

Impact of GST 2.0 on the Indian Economy

Kanwarjeet Malik^{1*} | Vijayalakshmi²

¹Associate Professor (Pt. C.L.S. Government College Karnal) cum Research Scholar in Guru Jambheshwar University, Hisar.

²Assistant Professor (Pt. C.L.S. Government College Karnal) Cum Research Scholar in Ch. Charan Singh University, Meerut.

*Corresponding Author: kanwarjeetmalik75@gmail.com

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ABSTRACT

One of India's largest tax amendments since the Goods and Services Tax (GST) was introduced in 2017 is the introduction of GST 2.0 in September 2025. The new framework addressed common issues, including reversed duty structures, improved digital acceptance, and a simplified rate structure. The results indicate that although the reform necessitates short-term fiscal adjustments, it has a significant potential to improve long-term economic growth, efficiency, and transparency. The study examines the potential benefits of formally including MSMEs in the tax system under GST 2.0, including improved competitiveness, better access to financing, and increased transparency. Additionally, it examines how MSMEs manage the costs of compliance, digitalisation, and regulatory awareness. Drawing from a variety of qualitative observations, using quantitative inputs, the study aims to evaluate the combined effects of MSME expansion, including GST reforms, on employment creation, economic growth, and sustainable development. To promote sustainable and fair economic development, the study concluded with policy recommendations to improve MSME support systems and to maximise the implementation of GST 2.0.

Keywords: Goods and Services Tax, India, Economy, Tax rates, GST 1.0, GST 2.0, GST rate, GDP, Sectors of Economy.

Introduction

The study paper evaluates the impact of GST on the Indian economy. The Products and Services Tax became effective on July 1, 2017, in an important session of Parliament. The Lok Sabha has eventually passed the GST bill, and it is expected to have a significant impact on businesses and consumers. More than 160 countries have implemented GST. The GST council has been appointed by Arun Jaitley, the Union Finance Minister. Product and provider taxes may apply to items and services manufactured, sold, or consumed in India. This paper provides information on the norms, aims, and effects of product and service taxes in India.

GST, or Goods and Services Tax, is a tax that customers have to pay when they purchase any goods or services, including meals, clothing, electronics, daily necessities, transportation, tours, and many more. GST is an indirect tax, meaning it is levied on manufacturers, dealers, and service providers, rather than directly on clients. It improved transparency and minimised cascade effects by combining many federal and state taxes under a single national framework. But over time, inefficiency was brought about by numerous rate changes, frequent changes, and administrative difficulties. The Indian government implemented GST 2.0 in 2025 with a priority on financial cooperation, digitalisation,

and simplification to address these issues. Using information from official sources such as the Reserve Bank of India (RBI), the Ministry of Finance, and the Central Board of Indirect Taxes and Customs (CBIC), this study investigates its effects on the economy.

Tax Structure Changes under GST 2.0

GST 2.0 replaces the earlier four-tier system (5%, 12%, 18%, 28%) with a streamlined structure:

- **5% (Merit Rate):** Essential goods and services, including most food items, personal care products, agricultural inputs, and select daily-use items.
- **18% (Standard Rate):** Most goods and services not classified as essentials or luxury/sin goods.
- **40% (De-merit Rate):** Luxury vehicles, high-end motorcycles, tobacco products, pan masala, aerated drinks, and other sin/luxury items.
- **0% (Exempt):** Expanded to include UHT milk, paneer, Indian breads, 33 life-saving drugs, and all individual health and life insurance policies.

Table 1: Summary of GST 2.0 Rate Changes by Category

| Category | Previous Rate(s) | New Rate | Notable Items/Examples |
|---------------------------|------------------|----------|--|
| Daily Essentials | 12–18% | 5% | Soaps, shampoos, toothpaste, ghee, butter |
| Healthcare | 5–18% | 0–5% | Life-saving drugs, insurance, and devices |
| Electronics & Durables | 28% | 18% | TVs, ACs, dishwashers, monitors |
| Automobiles (mass market) | 28% + cess | 18% | Small cars, motorcycles ≤350cc, 3-wheelers |
| Luxury/Sin Goods | 28% + cess | 40% | Luxury cars, superbikes, tobacco, drinks |
| Agriculture Inputs | 12–18% | 5% | Tractors, irrigation, bio-pesticides |
| Education Materials | 5–12% | 0% | Books, pencils, erasers, notebooks |

The elimination of the 12% and 28% slabs, and the consolidation of most goods and services into the 5% and 18% categories, is expected to reduce classification disputes and compliance costs, while the 40% rate on luxury and sin goods preserves fiscal space and supports public health objectives.

