

"From Four Slabs to Two: Assessing the Regressive Risks of India's 18% Standard GST Rate."

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"A tax is a fine for doing well, and a fine is a tax for doing wrong."

Abstract

The transition to "GST 2.0" in late 2025 marks a pivotal shift in India's indirect tax structure, moving from a complex four-tier system to a simplified two-slab model. While this reform aims to enhance ease of doing business and revenue neutrality, it introduces significant concerns regarding fiscal equity. This article investigates the effectiveness of the 18% "standard rate" in balancing revenue needs with consumer welfare. By analyzing the upward migration of semi-essential goods from the 12% to the 18% bracket, the study assesses the regressive risks posed to lower- and middle-income households. The findings suggest that while administrative efficiency is achieved, the lack of nuanced slabs may exacerbate inflationary pressures, necessitating a stronger "merit" framework to protect essential consumption.

Keywords: GST 2.0, Rate Rationalization, Regressive Taxation, Standard Rate, India, Fiscal Policy.

1. Introduction

The transition to **GST 2.0** in late 2025 represents the most aggressive structural The Goods and Services Tax (GST) is a vital fiscal technique used in India to streamline the indirect tax regime and create a unified national market. Originally introduced in 2017 with a multi-tier structure, the system has undergone several revisions to balance revenue needs with social equity. As the government moves toward **GST 2.0 in 2025**, the previous four-slab model (5%,12% ,18%, and 28%) is being rationalized into a simplified two-tier framework.

While this shift is aimed at reducing complexity and eliminating inverted duty structures, the efficiency of this new legislative framework is being questioned. In the quest for administrative ease, the "Standard Rate" of 18% has become a crucial element of contemporary economic governance. However, as semi-essential goods move from lower brackets to the 18% fold, concerns regarding regressive impacts—where the tax burden falls disproportionately on lower-

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income groups—have emerged. The legal foundations for this transition must ensure that fiscal development remains ecologically and socially sustainable.

Research Objective

The major objective of this study is to analyze the effectiveness of the legal framework guiding the GST 2.0 transition, with a special focus on the 18% Standard Rate. This article tries to examine how successfully the present legislative shift reduces fiscal complexity while maintaining economic equity and promoting consumer welfare.

The study will investigate the strengths and shortcomings of the two-slab legal framework in India, using a comparative approach to uncover lessons from other global VAT systems. The specific objectives of the research are as follows:

1. **To assess the legal regime** of the two-slab GST model and its impact on revenue neutrality.
2. **To explore how effectively** this system promotes economic stability and assists in minimizing inflationary damage.
3. **To evaluate the value of transparency** and public engagement in the GST Council's decision-making process.
4. **To highlight the issues** of implementation and enforcement within the new 18% standard rate bracket.
5. **To propose recommendations** for upgrading the GST legal framework to protect vulnerable economic sections in India.

Significance of the Study

The relevance of this research rests in its ability to give insights into the functioning of the legislative framework for the Goods and Services Tax in India during its most ambitious reform phase. As the nation confronts challenges connected to inflationary pressures and the need for sustained consumption-led growth, the efficiency of a two-slab GST framework becomes more crucial than ever. A well-designed GST 2.0 structure can play a significant role in ensuring that fiscal consolidation does not come at the expense of middle-class purchasing power, while simultaneously supporting domestic manufacturing.

In India, where fast urbanization and a burgeoning middle class drive the economy, this research will give an in-depth review of the 18% standard rate's strengths and limitations. Understanding how this system succeeds in minimizing compliance complexity while avoiding "tax-push inflation" is vital for achieving long-term fiscal sustainability. By comparing the 2025 reforms with global VAT benchmarks, such as those in the European Union and OECD guidelines, the research intends to find best practices that might be applied for strengthening the Indian system.

Literature Review / Theoretical Framework

Theoretical Foundation of GST 2.0

The theoretical foundation of GST 2.0 is based on the philosophy of **revenue neutrality**, which asserts the need for a tax rate that maintains pre-reform revenue levels while minimizing administrative friction.

