India’s Two-Tier GST Reform: Long-Term Revenue Gains Ahead

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GST Reform in India Latest News

- S&P Global Ratings noted that the proposed **two-tier GST structure** could reduce the effective taxation rate while boosting **long-term fiscal revenues**.
- The Centre’s proposal, to be discussed with states in an upcoming meeting, aims to simplify GST by reducing the slabs to just **5% and 18%**, along with a special **40% rate** for select luxury or sin goods.
- This reform is expected to **streamline compliance, reduce complexity, and potentially increase government revenues** over time, though its short-term impact on collections and affordability remains to be seen.

The Proposed Two-Slab GST System

- The central government plans to move from the current four-rate GST structure to two slabs of **5% and 18%**, with an additional **40% rate for sin and demerit goods**.

    - Currently, there are **4 slabs under GST** — 5, 12, 18 and 28 per cent and the taxation system has been an important component of the government's revenues.
- This reform is expected by the end of 2025 and aims to simplify compliance while reducing distortions in the indirect tax regime.
- The changes will reduce classification disputes, scope for litigation and evasion as well as remove duty inversion.

Declining Effective GST Rates

- Since its launch in 2017, GST rates have been gradually reduced.
- An RBI study in 2019 found that the weighted average GST rate had dropped from **14.4% to 11.6%**, achieved through base broadening and removing distortions.
- This trend is expected to continue under the new structure.

S&P's Position on GST Reform

- S&P Global Ratings has dismissed concerns that the Centre's proposal to reform the Goods and Services Tax (GST) regime will harm fiscal revenues.
- Director of the organisation explained that while tax rates may appear lower under the proposed **two-slab system**, simplified implementation and transparent accounting could actually improve revenue collection in the long run.
- It highlighted that GST has been a key driver of fiscal revenues over the past five to six years.
- S&P believes reforms will continue strengthening government finances rather than weakening them, even if short-term adjustments create some pressure.

Debt and Fiscal Targets

- S&P forecasts the combined central and state fiscal deficit at **7.3% of GDP in 2025–26**, narrowing to **6.6% by 2028–29**.
- Interest servicing remains a heavy burden but should ease gradually due to stronger revenues and cheaper financing.
- India's debt-to-GDP ratio is projected to fall from **83% in 2024–25 to 78% by 2028–29**, with the Centre targeting **49–51% by 2030–31**.

Rating Upgrade and Long-Term Outlook

- S&P upgraded India's rating to **BBB from BBB-**, citing its robust economic performance.
- The agency stressed that India's reforms, including GST rationalisation, support long-term fiscal sustainability despite short-term uncertainties.
- It upgraded India's rating to BBB from BBB- citing:
    - Strong and resilient economic expansion.
    - Political commitment to fiscal discipline.
    - Improved quality of government spending through higher capital expenditure.

    - A credible monetary policy framework ensuring controlled inflation.

Economists’ Perspective on Fiscal Impact

- Economists note that state governments could face revenue losses estimated at **₹7,000–9,000 crore annually**.
- However, these may be offset by stronger GDP growth, which boosts both direct and indirect tax collection.
- For 2025–26, the central government’s fiscal deficit impact is expected to be less than **0.1% of GDP**.

Source: IE | ET | BS
