

India's Indirect Tax Revolution: GST Development, GST 2.0 and the Road to Viksit Bharat 2047

The introduction of the Goods and Services Tax (GST) in India on July 1, 2017, represented the most ambitious structural fiscal reform since independence. By subsuming a chaotic web of central and state indirect levies, GST actualized the constitutional vision of a unified national market under the principle of “One Nation, One Tax.” As the cooperative federalist architecture enters its next evolutionary stage, dubbed “GST 2.0,” the tax regime is shifting from a teething compliance framework to an advanced engine of formalization, fiscal growth, and supply-chain efficiency.



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INTRODUCTION

INCEPTION OF THE GOODS AND SERVICES TAX: A CONSTITUTIONAL AND FISCAL REVOLUTION

Prior to July 1, 2017, India's indirect tax landscape was highly fragmented, characterized by structural inefficiencies, economic distortions, and geographical barriers. The Union Government levied Central Excise Duty, Service Tax, and Additional Customs Duties, while State Governments levied Value Added Tax (VAT), Central Sales Tax (CST), Entry Tax, Octroi, Luxury Tax, and Entertainment Tax. This dual-layered administrative machinery suffered from three fundamental structural flaws:

1. **The Cascading Tax Effect:** Taxes were levied on taxes. Because central taxes like excise duty could not be offset against state-level VAT, the tax burden cascaded down the supply chain, inflating production costs and undermining domestic competitiveness. This cascading element artificially bloated consumer prices.
2. **Fragmented Common Market:** Check posts at state borders acted as fiscal barriers, delaying logistics, increasing fuel consumption, and partitioning the nation into dozens of mini-markets.
3. **Double Taxation of Transactions:** Complex transactions involving both goods and services (such as software sales or restaurant dining) faced dual taxation under both central service tax and state VAT regimes.

CONSTITUTIONAL AMENDMENT AND COOPERATIVE FEDERALISM

Resolving these distortions required a historic realignment of constitutional powers. The Constitutional Amendment Act, 2016, inserted Article 246A, granting concurrent taxing powers to both Parliament and State Legislatures. It also established Article 279A, which created the GST Council—a joint forum of the Union and the States.

The voting architecture of the GST Council reflects a model of weighted cooperative federalism, where the Union holds a 33.33% weight, and the States combined hold a 66.67% weight. To pass any resolution, a 75% majority is required.

This formula prevents either the Centre or the States from making unilateral changes, forcing consensus-driven policymaking.

THE DESTINATION-BASED CONSUMPTION PRINCIPLE

GST fundamentally shifted India's indirect tax model from an *origin-based* tax to a *destination-based consumption* tax. Under the previous regime, tax revenues accrued to the manufacturing states (such as Maharashtra, Tamil Nadu, and Gujarat). Under GST, the tax is collected by the state where the goods or services are ultimately consumed.

To bridge the transition gap for manufacturing states, the Parliament enacted the GST (Compensation to States) Act, 2017, guaranteeing a 14% compounded annual growth rate in protected revenue for five years. This was financed through a dedicated GST Compensation Cess on demerit goods.

INDIA'S GST 2.0: A VISIONARY PARADIGM SHIFT FOR VIKSIT BHARAT 2047

On the occasion of India's 79th Independence Day in August 2025, a bold blueprint was unveiled to transform the indirect tax framework into **GST 2.0**. This next-generation reform moves away from the multi-rate, complex structure of the past decade toward a simplified, growth-oriented fiscal system designed to support India's vision of becoming a developed nation (Viksit Bharat) by 2047, targeting a GDP of \$30 to \$40 trillion.

STREAMLINING THE RATE STRUCTURE

For years, India's GST was criticized for its complex five-slab structure (0%, 5%, 12%, 18%, and 28%), which caused classification disputes, inverted duty structures, and high compliance costs. GST 2.0 simplifies this indirect tax system into a streamlined three-tier architecture:

- **The 5% Concessional Tier:** Reserved for essential items, basic foods, agricultural inputs, and critical medical devices, ensuring basic necessities remain affordable.
- **The 18% Standard Tier:** Consolidates the old 12% and 18% slabs. This tier covers the vast majority of standard manufacturing, professional services, IT services, consumer goods, and industrial inputs, reducing classification disputes.
- **The 40% Luxury and Demerit Tier:** Reserved for luxury cars, yachts, and select “sin” goods, ensuring the progressive nature of the tax is preserved.