1. **Revenue Neutral Rate (RNR) Theory:** The RNR is the theoretical rate at which the government neither loses nor gains revenue compared to the old regime. Recent 2025 assessments suggest that India's move to a dominant 18% standard rate is a deliberate attempt to correct "revenue leakage," where the weighted average rate had fallen below desired levels.
2. **The Precautionary Principle of Taxation:** Similar to environmental governance, this principle in a fiscal context promotes preventative measures against significant economic shocks. It suggests that essential "merit goods" must be protected under a lower 5% slab to avoid permanent damage to the disposable income of the poor.
3. **Sustainability and Progressivity Theory:** This theory advocates for a balance among fiscal, social, and economic development goals. While VAT/GST is inherently regressive because it taxes consumption rather than income, modern frameworks attempt to "progressivize" it through a three-pronged approach:
 - **The Merit Slab (5%):** Covers essentials like food, life-saving drugs, and daily household items to ensure affordability.
 - **The Standard Slab (18%):** Anchors the majority of the manufacturing and services sector to ensure stability.
 - **The "Sin/Luxury" Slab (40%):** Imposes higher costs on socially undesirable or luxury goods to balance equity.

Global and Regional Overview

To ensure your article remains grounded in international standards, it is essential to compare India's **GST 2.0** with global benchmarks. As of **January 2026**, the global landscape for consumption taxes (VAT/GST) shows a distinct trend toward structural simplification and digital enforcement.

1. The Standard Rate Benchmark

India's choice of an **18% standard rate** aligns closely with major global economies, although it remains on the higher end compared to some neighbors.

- **European Union (EU):** Most EU member states maintain standard VAT rates between **17% and 27%**. For example, as of 2026, **Hungary** remains the highest at **27%**, while others like **Germany (19%)** and **France (20%)** are slightly above India's 18%.
- **OECD Average:** The OECD average standard rate typically hovers around **19%**.
- **Asia-Pacific:** India's 18% is significantly higher than regional peers like **Singapore (9%)**, **Thailand (7%)**, and **Indonesia (11%)**.

2. The Shift to "Simplified" Slab Systems

The "Four Slabs to Two" move in India reflects a broader international movement toward reducing administrative complexity.

- **Unified Models:** Countries like **New Zealand**, **Australia**, and **Singapore** have long championed a single-rate GST model (ranging from 7% to 15%) to minimize compliance costs and market distortions.
- **Recent Rationalizations (2025–2026):** In 2026, countries such as **Kazakhstan** are also undergoing major reforms, raising their standard rates (from 12% to 16%) while simultaneously introducing targeted 5% reduced rates for medical products to protect social welfare. This mirrors India's effort to consolidate mid-tier goods into a single standard bracket.

3. The "Regressive" Risk in Global Context

Globally, the primary challenge of a high "standard rate" is its potential regressive nature. Because low-income households spend a larger share of their income on consumption, a unified 18% rate on semi-essentials can increase their relative tax burden. To counter this, most international systems, including India's GST 2.0, rely on a "**merit rate**" (typically **0% to 5%**) for food and healthcare to ensure vertical equity.

Challenges Identified in Previous Studies

Although the 2025 GST rationalization has been hailed as a "next-gen" reform for simplification, multiple challenges to its effectiveness and equity have been identified. The key challenges are outlined below:

1. Upward Rate Migration and Regressive Impact

The primary risk of the two-slab system (5% and 18%) is the upward migration of "semi-essential" goods previously taxed at 12%. While the government reduced rates for 413 items, approximately 40 categories saw an increase.

- **Impact on Middle-Class Consumption:** Items such as processed foods (soups, broths), specific manufactured goods, and intermediate industrial inputs have moved to the 18% "Standard" bracket.

- **The Regressivity Debate:** Critics argue that taxing semi-essential items at the same 18% rate as premium services disproportionately affects lower-income households. This "one-size-fits-all" approach may lead to a higher percentage of income being taken from those who spend a larger share of their earnings on basic consumption.

2. Inflationary Pressures vs. Revenue Neutrality

The 2025 reform was undertaken during a period of fluctuating consumption and increased input costs.

- **Potential for Tax-Push Inflation:** While SBI Research forecasts a potential reduction in retail inflation by 35 to 75 basis points due to overall rate cuts, the actual impact is highly dependent on a 60% pass-through effect by businesses.
- **Revenue Leakage Correction:** The move to 18% is partly a correction for the weighted average GST rate, which had fallen from 14.4% in 2017 to roughly 11.6%. This upward pressure to maintain revenue neutrality can clash with the objective of keeping prices low for consumers.