Revenue Collection Trends and Financial Federalism

- **National and State-wise Revenue Performance:-** Despite initial concerns about revenue loss due to rate cuts, empirical evidence and projections from SBI Research and other institutions indicate that GST collections have remained robust, with only a temporary dip followed by a rebound driven by increased consumption and improved compliance

Table 2: Year-wise GST Collection Trends (₹ lakh crore)

| Financial Year | Total GST Collection | Average Monthly Collection |
|----------------|----------------------|----------------------------|
| 2017-18 | 7.19 | 89,875 crore |
| 2018-19 | 11.77 | 98,083 crore |
| 2019-20 | 12.22 | 1.02 lakh crore |
| 2020-21 | 11.36 | 94,667 crore |
| 2021-22 | 14.83 | 1.24 lakh crore |
| 2022-23 | 18.08-18.10 | 1.51 lakh crore |
| 2023-24 | 20.18 | 1.68 lakh crore |
| 2024-25 | 22.08 | 1.84 lakh crore |

Monthly collections in 2025–26 have consistently exceeded ₹1.9 lakh crore, with April 2025 recording a historic high of ₹2.36 lakh crore

- **State-wise Impact:** The unique revenue-sharing architecture of GST ensures that states ultimately accrue nearly 70% of total GST collections, factoring in both SGST and devolution from the Centre's share. Projections for FY26 indicate that all major states are net gainers, with states like Maharashtra and Karnataka expected to see gains of 6% and 10.7%, respectively post-rationalization

Table 3: Selected State-wise GST Revenue Projections for FY26 (₹ crore)

| State | Pre-GST 2.0 | Post-GST 2.0 | Change |
|---------------|-------------|--------------|---------|
| Maharashtra | 1,83,907 | 2,10,066 | +26,159 |
| Karnataka | 99,137 | 1,14,240 | +15,103 |
| Uttar Pradesh | 85,689 | 1,59,977 | +74,287 |
| Tamil Nadu | 72,309 | 89,200 | +16,892 |
| Gujarat | 74,088 | 88,491 | +14,403 |

- **Fiscal Federalism:** The compensation cess mechanism continues to support states, with a surplus projected in the compensation fund even after servicing pandemic-era loans. The phased removal of the cess and the shift to a more buoyant, consumption-driven GST base are expected to sustain state finances Compliance Trends and Filing Patterns.

GST 2.0 introduces several measures to simplify compliance and enhance voluntary participation:

- **E-invoicing:** Mandatory for businesses with turnover above ₹5 crore, with proposals to lower the threshold further. This has improved backend tax accuracy and reduced evasion.
- **Automated Return Filing:** Pre-filled returns, AI-driven invoice matching, and real-time reconciliation have reduced manual errors and accelerated refund processing.
- **Filing Frequency:** Small taxpayers (turnover ≤ ₹5 crore) can opt for quarterly returns with monthly payments (QRMP scheme), while larger businesses file monthly.
- **Refund Timelines:** Refund processing times have dropped to 15–20 days, with 90% provisional refunds for exporters and inverted duty structure cases.

Table 4: Compliance and ITC Trends Post-GST 2.0

| Compliance Area | Key Changes/Requirements |
|------------------------|---|
| E-Invoicing | Mandatory for turnover > ₹5 crore from 1 Apr 2026 |
| Rule 86B | 1% cash payment rule with exceptions |
| Rule 37 & 37A | ITC reversal for unpaid vendors and non-filing suppliers |
| ISD Mechanism | Mandatory ISD registration for cross-state input services |
| HSN/SAC Automation | Manual entry disabled; dropdown selection mandatory |
| Litigation & Liability | Review of SCNs, appeals, and DRC-03A adjustments |

The MSME'S sector: Avital Engine of Growth

MSMEs are the backbone of the Indian economy, contributing significantly to employment establishment, innovation, and economic growth. According to the Ministry of MSME, India has over 63 million msme's that contribute about 30 per cent to the country's GDP and account for over 45% of exports. The sector employs more than 110 million people, making it the second largest Employer after agriculture

- **Access to finance:** inadequate credit and high rates restrict their growth and expansion.
- **Technological adoption:** Lack of understanding and resources could negatively impact the adoption of modern technology, reducing productivity and competitiveness.
- **Compliance burden:** complicated regulatory requirements and compliance procedures increase operational expenses and divert resources.
- **Infrastructure deficiencies,** such as power, transportation, and logistics, can impact efficiency and competitiveness.

GST challenges for MSME's

While GST aimed to simplify the tax regime, MSME's have faced several challenges in its implementation:

- **Compliance complexity:** Many MSMEs, particularly those with inadequate resources and experience, have found the multi-layered GST structure, with its various tax rates and compliance requirements, to be difficult.
- **Problems with Input Tax Credit (ITC):** The cost of doing business for MSMEs has increased due to ITC issues, including mismatched invoices and late payments.
- **Working capital restrictions:** MSMEs are facing working capital constraints due to having to pay GST on sales before receiving payment from customers.
- **Reserve charge mechanism (RCM):** The RCM has discouraged transactions with smaller, unregistered businesses, as registered buyers are required to pay GST on purchases from unregistered suppliers.