Feature	GST 1.0 (2017–2025)	GST 2.0 (Post- 2025/2026 Reforms)
Core Rate Slabs	5%, 12%, 18%, 28%	5% (Essentials), 18% (Standard)
Luxury / Sin Goods Rate	28% + Variable Compensation Cess	40% (Inclusive of standard rate + excise/cess)
Compensation Cess	Levied to fund state deficits	Phased out by March 31, 2026
E-Invoicing Threshold	Progressively lowered to INR 5 Cr	Near-universal integration for B2B/B2C transactions
Compliance System	Disparate return filings, manual reconciliations	Real-time ledger matching via AI/ML

By consolidating the standard tax rate at 18%, GST 2.0 resolves long-standing inverted duty structures—where inputs were taxed at a higher rate than finished goods—freeing up tied-up working capital and enhancing the competitiveness of domestic manufacturing.

THE BASE GST STRUCTURE UNDER THE HEALTH SECURITY SE NATIONAL SECURITY (HSNS) CESS ACT, 2025

One of the most significant structural changes under GST 2.0 is the scheduled expiration of the GST Compensation Cess on March 31, 2026. This cess was originally introduced to compensate states for revenue losses but was extended post-2022 to service the back-to-back debt incurred during the pandemic.

To maintain revenue neutrality for “sin” and “demerit” products without disrupting state finances or consumer prices, the Union Government enacted a dual legislative package in December 2025: the **Central Excise (Amendment) Act, 2025** and the **Health Security se National Security (HSNS) Cess Act, 2025**, which went into effect on February 1, 2026.

THE SHIFT TO A CAPACITY-BASED EXCISE LEVY

Historically, sectors like pan masala, chewing tobacco, and cigarettes have been highly prone to under-reporting and tax evasion. To counter this, the HSNS Cess Act, 2025, shifts these goods from a sales-based tax to a **capacity-linked monthly levy**. This tax is calculated based on the maximum rated speed of the installed manufacturing machinery or a flat monthly rate for manual processes, rather than declared sales value.

Under Section 5 and Schedule II of the HSNS Cess Act, the capacity-based monthly cess is strictly structured:

- **For Machine-Based Production:** The monthly levy is determined by the machine's maximum rated packing speed (measured in pouches or sticks per minute) and the net weight per pack. For a packing machine running up to 500 pouches per minute (with pack weights up to 2.5 grams), the statutory levy is fixed at INR 1.01 crore per month. For high-speed lines ranging between 1,001 and 1,500 pouches per minute with pouch weights exceeding 10 grams, the rate climbs to INR 25.47 crore per month.
- **For Wholly Manual Production:** Factories operating entirely through manual labor, with no mechanical packing machinery installed, are levied a flat rate of INR 11 lakh per month per factory unit.

This structured levy makes it incredibly difficult to under-report production volumes. The law also establishes strict enforcement measures, where operating an unregistered or undeclared manufacturing machine carries a statutory penalty of up to INR 10,000 or an amount equal to the evaded cess, whichever is higher, alongside the potential seizure and confiscation of the machinery.

earmarking of proceeds and the federal balance

The proceeds collected under the HSNS Cess Act are credited directly to the Consolidated Fund of India. Unlike standard central surcharges, these funds are earmarked for two strategic pillars:

1. **Public Health Infrastructure:** Funding diagnostic networks, preventive oncology programs, and specialized cancer hospitals to offset the public health costs of tobacco consumption.
2. **National Security Capabilities:** Allocating predictable capital to fund long-term defense procurement, autonomous defense systems, cybersecurity networks, and precision weapons.

Importantly, to maintain the spirit of cooperative federalism, the Union Government shares a portion of these revenues with the states, ensuring that local health programs remain funded.

THE SUNSET OF THE ANTI-PROFITEERING FRAMEWORK & MARKET PRICE ADJUSTMENTS

Section 171 of the Central Goods and Services Tax (CGST) Act, 2017, originally mandated that any reduction in tax rates or benefit of Input Tax Credit (ITC) must be passed on to the consumer by way of a commensurate reduction in prices. This provision was administered by the National Anti-Profiteering Authority (NAA).

While the NAA was created to protect consumers from artificial price inflation during the initial transition to GST, it faced significant challenges. Businesses struggled with the lack of a standardized, statutory formula to calculate “commensurate reduction” across diverse product portfolios, leading to extensive litigation in various High Courts.

The Transition to the CCI and the Sunset

To streamline administration, the Union Government dissolved the NAA in December 2022, transferring its investigative responsibilities to the Competition Commission of India (CCI). Under the GST 2.0 reforms, the anti-profiteering framework is undergoing a structured sunset.