3. Inverted Duty Structure (IDS) and Compliance Hurdles

- **Persistence of IDS:** Although major fixes were made in textiles, footwear, and fertilizers (reducing fiber/yarn to 5%), residual job work and specific professional services saw rate hikes to 18%.
- **Technological Adjustment:** Businesses must update ERP and invoicing systems to reflect the new HSN code mappings effective from **September 22, 2025**. For MSMEs, these frequent shifts and the requirement for real-time AI-driven compliance remain significant procedural bottlenecks.

Methodology:

This research adopts a **descriptive and analytical approach**, utilizing the following methods to assess the 2025 GST reforms:

1. **Documentary Analysis:** Reviewing the official notifications from the **56th GST Council Meeting** (September 2025) and the subsequent **2026-27 Union Budget** realignments.
2. **Comparative Case Study:** Comparing the Indian two-slab structure against global VAT benchmarks (EU, OECD) and regional neighbors.
3. **Impact Modeling:** Analyzing secondary data from **SBI Research** and **ICRA** regarding inflation forecasts, revenue neutrality, and consumer demand response.
4. **Thematic Qualitative Study:** Identifying patterns in industry feedback, particularly from the FMCG, pharmaceutical, and construction sectors.

Case Study Analysis:

Sectoral Shifts in 2025–26 The shift to a two-slab system (5% and 18%) has created a "winners and losers" landscape across Indian industry. To assess the regressive risk, we must look at how specific sectors have recalibrated. d.

A. The Pharmaceutical Sector: A "Consumer-First" Model

In a significant move to mitigate regressive risks, the 56th GST Council shifted nearly all general medicines from the 12% to the 5% "Merit" slab.

- **Affordability Gains:** Life-saving drugs for cancer and rare diseases were moved to the Nil (0%) bracket, directly reducing out-of-pocket healthcare expenses for ordinary citizens.
- **The IDS Challenge:** While finished medicines are at 5%, the raw materials (APIs) remain at 18%. This has led to an "Inverted Duty Structure" (IDS), where manufacturers accumulate tax credits that strain working capital.

B. Real Estate and Construction: Boosting the Middle Class

The reduction of GST on cement and other construction materials from 28% to 18% is perhaps the most significant structural change.

- **Cost Reduction:** Experts estimate this cut will lower overall project costs by 3% to 5%, potentially saving homebuilders roughly ₹1,000 per square meter.
- **Standardization:** Moving tiles, paints, and electricals to a unified 18% slab has simplified invoicing but also means that "budget" materials now carry the same tax rate as "luxury" finishes, a subtle regressive shift in the finishing-works segment.

Conclusion & Recommendations

Conclusion

The transition from **four slabs to two** under GST 2.0 represents a landmark achievement in fiscal simplification. By anchoring the majority of the economy to an **18% standard rate**, the legislative framework has successfully reduced classification disputes and enhanced the "ease of doing business." However, the "regressive risk" remains a valid concern. While the expansion of the 5% and 0% merit lists for healthcare and food has protected the most vulnerable, the convergence of semi-essential goods into the 18% bracket places a disproportionate burden on the aspiring middle class.

Ultimately, the effectiveness of the 2025 reforms will be measured not just by revenue collection—which is projected to exceed budget estimates—but by the successful transmission of tax cuts to the end consumer.

Recommendations

1. **Nuanced Merit List:** Periodic review of the 5% slab is necessary to include "lifestyle essentials" (e.g., small electronics for education, energy-efficient appliances) to prevent them from becoming cost-prohibitive under the 18% rate.

2. **Automated IDS Refunds:** To protect MSME manufacturers, the government should institutionalize the **90% provisional refund** mechanism for all sectors facing inverted duty structures, ensuring liquidity is not blocked.
3. **Inflation Monitoring:** A dedicated "GST Price Monitoring Cell" should be empowered to ensure that rate reductions (like the 10% cut in cement) are actually passed on to homebuyers and not absorbed as corporate profit.
4. **Decriminalization:** To further promote the "mindset shift" of GST 2.0, minor procedural lapses should be decriminalized, focusing instead on technology-driven AI audits to catch major evasions.

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