E-commerce and Marketplaces

GST 2.0 introduces several reforms to streamline e-commerce compliance:

- **Mandatory Registration:** All e-commerce operators and suppliers must register, regardless of turnover.
- **Tax Collection at Source (TCS):** Operators must collect 1% TCS on net taxable supplies, with exemptions for small suppliers (≤₹5 lakh annual sales).
- **Reverse Charge Mechanism:** Operators are liable for GST on notified services (e.g., ride-hailing, food delivery) under Section 9(5).
- **Automated Compliance:** Real-time transaction monitoring, automated TCS calculation, and monthly GSTR-8 filings are now standard.
- **Composition Scheme:** Composition taxpayers can supply goods via e-commerce for intra-state transactions without separate registration.
- **Challenges:** E-commerce platforms must invest in robust technology systems, manage complex documentation, and ensure timely TCS remittance to avoid penalties.

Dispute Resolution

The operationalisation of the GST Appellate Tribunal (GSTAT) is a major step forward, with appeals accepted from September 2025 and hearings commencing by December 2025. This is expected to clear the backlog of over 40,000 pending cases and provide greater legal certainty.

Government and Think-Tank Analyses

- **SBI Research:** Projects that GST 2.0 will boost consumption, lower inflation, and support higher growth, with minimal impact on the fiscal deficit due to offsetting gains from increased demand and compliance.
- **Bank of Baroda, HDFC Bank, CareEdge:** Forecast a moderation in CPI inflation by 50–90 bps, with a positive impact on household welfare and consumption.
- **NITI Aayog, CII, FICCI:** Hail GST 2.0 as a defining milestone, emphasising its role in driving transparency, investment, and inclusive growth

Table 5: Sector-wise Impact Summary

| Sector | Positive Impacts | Negative/Challenges |
|------------------|---|--|
| Manufacturing | Lower input costs, improved ITC, export competitiveness | System upgrades, transitional compliance |
| Automotive | Cheaper mass vehicles, EV support, and logistics cost reduction | Higher tax on luxury vehicles, inventory |
| Textile/ apparel | IDS correction, liquidity, export boost | Accessories at higher rates, pricing |
| Electronics | Lower GST, domestic manufacturing, MSME support | Import substitution challenges |

| | | |
|-------------|--|-----------------------------------|
| Agriculture | Lower input costs, mechanisation, and rural income | Diesel/electricity outside GST |
| Services | Cheaper hotels, wellness, healthcare, and insurance | ITC reversal, pricing adjustments |
| MSMEs | Simplified compliance, faster refunds, and formalisation | HSN reporting, digital adaptation |
| E-commerce | Streamlined TCS, compliance, and composition scheme | Tech investment, documentation |

Table 6: Revenue Trends and Projections

| Year | Total GST Collection (₹ lakh crore) | YoY Growth (%) |
|---------|-------------------------------------|----------------|
| 2022-23 | 18.08–18.10 | - |
| 2023-24 | 20.18 | - |
| 2024-25 | 22.08 | 9.4 |
| 2025-26 | >23.5 (projected) | 7–10 |

*Projections based on current trends and post-GST 2.0

Literature Review

Saurabh Suman (2017) has done a study on GST implementation by MSME's and addressed the problem related to GST in this paper. found that problems will be solved with time, and GST will be good for Business owners in the long run.

Singh (2018): GST and its Effect on MSME's in Rajasthan. The study found that the GST has increased the compliance cost for MSMEs. and it also found that the GST implementation has led to a decrease in the number of MSMEs.

Legal & Economic Dimensions: The legal review highlights that GST 2.0 redefines Centre-state fiscal relations and addresses long-standing issues such as inverted duty structures and tax uncertainty, but also warns of transitional challenges. Comparative work notes that India's new structure, with a limited number of slabs and a clear demerit rate, is closer to VAT/GST systems in countries such as Australia and Canada, though it remains more complex than true single-rate regimes.

Objectives

- To study the challenges of GST faced by MSMSEs in the Indian economy.
- To assess the impact of GST 2. On the Indian economy.
- To find out the effects of GST 2. In various sectors of the Indian economy.

Hypothesis

Objective 1: To study the challenges of GST faced by MSMSEs in the Indian economy.

H (0): There is no significant impact of GST implementation on the growth and significance of MSME's in the Indian economy.

H (1): GST implementation has a significant impact on the performance and growth of MSME's in the Indian economy.

Objective 2: To assess the impact of GST 2. On the Indian economy.