This sunset marks a transition back to market-driven pricing mechanisms. The rationale for this policy shift includes:

- **Market Maturation:** With the tax regime now fully established, competitive market forces are more effective at regulating retail prices than rigid administrative mandates.
- **Reduction of Compliance and Litigation Costs:** The sunset resolves hundreds of outstanding tax disputes, allowing businesses to adjust pricing structures without the threat of retroactive regulatory investigations.
- **Ease of Pricing Recalibration:** As GST 2.0 simplifies tax rates, businesses can restructure their Maximum Retail Prices (MRPs) to align with standard currency denominations (such as INR 5, INR 10, or INR 20), avoiding fractional pricing complexities.

The removal of these pricing constraints allows enterprises to quickly reinvest tax savings into capacity expansion, research and development, and supply-chain efficiency.

India's Goods and Services Tax has evolved from a complex, multi-layered reform into a stable and mature digital tax ecosystem. The transition to GST 2.0 represents a strategic step forward, simplifying compliance, improving transparency, and strengthening the country's fiscal framework.

DIGITAL TRANSFORMATION & TECHNOLOGY BACK SUPPORT (GSTN)

At the heart of India's indirect tax system is the GST Network (GSTN), a state-of-the-art technological platform that manages billions of invoices, taxpayer registrations, and monthly return filings. By processing millions of transactions per second, GSTN has evolved from a basic transactional database into a powerful analytics engine.

CURRENT NORMS AND DIGITAL GUARDRAILS

Today's GSTN operates on a system of real-time data integration, utilizing strict digital validations to prevent tax evasion:

- **GSTR-2B Automated Ledger Matching:** GSTR-2B is a static, auto-drafted Input Tax Credit (ITC) statement generated for every taxpayer. It matches purchase invoices with those uploaded by suppliers in their GSTR-1, ensuring that ITC can only be claimed if the supplier has paid the corresponding tax to the government.
- **Risk-Based Scrutiny & Parametric Profiling:** The system uses automated algorithms to identify anomalies,

such as discrepancies between GSTR-1 (declared outward liability) and GSTR-3B (actual tax paid), flag sudden surges in ITC utilization, or spot high-risk taxpayer profiles.

- **Geotagging and Biometric Authentication:** To combat “fly-by-night” operators using fake identities to pass fraudulent ITC, registration now requires geotagged business premises and biometric-based Aadhaar authentication.

Future Tech Expectations: AI, ML, and Next-Gen Architectures

As GST 2.0 scales, the technological architecture is expected to incorporate several key innovations:

1. **AI-Driven Predictive Audit Frameworks:** Moving beyond reactive auditing, the GSTN will leverage deep learning models to assess a business's compliance history, industry averages, and supply-chain patterns to predict tax evasion before returns are finalized.
2. **Blockchain-Enabled Input Tax Ledgers:** Utilizing permissioned blockchain ledgers to secure the supply chain would create an immutable, shared record of transactions. This would prevent the creation of fake, circular-trading invoices, as each credit claimed would be cryptographically linked to a verified physical transaction.
3. **Decentralized, Real-Time Query Resolvers:** Natural Language Processing (NLP) tools and AI-driven assistants will handle routine taxpayer queries, draft automated clarification letters, and speed up the dispute resolution process.

INTEGRATION OF E-INVOICING AND E-WAY BILLS: SYNERGY AND SUPPLY CHAIN IMPACT

Among the most successful structural reforms within the GST ecosystem is the integration of the Electronic Invoice (e-invoice) registry with the Electronic Way (e-way) Bill system. E-invoicing, initially mandated for large corporations, has been progressively extended to all businesses with an aggregate annual turnover exceeding INR 5 crore, bringing the vast majority of commercial business-to-business (B2B) transactions under a single digital framework.

The Integrated Transaction Flow

The integration of these systems has streamlined business transactions:

1. When a seller generates a sales invoice on their ERP system, the data is uploaded to the central Invoice Registration Portal (IRP).
2. The IRP validates the data, generates a unique Invoice Reference Number (IRN) and a secure QR code, and digitally signs the invoice.
3. This transaction data is shared in real time with both the GST Portal (to pre-fill the GSTR-1 return) and the E-Way Bill Portal.

4. Using this data, the E-Way Bill Portal automatically populates Part-A of the e-way bill. The transporter only needs to enter the vehicle registration number (Part-B) to generate the final transit permit.

