inventory purchased at old, higher GST rates face financial strain and competitive pressure to reprice quickly and pass on the full tax benefit to the consumer, which is a major factor in determining the immediate success of the demand stimulus. They conclude that the long-term goal of simplification outweighs the short-term operational challenges.

5. Taxmann Research Editorial (September 2025)

The Taxmann research editorial (2025) focuses specifically on the fiscal and compliance challenges during the transitional period. It underscores that while rate rationalization is a welcome step, the sudden drop in output tax rates on finished goods leaves businesses with stranded credits (unutilized ITC) from inputs procured at higher rates. The editorial critiques the historical ambiguity surrounding the refund of this non-inverted IDS and stresses that the government's push for reform must be immediately accompanied by robust, clear, and automatic transitional relief mechanisms (like expedited provisional refunds) to prevent the reform itself from becoming a new source of litigation and financial strain for businesses. This is a critical factor for the seamless transition of the two-tier structure.

STATEMENT PROBLEM:
The central problem is assessing whether the latest GST rate rationalization (GST 2.0 reforms), moving to a simplified two-tier structure (5% and 18%), can successfully achieve the intended goals of simplification and consumption stimulus without undermining fiscal sustainability and creating new economic distortions. While the cuts benefit sectors like FMCG and Automobiles, the problem involves the uneven sectoral impact, including potential cost escalation in services (shifting from 12% to 18%) and the risk of revenue shortfall due to widespread rate reductions. This necessitates a critical evaluation to determine if the benefits outweigh the transitional costs and the risk of new Inverted Duty Structures (IDS) in vulnerable manufacturing segments.

HYPOTHESIS:

1) Hypothesis 1 (Simplification/Consumption): The simplification of the GST structure into a dominant two-tier system (5% and 18%) will significantly boost consumer demand for goods receiving rate cuts (e.g., consumer durables) and lead to a measurable decrease in compliance related disputes across all sectors.

2) Hypothesis 2 (IDS/Competitiveness): The targeted correction of the Inverted Duty Structure (IDS) in sectors like Textiles will successfully release blocked Input Tax Credit (ITC) and enhance export competitiveness, but output rate reductions in other sectors (e.g., Pharma) will concurrently create new instances of IDS.

3) Hypothesis 3 (Fiscal/Trade-offs): The widespread rate reductions will lead to a short-term revenue shortfall, as the positive impact of the new 40% De-Merit Rate and the negative cost impact from rate increases on certain services (shifting from 12% to 18%) will be insufficient to fully compensate for the lost tax revenue.

RESEARCH METHODOLOGY:

To study the reference of **"GST Rate Rationalization: A Critical Evaluation of the Latest Amendments (GST 2.0 Reforms) and Their Impact on Different Sectors" with respect to Thane Region** a questionnaire was designed and the primary data was collected. The secondary data was collected through various sources like internet, Journals, Research Papers, books etc. The sample size is determined as **72 respondent's** opinion from the different sector from Thane Region

Sampling: The Sample collected from **72 respondents** from Thane Region Maharashtra.

Tools Utilized: Simple Percentage Method {This Method refers to the Special type of rate which help in comparing between two sources of data

{P = X/Y*100}

WHERE X = No of respondents in a Specific Category to be measured.

WHERE Y = Total No of respondents.

DATA COLLECTION: BASED ON PRIMARY DATA

1) To what extent has the move to a two-tier (5% & 18%) structure reduced HSN classification disputes in your industry?

Particulars	%	Count
Significantly Reduced	1.38	1
Marginally Reduced	4.16	3
No Change	55.55	40
Increased Complexity	38.88	28

2) Has the reduction of GST on man-made fibers and agricultural machinery to 5% resolved your previous issues with blocked Input Tax Credits (ITC)?

Particulars	%	Count
Fully Resolved	73.62	53
Partially Resolved	20.83	15
Not Resolved	5.56	4
Not Applicable to my sector	0	00

3) For products that moved from 18% to 5% (e.g., hair oil, soaps), how much of the tax benefit was passed to consumers?

Particulars	%	Count
100% (Full MRP reduction)	51.38	37
50-75% (Partial reduction)	25	18
0% (Absorbed to offset rising raw material costs)	19.44	14
Prices actually increased due to inflation	4.17	3

4) How has the rationalization of rates impacted your monthly working capital cycle?

