GST 2.0 Insights
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GST 2.0 - Key Impact Areas and Way Forward for the Business

The 56th GST Council Meeting has proposed a major rate rationalization by streamlining GST into three slabs: 5% for merit goods, 18% as the standard rate, and 40% for sin and luxury goods, effective from 22nd September 2025. Companies should proactively assess the key impact areas to ensure a smooth transition.

- **Overall Business Impact:** The revised GST rate structure necessitates a thorough review of pricing, supply chain costs, and financial planning, particularly in terms of input and output tax alignment and input tax credit (ITC) treatment. Key implications include:

  – Where previously taxable output become exempt, ITC will be disallowed, leading to embedded tax costs. Reversal of ITC on closing stock will also be required under Section 18 of the CGST Act.

  – Where output tax is reduced from 18% to 5%, ITC remains admissible. However lower output tax may result in accumulation of unutilized credit, especially where inputs or input services continue to attract 18%. Refunds of input services and capital goods are restricted under the inverted duty structure refund scheme.

  – Where inputs are taxed at 5% while output remains at 18%, businesses may experience lower ITC buildup but higher cash tax outflows, impacting on working capital.

  – Incentive amounts under state schemes or budgetary support schemes, often tied to output tax paid in cash, may be affected due to lower tax outflows.

  – Although the National Anti-Profiteering Authority has ceased new investigations post 1 April 2025, businesses are still expected to pass on tax reductions.

- **Classification Review:** With the 12% slab removed, most goods and services now fall under either 5% or 18%, aiming to reduce classification disputes. However, the wider 13% rate gap heightens the risk of misclassification. Businesses should therefore carefully reassess their classification of both outward supplies and inward procurements.

- **Contract Review and Renegotiation:** Companies should reassess existing contracts to identify GST passthrough or adjustment clauses and evaluate their applicability under the revised rate structure. The impact will vary depending on whether contracts are tax-inclusive or tax-exclusive. In parallel, businesses should revisit pricing arrangements and assess the feasibility of renegotiating vendor terms to reflect revised cost structures and safeguard margins.

- **Inventory Management and Transitional Rules:** Rate changes affect both finished goods and raw materials. For example, goods procured at higher rates and supplied post 22nd September 2025 at lower rates may lead to ITC mismatch/accumulation. Businesses should review stock and align procurement and dispatch to optimize tax positions. Transitional provisions under Section 14 of the CGST Act will apply, determining the applicable rate based on invoice and payment timing. Various options need to be evaluated such as issuance of credit notes/discounts to clear inventory and ensuring compliances to other regulatory requirements such as labeling /relabeling where applicable.

- **ERP & Accounting Systems** ERP, billing, and point-of-sale systems must be updated to reflect the revised GST rates and transitional rules. Tax codes, product catalogues, and price lists should be revised. For consumer-facing industries, updated prices must appear across all interfaces such as websites, menus, labels etc. For MRP goods, unsold stock may require relabeling or stickering in line with Legal Metrology rules.

- **Compliance and Documentation:** Businesses should capture key transition aspects such as rate changes, contract revisions, and pricing decisions. Robust recordkeeping will be essential to demonstrate compliance and defend positions during audits or litigation.

- **Communication and Training:** Cross-functional teams such as tax, finance, procurement, sales etc. should be trained in the revised GST framework to ensure consistent implementation. Simultaneously, Companies must issue clear, timely communication with customers and vendors explaining price changes, contractual effects, and operational adjustments.

- **Preparing for GSTAT:** GST Appellate Tribunal is expected to become operational by end-September 2025, with hearings commencing from December 2025. Taxpayers can file backlog appeals until 30th June 2026. The Principal Bench in New Delhi will also act as the National Appellate Authority for Advance Ruling. Companies should prepare early, given strict timelines and procedural requirements under the GSTAT Rules, including correct bench identification, documentation readiness, and pre-deposit compliance.

- **Government Advocacy:** Industry representation is needed for a smooth transition and policy alignment. Priorities include relief or utilization of accumulated Compensation Cess, clarity on anti-profiteering rules, and amendments for inverted duty structure cases to enable refunds. Temporary relaxations under Legal Metrology for MRP re-stickering, guidance on ITC reversal under Section 18 of CGST where supplies are now exempt, and recalibration of state incentive schemes after rate changes will also be crucial.

Key sector-specific impacts and action points are detailed below.

- **Automobile:** The automobile sector is expected to benefit from the GST rate reduction to 18% on small cars, two-wheelers, and commercial vehicles, and 40% on larger vehicles. The move to a uniform 18% rate on most auto components addresses long-standing classification disputes in the sector. However, with the omission of Compensation Cess, any unutilised credit may become a cost. Manufacturers and dealers should review pricing, reconcile cess balances, and realign tax treatment of warranties, discounts, and incentives.

- **Logistics:** Multiple-rate options continue within the same service category. For instance, goods transport agency services offer a 5% rate without ITC and an 18% credit-eligible option (increased from earlier 12%). Choosing the appropriate structure now carries greater commercial and credit implications. Companies involved in multimodal transport, containerized rail movement, and goods carriage rentals must reassess the cost-efficiency of available options, considering downstream ITC flow and pricing strategies.

- **Insurance:** While individual life and health policies along with their reinsurance are now exempt, related ITC is now ineligible, increasing embedded costs. This will impact margins, requiring repricing of products and recalibration of distributor commissions. Insurers will need to compute and reverse ITC proportionate to exempt turnover. Since group policies remain taxable, the input side must be appropriately classified and documented to avoid disputes.

- **Pharmaceuticals:** The pharmaceutical sector faces a deepening of the inverted duty structure, with most medicaments and diagnostic kits now taxed at 5%, while many inputs such as active pharmaceutical ingredients and input services remain at 18%. This realignment is likely to result in accumulation of unutilized ITC, requiring businesses to assess refund eligibility and maintain robust documentation of input–output linkages.

- **Construction:** The construction and infrastructure sector will be significantly impacted by the reduction of GST on cement from 28% to 18%, altering the cost base for ongoing and future projects. Many composite works contracts are now aligned to a standard 18% rate with full ITC. For existing contracts, this change may necessitate renegotiation or activation of change-in-tax clauses to preserve commercial fairness. Purchase orders, subcontracting chains, and escalation clauses must be reviewed to ensure seamless ITC flow.

- **FMCG sector:** GST rates on a wide range of essential and packaged goods including dairy products, confectioneries, toiletries, apparel below ₹2,500 etc. have been reduced to 5% and durables like ACs and TVs are now taxed at 18%. This rationalization is expected to ease classification issues and improve affordability for consumers. However, there exist issues relating to possibility of accumulated ITC, MRP relabeling, billing system updates, and reduction in state-linked incentive tied to net GST outflow. Companies should therefore reassess trade margins and plan for transitional stock compliance.

The proposed rate rationalization is a positive step that can simplify compliance and reduce classification disputes under the GST regime. However, the transition also poses practical challenges as stated above. Companies that proactively reassess their classifications, pricing models, vendor arrangements, inventory planning, and system readiness will be best positioned to adapt to the revised structure and avoid disruption.

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