Supply Chain and Logistic Impacts

This integrated digital flow has had a profound impact on logistics:

- **Elimination of Interstate Bottlenecks:** Physical check posts at state borders have been replaced by RFID readers and automated ANPR (Automatic Number Plate Recognition) cameras, reducing long transit delays.
- **Optimized Warehousing:** Free from state-specific tax barriers, businesses have shifted from maintaining small, tax-optimized warehouses in every state to setting up large, strategically located logistics hubs, reducing overall inventory costs.
- **Curbing Circular Trading:** Real-time invoice matching makes it virtually impossible to generate fake paper-trail invoices for circular trading, as any discrepancy between physical transport records (e-way bills) and financial declarations (e-invoices) is immediately flagged.

GST AND MSME INTEGRATION: THE FORMALIZATION ENGINE

Micro, Small, and Medium Enterprises (MSMEs) form the backbone of the Indian economy, contributing over 30% of the country's GDP and employing millions of people. Historically, the informal nature of the MSME sector kept many businesses outside the formal tax net, limiting their access to organized credit. GST has acted as a powerful driver of formalization across this sector.

Easing the Compliance Burden

While early GST compliance requirements were challenging for smaller enterprises, targeted administrative reforms have introduced several supportive measures:

- **Quarterly Return Monthly Payment (QRMP) Scheme:** Businesses with an aggregate turnover of up to INR 5 crore can file their GSTR-1 and GSTR-3B returns quarterly, while making simplified tax payments monthly, reducing administrative costs.
- **Enhanced Composition Scheme:** Small businesses with turnovers up to INR 1.5 crore (and service providers up to INR 50 lakh) can pay a flat tax rate on their turnover (ranging from 1% to 6%) and file a single, simplified annual return, bypassing complex invoice-matching processes.
- **Pre-Filled Interactive Returns:** System-generated GSTR-3B and GSTR-2B statements reduce manual data entry, lowering errors and keeping compliance costs manageable for small entrepreneurs.

Formalization and Financial Inclusion

The digital records generated by GST compliance have also improved MSMEs' access to credit:

- **Transaction-Led Lending:** Traditionally, banks required physical collateral to extend business loans. Today, MSMEs can leverage their verified GST return data as proof of cash flow, allowing financial institutions to offer unsecured, short-term working capital loans.

- **Integration with the Open Credit Enabled Network (OCEN):** This integration allows lenders to evaluate and disburse loans based on real-time GST invoices. Small businesses can secure financing for specific purchase orders within minutes, addressing critical cash flow gaps.
- **The "Pull Factor" of ITC:** Because large enterprises can only claim input tax credits if their suppliers are registered and compliant, they actively encourage their MSME vendors to join the GST network, pulling them into the formal economy.

TAXING CROSS-BORDER E-COMMERCE & DIGITAL PLATFORMS: CHALLENGES AND SOLUTIONS

The rapid growth of the digital economy, cloud computing, cross-border e-commerce, and gig platforms has challenged traditional brick-and-mortar tax concepts. Establishing the correct place of supply and ensuring fair tax collection for digital services remains a complex policy area.

Challenges in the Digital Ecosystem

1. **The "Lack of Physical Presence" Dilemma:** Digital service providers (such as streaming platforms, SaaS providers, and online gaming networks) can deliver high-value services to Indian consumers without maintaining a physical office in the country, complicating traditional tax collection methods.
2. **Intermediary Liability and Compliance:** Multi-seller e-commerce marketplaces (such as Amazon, Flipkart, or hotel booking portals) manage transactions on behalf of thousands of third-party sellers, making it difficult to track tax compliance at scale.
3. **Classification of Digital Goods:** Distinguishing between a transaction of goods versus a supply of services—such as downloading software, purchasing digital art, or subscribing to cloud storage—often leads to classification disputes.

Modern Policy Solutions

To address these challenges, the Indian GST framework has established several mechanisms:

- **The OIDAR (Online Information Database Access and Retrieval) Framework:** Foreign digital service providers delivering services directly to non-taxable Indian consumers (B2C) must register with the Indian government and pay GST on their services. For business-to-business (B2B) transactions, the tax liability is managed by the Indian purchaser under the Reverse Charge Mechanism (RCM).
- **Tax Collected at Source (TCS) under Section 52:** E-commerce operators are legally mandated to collect TCS at a rate of 1% of the net value of taxable supplies made through their platform by other sellers, providing clear data on online sales.
- **Global Tax Consensus Coordination:** India continues to align its digital tax rules with the OECD's two-pillar solution. This framework ensures that multi-national enterprises pay a fair share of taxes in the jurisdictions where they generate consumer value.

