GST 2.0 Reforms: Balancing Populism with a Pragmatic Lens

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Mayank Mohanka
FCA (Partner, S M Mohanka & Associates)

Introduction

On the proud occasion of India’s 79th Independence Day, the Hon’ble Prime Minister signalled the advent of what may well be called the "Next Generation GST Reforms"—a GST 2.0 that aims to simplify the existing regime, bring greater certainty to taxpayers, and reinvigorate economic momentum. Eight years after the introduction of GST, the system has undoubtedly matured, but it continues to face certain structural, administrative, and jurisprudential challenges. The Government’s intent, as channelled through the deliberations of the Group of Ministers (GoM), is clear: a simpler rate structure, correction of inverted duty anomalies, faster refunds, reduced litigation, and enhanced ease of compliance.

Yet, while the popular sentiment rightly celebrates the promise of lower rates, cheaper essential commodities, and smoother compliance, a note of pragmatism must accompany popularism if the reforms are to yield their intended objectives. The challenge is not merely one of policy aspiration but of striking the right balance between revenue buoyancy, state fiscal autonomy, business competitiveness, and consumer welfare.

The Promise of Rate Rationalisation

The centrepiece of GST 2.0 is the proposed rate rationalisation. Presently, the GST architecture comprises multiple slabs—5%, 12%, 18% and 28%—with the Compensation Cess superimposed on certain demerit goods. The GoM has proposed to move towards a more streamlined structure of just two principal slabs: 5% as the lower “merit” rate and 18% as the standard rate. Additionally, an exceptional higher slab of 40% is proposed for sin goods such as tobacco, cigarettes, and alcohol, aligning both with the revenue imperative and the public health policy objective of discouraging their consumption.

For consumers, the rationalisation of rates holds the promise of tangible relief. Many goods of daily use—groceries, stationery, footwear, kitchenware—currently taxed at 12% could migrate to the lower 5% slab, directly reducing household budgets. For businesses, such rationalisation could resolve the recurring disputes of classification that have consumed disproportionate litigation bandwidth. The so-called “paratha versus roti” saga, the debate on whether a mobile charger is an accessory or a component, or whether printed material is goods or services, all stem from the artificiality of multiple slabs. By reducing the rate bands, the reform strikes at the very root of classification ambiguity.

The Inverted Duty Structure Dilemma

Another persistent flaw in the GST framework is the inverted duty structure, where the GST rate on inputs exceeds the rate on outputs, leading to the accumulation of unutilised input tax credits (ITC). Industries such as textiles, footwear, mobile phones, and newspapers have been repeatedly constrained by working capital blockages on account of this structural misalignment. For instance, footwear manufacturers procure soles and uppers at 18% GST but sell shoes under ₹1,000 at 12%, while publishers pay 18% on ink but sell newspapers at nil GST.

Correcting such anomalies has long been recognised as a necessity, and GST 2.0 seeks to address this by aligning output rates with input rates. However, the reform requires careful calibration. If the output product is shifted to the 5% slab while input services continue to be taxed at 18%, the problem persists in another form. Thus, rate rationalisation cannot be pursued in isolation; it must be viewed in tandem with inverted duty correction, else the same working capital strain will reappear in different industries.

Interplay Between Rate Rationalisation, Inverted Duty Correction and Classification Disputes

The three pillars of GST 2.0—rate rationalisation, inverted duty structure correction, and classification clarity—are not watertight compartments but interdependent levers. Rationalisation of rates reduces the scope of classification disputes by limiting the number of bands. At the same time, it aids in minimising inverted duty problems by allowing greater alignment of input and output taxes. Conversely, failure to harmonise services with goods could aggravate inverted structures in sectors where services constitute significant inputs.

Take the automobile industry as a case study. Automobiles attract 28% GST with Compensation Cess, but their components and accessories are scattered across 18% and 28%. If GST 2.0 rationalises the component rates without addressing the overarching cess regime, the distortion will continue. Similarly, in consumer electronics, rationalising the rate on finished goods without corresponding alignment of input services like warranty, logistics, or IT support would perpetuate partial credit blockages.

The Sunset of the Compensation Cess

A related challenge is the impending abolition of the GST Compensation Cess by 31st March 2026. The cess, initially designed as a five-year mechanism to protect state revenues post-GST introduction, has since been extended to service the debt raised for Covid-related compensation. With its abolition on the horizon, GST 2.0 must address the fiscal vacuum this will create for both the Centre and the States.

The proposed 40% slab on sin goods could partly compensate for this gap, but over-reliance on such demerit taxation may not be sustainable. Instead, a broader base with fewer exemptions, combined with improved compliance through technological integration, will be essential. The Supreme Court in *Union of India v. Mohit Minerals Pvt. Ltd.* (2022) [TS-246-SC-2022-GST] has already underlined the delicate balance of federal fiscal powers under GST, cautioning against unilateral impositions. This underscores the need for consensus-based reforms that ensure state buy-in while sustaining the revenue neutrality principle.

Challenges Ahead: The Pragmatic Lens

While the aspirations of GST 2.0 are laudable, several practical challenges demand attention. First, the fiscal consequences of large-scale migration of goods into the 5% slab cannot be overlooked. Though consumer welfare is central, the tax system cannot afford revenue instability. The pragmatic approach lies in phased rationalisation, where priority essentials are moved first, followed by periodic review of other categories.

Second, the ITC framework remains fraught with restrictions. Section 17(5) of the CGST Act continues to deny credits on several legitimate business expenses, leading to cascading even under GST. Unless such provisions are revisited, rate rationalisation alone cannot deliver full efficiency.

Third, compliance ease must translate into real-world relief. While pre-filled returns and faster refunds are being mooted, the implementation will determine their efficacy. Past experiences with GSTN glitches remind us that technology is only as good as its execution.

Finally, jurisprudence will remain a key determinant. From *AAAR rulings on parathas*, to High Court pronouncements on ITC eligibility, GST law has already generated a substantial body of case law. The success of GST 2.0 will hinge on drafting reforms in a manner that pre-empts interpretational disputes rather than creating fresh ambiguities.

Conclusion

GST 2.0 represents both a promise and a challenge. The promise lies in simplification, fairness, and consumer relief. The challenge lies in ensuring that popularism does not eclipse pragmatism. As we move towards 2026, with the abolition of the Compensation Cess and a maturing GST ecosystem, the reforms must be carefully sequenced, legally precise, and administratively robust.

If done right, GST 2.0 could indeed be a “double Diwali bonanza”—not just for consumers who seek relief at the checkout counter, but also for businesses who seek predictability, and for governments who seek buoyancy. The true success of the reform will lie in ensuring that each stakeholder experiences not only ease of living and ease of doing business but also a sense of fairness and stability in India’s most ambitious indirect tax reform.