Particulars	%	Count
Improved (Better cash flow)	12.5	9
Strained (Due to ITC reversal on exempt items)	4.17	3
Neutral	55.55	40
Highly Strained	27.78	20

5) Has the simplified rate structure led to a decrease in your expenditure on tax consultancy and compliance software?

Particulars	%	Count
Decrease of >20%	27.78	20
Decrease of 5-10%	19.44	14
No change in costs	25	18
Increased (due to transition costs)	27.78	20

6) Have you noticed a spike in sales for durables (ACs, TVs) after they were moved from 28% to 18%?

Particulars	%	Count
Significant increase (>15%)	41.67	30
Moderate increase (5-10%)	27.78	20
No noticeable change	16.67	12
Decrease (due to macro-economic factors)	13.88	10

7) What is the primary impact of exempting (0% GST) individual health and life insurance premiums?

Particulars	%	Count
Increased policy adoption (Penetration)	38.88	28
No change in consumer behavior	19.44	14
Insurers absorbed the benefit as "Service Charges"	13.88	10
Lead to higher costs due to loss of ITC for insurers	27.78	20

8) Do you believe the 18% "Standard Rate" is sufficient to maintain revenue buoyancy without a future hike?

Particulars	%	Count
Yes, consumption growth will offset rate cuts	45.83	33
No, a hike to 20% might be necessary	33.33	24
Unsure	6.94	5
The 40% Sin rate will bridge the entire gap	13.88	10

9) With the 2026 oversight mechanisms in place, do you feel businesses are transparent in sharing tax-cut benefits?

Particulars	%	Count
Very Transparent	52.78	38
Moderately Transparent	26.38	19
Lacking Transparency	13.88	10
Highly Opaque	6.94	5

10) Does the flat 40% rate on aerated drinks and luxury vehicles effectively serve as a "social equalizer"?

Particulars	%	Count
Strongly Agree	59.72	43
Agree	19.44	14
Disagree (Stifles manufacturing growth)	11.11	8
Neutral	9.72	7

FINDINDS BASED ON PRIMARY DATA:

- **From table no: 1:** To what extent has the move to a two-tier (5% & 18%) structure reduced HSN classification disputes in your industry? ,Out of 72 response 55.55% were agree regarding NO CHANGE.
- **From table no: 2:** Has the reduction of GST on man-made fibers and agricultural machinery to 5% resolved your previous issues with blocked Input Tax Credits (ITC)? Out of 72 response 73.62% were agree regarding Fully resolved.
- **From table no: 3:** For products that moved from 18% to 5% (e.g., hair oil, soaps), how much of the tax benefit was passed to consumers? Increased (due to transition costs)**From table no: 4:** How has the rationalization of rates impacted your monthly working capital cycle? Out of 72 response 55.55% were agree regarding on Neutral Basis.
- **From table no: 5:** Has the simplified rate structure led to a decrease in your expenditure on tax consultancy and compliance software? Out of 72 response 273.78% were agree regarding on both basis ie Decrease of >20% , Increased (due to transition costs).
- **From table no: 6:** Have you noticed a spike in sales for durables (ACs, TVs) after they were moved from 28% to 18%? Out of 72 response 41.67% were agree regarding Significant increase (>15%)
- **From table no: 7:** What is the primary impact of exempting (0% GST) individual health and life insurance premiums? Out of 72 response 38.88% were agree regarding Increased policy adoption (Penetration).
- **From table no: 8:** Do you believe the 18% "Standard Rate" is sufficient to maintain revenue buoyancy without a future hike? Out of 72 response 45.83% were agree regarding Yes, consumption growth will offset rate cuts.
- **From table no: 9:** With the 2026 oversight mechanisms in place, do you feel businesses are transparent in sharing tax-cut benefits? Out of 72 response 52.78% were agree regarding Very Transparent in matter.
- **From table no: 10:** Does the flat 40% rate on aerated drinks and luxury vehicles effectively serve as a "social equalizer"? Out of 72 response 59.72% were agree regarding strongly agree with respect to social equalizer.

FINDINDS BASED ON SECONDARY DATA:

The Goods and Services Tax (GST) required the entire Indian population of 133 crore to adopt a new classification system, a significant undertaking in a fundamentally change-resistant society. While the clear categorization of commodities and services has resolved a majority of initial classification problems (Kulkarni & Yadav, 2021), the reform immediately encountered severe operational hurdles.Goods and Services Tax (GST) is widely recognized to offer superior systemic advantages over the previous multi-layered tax regime, primarily by establishing a system where submitting and managing taxes is generally simpler, more reliable, and more adaptable.