GREEN ENERGY SUBSIDIES AND THEIR GST IMPLICATIONS

India's commitment to achieving net-zero carbon emissions by 2070 has made the transition to sustainable energy a key economic priority. The GST framework plays a central role in aligning corporate incentives with these national environmental goals.

Resolving Inverted Duty Structures

In the early stages of the GST regime, the renewable energy sector faced a challenging inverted duty structure. Inputs such as steel, cement, copper cables, and specialized electronics were taxed at 18% or 28%, while completed solar power systems or wind turbines enjoyed a concessional rate of 5%. This tax mismatch left green energy developers with unutilized input tax credits, increasing project costs.

Under the GST 2.0 reforms, these imbalances are being addressed:

- **Rationalized Rate for Solar Power Gen Units:** To resolve the inverted tax issue, a balanced flat rate of 12% has been applied to renewable energy equipment, aligning the tax on components with the rate on complete installations and improving overall project cash flows.
- **Incentivizing the Electric Vehicle (EV) Ecosystem:** To accelerate the transition to clean transport, EVs are taxed at a concessional rate of 5%, while EV charging stations have also seen rate reductions from 18% to 5%, encouraging private investment in charging infrastructure.

Supporting Waste Management and Sustainability

Beyond clean energy, recent GST rate adjustments actively encourage sustainable waste management:

- **Biodegradable Alternatives:** The GST rate on biodegradable bags was reduced from 18% to 5%, helping small manufacturers scale up production and compete with single-use plastics.
- **Common Effluent Treatment Plants (CETPs):** The tax rate on the construction and operation of CETPs was reduced from 12% to 5%, lowering waste treatment costs for small and medium-sized industrial clusters.
- **Scrap Metal and Circular Economy Incentives:** Streamlining the tax rules for recycling metal scrap helps reduce the reliance on raw materials, promoting a circular industrial economy.

MACROECONOMIC EVALUATION: SECTORAL IMPACTS, GROWTH, INFLATION, AND DEMAND DYNAMICS

The transition to GST 2.0 has had a broad impact on India's macroeconomic indicators, helping to stabilize inflation, stimulate domestic demand, and improve overall supply-chain efficiency.

Manufacturing and Heavy Industries

The manufacturing sector has been a key beneficiary of the simplified GST structure. The elimination of octroi and state-level entry taxes has significantly improved supply-chain efficiency.

- **Logistical Time Savings:** Integrated e-way bills and e-invoicing have reduced logistics transit times by 20 to 30%, cutting transportation costs and reducing the need for high inventory cushions.

- **Investment Reinvestment:** Lower transaction and compliance costs have allowed manufacturers to expand production capacity, boosting competitiveness under the *Make in India* initiative.

Services and the Knowledge Economy

The services sector, which accounts for over 50% of India's GDP, has transitioned smoothly to the centralized digital compliance framework.

- **Ease of Compliance for IT and Professional Services:** Standardizing service tax rates under the 18% slab has simplified billing for IT, legal, and financial services, resolving previous classification disputes.
- **Healthcare and Wellness Incentives:** Recent rate adjustments, including lowering the GST on job-work services for pharmaceuticals from 12% to 5%, have helped make essential healthcare and medicines more affordable across the country.

Real Estate and Construction

While the real estate sector has historically had a large informal component, the gradual integration of inputs under the GST net has encouraged greater transparency.

- **Input Tax Credit for Commercial Construction:** Encouraging developers to purchase raw materials like steel and cement from registered suppliers has helped reduce under-the-table transactions, improving financial accountability in the sector.

CONCLUSION: THE ROAD TO VIKSIT BHARAT @ 2047

India's Goods and Services Tax has evolved from a complex, multi-layered reform into a stable and mature digital tax ecosystem. The transition to **GST 2.0** represents a strategic step forward, simplifying compliance, improving transparency, and strengthening the country's fiscal framework.

By replacing the GST Compensation Cess with the capacity-based levy of the **Health Security and National Security (HSNS) Cess Act, 2025**, the government has secured a reliable, earmarked revenue stream for national security and public health without increasing the tax burden on standard consumer goods. At the same time, the sunset of the anti-profiteering framework and the digitization of the GSTN portal have made it easier to do business, fostering a more competitive market environment.

As India works toward its goal of becoming a developed nation (Viksit Bharat) by **2047**, a simplified, transparent, and digitally advanced GST system will continue to play a vital role. By promoting cooperative federalism, driving economic formalization, and supporting sustainable growth, these ongoing tax reforms lay a strong foundation for India's long-term economic development.

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