

# GST quick take: Reform of 3 C's - *'Consumption, Compensation & Correction'*

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# Key Takeaways (1)

Kindly note that this is a quick take on the GST rate rationalization impact and will be followed up with a detailed report as further clarity emerges on minute details of this much-awaited reform.

**Key takeaway:** *The fiscal worries with respect to GST reform were put to rest with the government clearly providing a number of Rs 48,000 cr (~0.1% of GDP, impact in FY26 to be halved) on fiscal impact (using consumption base of FY24), a level better aligned with media sources and vis-à-vis wide-ranging market estimates of Rs 50,000 - 2,00,000 cr. We estimate that this is based on hike in base tax rate for sin goods rising to 40% from 28% and more importantly from items with c.80% revenue share in 12% slab moving to 18%. Moreover, fiscal impact may be lower depending on the extent of consumption multiplier effects with inflation relief of at least ~50-60bps (our conservative estimate for change in annual CPI assuming anti-profiteering steps are effective) estimated.*

Also, from monetary policy perspective, we hold onto our call of token 25-50bps rate cut(s) in H2-FY26 the final leg of the policy easing cycle. While the inflation impact of GST reform may be one-off, we have maintained our view that the inflation numbers are already trailing MPC's projections for coming qtrs. by 30-50bps (excluding GST impact), with a worsening growth outlook seen post frontload in Q1.

**Detailed back ground:** The much-awaited GST announcement clearly signaled the government's intent for reform to support business activity (via ease of doing business) and provide a consumption boost (via rate rationalization easing tax burden). We also must compliment that the implementation is targeted to be earlier than initially planned as from a Diwali bonanza, making it a Navratri Gift to uplift macros & markets.

As discussed in media reports post the initial announcement on 15th August, the GST rates have been rationalized to a two tier structure (5% and 18%, with 12% and 28% done away with) while a new 40% slab has been created for sin goods (a hike from 28% base rate initially). That said, even for the latter, the effective rate also comes down as compensation cess is also discontinued, except for in case of Pan Masala, tobacco etc where cess would prevail till the loan & interest payment obligations under compensation cess account are completely discharged.

We sum up the GST reform impact via 3 C's:

- 1. Consumption:** The reform is expected to provide a consumption boost by lowering tax burden on a mix of essentials and durables. Our estimation of inflation relief from GST reforms is at least ~50-60bps with impact likely to be seen immediately post implementation even as the growth multiplier effect may come up with a lag. While growth multiplier of GST tax rate cut is ~1, we assert that the impact may be way higher given the impact via ease of doing business and boosters provided via rate cuts for segments like cement (& hence for construction activity). That said, the rate rejig is balanced, in our view, and intended to provide relief to common man even as the income segments at the upper segments of income pyramid may pay higher tax rate for goods and services like apparel above Rs 2500 per piece, air travel other than economy class among others.
- 2. Compensation:** The government indicated that the compensation cess also ends for sin goods yet the base tax rate has been upped from 28% to 40%. This is applicable to all sin goods except for pan, tobacco etc where cess would be applicable till the outstanding loan & interest obligations under the cess account are discharged. The Finance Minister asserted in the press conference that this maybe completed in CY2025 itself, post which decision would be taken for rates in this segment. We think effective rate for pan, tobacco is unlikely to come down and compensation cess may be replaced with a health cess (which would be fiscally +ve as well).
- 3. Correction:** The rate rationalization is not just intended to bring relief to the common man but also 'correct' the inverted duty structure for sectors like manmade textiles, fertilizers. In specific, it has been a long standing ask for the textiles sector to correct the divergence in the GST rate for inputs and output which has now been corrected.

*Apart from this, insurance sector impact is also likely to be positive given that all individual health and life insurance policies (with re-insurance) have been exempted from GST versus 18% tax levy currently. While concerns have been raised regarding the input tax credit is not provided for insurers and they may potentially pass this as a potential cost to customers, the relief in premiums for individuals is expected to still come down by at least 4-5% (if not 18% entirely).*