H (0): The implementation of GST 2. O has a positive impact on the efficiency and growth of the Indian economy

H (1): The implementation of GST 2.0 has no significant impact on the efficiency and growth of the Indian economy.

Objective 3: To find out the effects of GST 2. In various sectors of the Indian economy.

H (0): GST 2. O has no significant effect on the performance of all the sectors of the Indian economy.

H (1): GST 2. O has a significant effect on the performance of various sectors in the Indian economy

Research Methodology

As the reform is very recent, most work on the college level will depend on secondary data:

Data Sources

- PIB, GST Council, Ministry of Finance – Official fact sheets and press releases.
- Industry/consulting reports (KPMG, EY, tax advisory portals).
- News and sectoral case studies (e.g. auto, logistics, e-commerce), Academic journal articles (IJSI, IJSDR, law and economics reviews).

Methods

- Descriptive analysis of rate changes before vs after GST 2.0.
- Simple comparison of pre- and post-reform prices and tax incidence for selected goods/services
- Qualitative analysis of stakeholders' responses (industry bodies, chambers of commerce, consumer groups).

Analysis of Impact

- **Effects on Consumption and Households**
 - According to a joint report, rate cuts and exemptions under GST 2.0, particularly on necessities, healthcare, education, and basic mobility, might result in a 27–30% reduction in indirect tax burden for Indian households.
 - Reduced GST on consumer durables and FMCG is anticipated to boost demand and raise disposable income, especially in rural and semi-urban markets.
 - In contrast, consumers of luxury and sinful goods (such as tobacco, some luxury cars, and high-end beverages) are subject to a higher effective tax incidence of 40%, which aligns with equity and health objectives.
 - Net effect: targeted disincentives for unhealthy or conspicuous expenditure, together with a general increase in consumption for middle-class and mass-market households.
- **Mobility and Automobiles**
 - GST rates for several small and mid-segment automobiles have been lowered (for example, from 28% to 18%). resulting in higher sales, especially for luxury brands like Mercedes-Benz, and significant price reductions by manufacturers like Maruti Suzuki following the reform.
 - This can increase personal mobility, promote logistics efficiency, and support ancillary businesses like tyres and vehicle parts.
- **Effect on Services: Insurance, Healthcare, and Education**
 - Increased exemptions for formal education services, as well as lower rates or exemptions for health insurance and some healthcare services, directly reduce the cost of risk protection and the development of human capital.
 - It is expected that this will increase affordability and accessibility, particularly for vulnerable and middle-class households.
- **Effects on E-Commerce and Logistics**
 - GST 2.0 reduces the complexity of compliance by simplifying slabs and resolving classification conflicts for e-commerce, warehousing, and logistics companies.
 - Early analysis points to increased supply-chain efficiency and reduced logistics costs.

During the first phase after the new structure, the Finance Minister observed an important rise in e-commerce trade (about 22%), indicating a strong digital-retail trend.
- **Federalism and Fiscal Impact**
 - **Revenue Risks:** In the short term, rationalisation and rate reductions may result in lower revenue (some estimates place States that depend significantly on GST transfers are concerned about the possible loss of roughly 0.3–0.4% of GDP).
 - **Compensation Issues:** If the International Journal for Novel Research in Economics, Finance, and Management reassures states that the compensation cess and restructuring rates are being phased out, difficulties within the GST Council may reemerge.

- **Medium-Term View:** Over a period of three to five years, GST 2.0 may be financially neutral or even positive if increased compliance, faster growth, and fewer lawsuits materialise.

Risks and Limitations

- **Transitional Compliance:** New HSN classifications, rate mapping, and ERP modifications may cause temporary difficulty, particularly for MSMEs.
- **Sector-Specific Grievances:** According to some industries, the 40% tax on some luxury services or beverages is too high and could harm MSMEs and agricultural-related value chains.
- **Anti-Profitteering and Pass-Through:** Effective control and legal clarity are necessary to ensure that companies pass on tax reductions to customers rather than absorbing them as higher profits.
- **Tax Administration Capacity:** Robust IT systems, dispute resolution, and uniformity in advance decisions are still necessary for the implementation of simplified slabs.

Conclusion

India's biggest tax change since 2017 is GST 2.0. The reform seeks to make the indirect tax system more straightforward, pro-growth, and citizen-focused by reducing rates to mostly 5% and 18%, adding a targeted 40% demerit slab, and increasing exemptions for socially important industries.

Early data points to favourable effects on consumption, important industries like FMCG and cars, and macroeconomic confidence; many projections have raised India's GDP expectations.

However, there are certain difficulties with GST 2.0. State revenue risks, industry-specific complaints, and administrative needs necessitate ongoing adjustment and cooperative federalism. GST 2.0 can greatly increase India's competitiveness, boost welfare, and solidify the benefits of tax reform if these risks are properly controlled.

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