Benefits for Small and Medium-sized Enterprises (SMEs)

1) A key finding is that the GST offers numerous welfares to Small and Medium-sized Enterprises (SMEs) compared to the former system. These benefits include:
2) A streamlined process for claiming and collecting Input Tax Credits (ITC).
3) The establishment of a uniform tax rate across states.
4) The elimination of the complex and convoluted flow tax system, leading to overall simplified taxation.

SUGGESTION:

- To fully realize the potential of the latest GST rate rationalization (GST 2.0), particularly the move towards the **two-tier structure (5% and 18%)**, the following critical suggestions should be adopted, focusing on fiscal stability, compliance, and sectoral equity:
- **Strictly Monitor and Enforce Anti-Profiteering:** The government must significantly strengthen the **National Anti-Profiteering Authority (NAA)** to ensure that the benefits of rate cuts, especially on **FMCG essentials** (moved to 5%), are **mandatorily passed on** to the final consumer. . Failure to do so will nullify the intended boost to **affordability** and **consumption stimulus**, making the revenue sacrifice ineffective.
- **Expedite and Automate ITC Refunds for New IDS Cases:** While the rationalization corrected the **Inverted Duty Structure (IDS)** in Textiles, new inversions are emerging in sectors like **Pharmaceuticals** and renewable energy (due to lower output rates). The government must implement a **fully automated, risk-based provisional refund mechanism** to ensure swift, hassle-free clearance of accumulated **Input Tax Credit (ITC)**. This is crucial to unblock **working capital** and maintain the **competitiveness** of these key manufacturing and export-oriented sectors.
- **Address the Service Sector Disparity:** A clear policy decision is needed for services that moved from the 12% slab to the **18% Standard Rate**. To mitigate unintended **cost escalation** and prevent inflation, the GST Council should explore either a special, dedicated intermediate rate (e.g., 15%) for mass-consumption services or permit full, unambiguous **ITC utilization** to ensure the burden is not passed on to the final consumer.
- **Gradual Inclusion of Excluded Sectors:** For long-term sustainability and complete elimination of cascading effects, a phased roadmap for the eventual inclusion of **Petroleum Products** and **Real Estate** under the GST ambit must be developed. This will stabilize the tax base and ensure the GST is a true "One Nation, One Tax" regime.

CONCLUSION

The latest phase of GST rate rationalization, driven by the 56th GST Council meeting and establishing the dominant two-tier structure (5% and 18%), represents a critical and largely positive milestone in refining India's indirect tax system. The overarching conclusion is that this bold reform successfully achieves its primary goals of structural simplification and inverted duty structure (IDS) correction, while simultaneously serving as a significant consumption stimulus.

The key success lies in the positive and measurable impact across multiple sectors. Consumer goods (FMCG) and the Automobile sector are clear beneficiaries, with rate cuts on essentials and aspirational goods (like small cars and durables moving from 28% to 18%) directly boosting affordability and demand. Furthermore, the targeted correction of IDS in Textiles and Fertilisers has provided immediate relief by freeing up blocked working capital (ITC), thereby enhancing the global competitiveness of domestic manufacturing.

However, the evaluation highlights two significant caveats. First, the extensive rate cuts introduce a considerable short-term fiscal risk for the government, making the long-term sustainability dependent on achieving higher tax buoyancy and strict enforcement of the 40% De-Merit Rate. Second, the simplification is not without trade-offs: the abolition of the 12% slab has potentially led to cost escalation for certain services that now default to the 18% Standard Rate, creating uneven sectoral impacts.

In the final analysis, the GST rate rationalization is a necessary and progressive step towards efficiency and equity. Its lasting success will depend less on the initial rate changes and more on the government's sustained commitment to:

(1) Automating ITC refunds to resolve emerging IDS issues in sectors like Pharma,

(2) Strengthening anti-profiteering mechanisms to ensure lower prices reach the consumer, and

(3) Developing a clear roadmap for the eventual inclusion of excluded items like petroleum.

The reform has laid a solid foundation, but continuous administrative refinement is essential for the system to reach its full potential.

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