India’s Tobacco Taxation Reforms – Explained

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Tobacco Taxation Latest News

- India has notified a new taxation regime for tobacco and related sin goods, effective February 1, following legislative changes approved by Parliament.

Taxation on Tobacco and Sin Goods in India

- Sin goods such as tobacco, pan masala, and alcohol are taxed heavily in India due to their adverse public health and social impacts.
- Tobacco taxation serves a dual policy purpose: discouraging consumption through higher prices and generating revenue for public expenditure, particularly in health and social security.

Structure of Tobacco Taxation in India

- India follows a multi-layered taxation framework for tobacco products, involving:
  - Goods and Services Tax (GST)
  - Central Excise Duty

    - Cess (earlier GST Compensation Cess, now replaced for tobacco)
- Under GST, tobacco products have always been placed in the highest tax slabs due to their classification as demerit goods.
- However, despite high nominal tax rates, tobacco products, especially cigarettes, remained relatively affordable for consumers over the past decade.

Public Health Rationale

- Global public health bodies, including the WHO, recommend that tobacco prices should rise faster than income growth to reduce affordability and consumption.
- In India, stagnation in effective excise duties meant that real prices of cigarettes did not rise sufficiently, weakening tobacco control efforts.

Revenue Considerations

- Historically, tobacco has been a major contributor to indirect tax revenues.
- The GST Compensation Cess, introduced in 2017, was meant to compensate States for revenue losses due to GST implementation.
- While it ended for most goods, tobacco remained one of the last items subjected to this cess, reflecting both its revenue potential and public policy priority.

Shift Towards Purpose-Specific Cess

- The recent reform reflects a shift from a general compensation-oriented cess to a **dedicated, non-lapsable cess**, designed to ensure predictable funding without raising broad-based taxes.
- This approach aligns fiscal objectives with sector-specific policy needs, particularly national security and long-term preparedness.

News Summary

- The Union Finance Ministry has notified a comprehensive restructuring of tobacco taxation, effective **February 1**, following the passage of the **Central Excise (Amendment) Act, 2025**.
- This marks one of the most significant overhauls of tobacco taxation since the introduction of GST.

End of GST Compensation Cess

- The GST compensation cess on tobacco products will cease from February 1, as the original objective of compensating States for GST-related losses has largely been met.
- The cess had already been extended beyond its original timeline due to pandemic-induced revenue shortfalls.

Introduction of New Excise and Cess Framework

- To replace the compensation cess, the government has introduced:

    - Revised central excise duties on tobacco products
    - A new cess under the Health Security-cum-National Security Act, 2025, applicable to pan masala and related units
- This new cess is designed to create a non-lapsable and predictable revenue stream, particularly for long-term security preparedness and capacity building, without increasing the tax burden on the general population.

Revised GST Slabs

- Significant changes in GST rates include:
    - **Beedis** shifted to the **18% GST slab** from the earlier 28% category
    - All other tobacco products, including **cigarettes** and **chewing tobacco**, moved to a **40% GST slab**
- These changes are aimed at simplifying the tax structure while ensuring higher effective taxation on products with greater health risks.

New Valuation Mechanism

- For smokeless tobacco products such as gutkha, khaini, jarda, and chewing tobacco, GST valuation will now be based on the **retail sale price (RSP)** declared on packaging.
- This is expected to curb under-reporting and tax evasion, a persistent issue in the tobacco sector.

Significance

- The reform aligns India's tobacco taxation closer to global public health guidance by:
    - Increasing the real prices of tobacco products
    - Reducing affordability over time
    - Strengthening enforcement through clearer valuation rules
- At the same time, it ensures fiscal stability by replacing a temporary cess with a purpose-specific, long-term revenue instrument.

Source: TH | TOI