# Direct impact of GST on inflation estimated at least ~60bps based on a 'conservative' estimate

Segment	Impact	Comments
<b>Total</b>	<b>~60</b>	
of which		
<b>Food</b>	<b>-13</b>	<i>Food items having a prominent impact on CPI is primarily led by processed foods like butter, ghee, bhujiya, processed food and juices etc. which currently attract a GST of 12% and are expected to move to 5% slab</i>
<b>Fuel</b>	<b>0</b>	<i>Most sub segments other than electricity have 0% GST and remain outside GST ambit so there will not be much impact from this segment</i>
<b>Tobacco</b>	<b>0</b>	<i>No change in effective rates (at least 40% to &gt;100% for some items) as compensation cess remains applicable for this segment</i>
<b>Housing</b>	<b>0</b>	<i>18% GST is applicable on lease or rental of immovable property for business services that is unlikely to see change in tax slab.</i>
<b>Clothing &amp; footwear</b>	<b>-2</b>	<ul style="list-style-type: none"> <li>➤ <i>Articles of apparel &amp; footwear above Rs 1000 per piece and below Rs 2500 per piece to be moved from 12% to 5% slab while Rs 2500 per piece to be moved from 12% to 18% slab</i></li> <li>➤ <i>Inflation impact of this segment contingent on market share for the products in higher price category.</i></li> </ul>
<b>Miscellaneous</b>	<b>-45</b>	<ul style="list-style-type: none"> <li>➤ <i>Major impact is expected to come from a potential shift in household durables like ACs, TVs, washing machines etc. and auto segment like cars, 2W etc. from 28% to 18% slab.</i></li> <li>➤ <i>The <u>inflation impact may be higher depending on segmentation of Medicine non-institutional</u> across all 4 slabs (0%, 5%, 12% and 18%) currently though most have been reduced to Nil in new regime</i></li> </ul>

*Media reports quoting govt sources were also providing a range of Rs 40,000 cr to Rs 60,000 cr which aligns more with our scenario assuming 50:50 ratio of share of sin goods in 28% bracket now being shifted to 40% rate*

GST Rate Slab (%; old)	Share in Revenue# (%; under old regime)	Revenue Amt (Rs. lakh cr)^	GST Rate Slab (%; new)	Scenario*	
				Revenue	Gain /Loss
5	6	1.2	5	1.3	0.1
12	5	1.0			-1.0
18	74	15.2	18	18.2	3.0
28	15	3.1			-3.1
40	0	0.0	40	0.5	0.5
<b>Total</b>		<b>20.6</b>		<b>20.0</b>	<b>-0.5</b>

# as per parliament reply to question no. 1012 replied by MoF Shri Pankaj Chaudhary

^ exclusive of compensation cess

\*assuming shift of 90% revenue generating items from the tax slab of 28% to 18% tax slab & rest 10% to 40% tax slab, while 80% revenue generating items shifted from 12% to 18% slab & rest move from 12% to 5% slab

➤ While the Finance Ministry signaled an annual fiscal impact of Rs 48,000 cr of GST rate rationalization based on FY24 consumption basket, the media reports also carried a bifurcation, in terms of the Rs 93,000 cr of fiscal hit on shift from 28% and 12% to lower slabs while the switch from 28% to 40% for sin goods is likely to be fiscally positive to the tune of Rs 45,000 cr.

➤ When we tried mapping the numbers with fiscal impact under specific slabs, our estimates show that, ~90% revenue generating items under the tax slab of 28% move to 18% tax slab & rest 10% (sin goods) to 40% tax slab, while 80% revenue generating items shifted from 12% to 18% slab and rest move from 12% to 5% slab

# GST compensation cess realignment to absorb the fund's outstanding loan & interest obligations

Compensation Cess Collection	Rs. In Cr	Growth (%)
FY2017-18	62,614	-
FY2018-19	97,369	56%
FY2019-20	98,749	1%
FY2020-21	88,342	-11%
FY2021-22	1,07,667	22%
FY2022-23	1,28,286	19%
FY2023-24	1,44,554	13%
FY2024-25	1,53,303	6%
FY2025-26 (BE)	1,67,110	9%

Compensation Cess Project Collection up to March 2025	In Rs Crore
2017-18 (from July 2017)	62,612
2018-19	95,081
2019-20	95,551
2020-21	85,191
2021-22	1,04,609
2022-23	1,25,863
2023-24	1,41,809
2024-25	1,53,303
FY2025-26 (BE)	1,67,110
Collection from July '17 to March'26	10,31,129
Compensation Paid till 05 <sup>o</sup> September 2024	-6,64,203
Back-to-Back Loan Repayable	-2,69,208*
Estimated Compensation payable	-13,000
Interest on B2B Loan (projected)	-51,561
Excess compensation to be recovered	213
<b>Expected Surplus in Compensation Account as of March 31, 2026</b>	<b>33,370</b>

\*includes ~Rs.86,000 Cr bonds due for redemption in April 2026

- As per budgeted numbers, the fund was tracking to end March 2026 with ~Rs 30,000 – 40,000 cr closing balance even after adjusting for the pending interest payment and redemption of ~Rs 86,000 cr of cess bond maturity due in April'26.
- Compensation cess is being discontinued, except for in case of Pan Masala, tobacco etc where cess would prevail till the loan & interest payment obligations under compensation cess account are completely discharged.
- The Finance Minister asserted in the press conference that this maybe completed in CY2025 itself, post which decision would be taken for rates in this segment. We think effective rate for pan, tobacco is unlikely to come down and compensation cess may be replaced with a health cess (which would be fiscally +ve as well).

# Thank You !

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