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EDITORIAL ANALYSIS

GST 2.0: Reading the Two-Slab Reform and What Comes Next

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THE LIFT LINE

For eight years the argument about the Goods and Services Tax was that it had too many rates. That argument is now over. With **GST 2.0**, the Council has done the hard thing and simplified the structure. The interesting question has shifted from whether to rationalise to whether the rationalisation will pay for itself.

WHY THIS EDITORIAL MATTERS FOR YOUR EXAM

The **GST**, launched in **2017**, folded a thicket of central and state indirect taxes into one system. Its governing body, the **GST Council**, is a constitutional entity under **Article 279A**, a rare institution of cooperative federalism where the Union and the states together set rates by weighted vote. In **September 2025** that Council carried out its most significant redesign yet, and the exam now rewards the aspirant who can analyse an accomplished reform rather than debate a proposal that has already been settled.

This is a fiscal-federalism question as much as a tax question. For **Prelims**, hold the specifics: GST launched **1 July 2017**; the **GST Council** is a constitutional body under **Article 279A**; **GST 2.0** was decided at the **56th GST Council meeting on 3 September 2025** and took effect on **22 September 2025**; it removed the **12 and 28 per cent** slabs, leaving **0 per cent (exempt), 5 per cent (merit) and 18 per cent (standard)**, plus a **special 40 per cent rate** on demerit, luxury and sin goods; and the **compensation cess** was discontinued. **GS Paper 3:** mobilisation of resources, government budgeting, and fiscal federalism. For **Mains,** the analysis is about whether a simpler structure delivers on compliance, consumption and revenue buoyancy while safeguarding the finances of the states.

BACKGROUND AND CONTEXT

GST replaced a fragmented indirect-tax regime with a common national market. To make the 2017 transition politically acceptable, the Council adopted a four-slab structure of **0, 5, 12, 18 and 28 per cent** plus a **compensation cess**, so that essentials could be taxed lightly and luxuries heavily. That design bought consensus, but it embedded permanent complexity.

Two structural problems persisted for years. The first was **classification disputes**, where firms and tax authorities argued over which slab a product belonged to, generating litigation. The second was the **inverted duty structure**, where inputs were taxed at a higher rate than the finished good, trapping working capital in refund claims. Both flowed directly from having many rates. **GST 2.0** is the Council's answer: most goods in the old 12 per cent slab moved to **5 per cent** and most in the 28 per cent slab moved to **18 per cent**, and the cess, originally levied to compensate states for five years, was retired.

THE CORE ARGUMENT / ISSUE

What GST 2.0 Actually Did

The reform attacked the root of most disputes. By collapsing four working slabs into essentially two operative rates, plus a **40 per cent** rate ring-fenced for demerit goods such as tobacco, pan masala and high-end cars, it sharply reduced the number of rate boundaries over which classification arguments arise. Fewer borders mean fewer border wars over which side of a rate a product sits on, and a lighter middle burden should support consumption.

The Revenue Anxiety

Simplification is not free. Moving large baskets of goods down from 12 to 5 per cent and from 28 to 18 per cent lowers the effective tax on those goods, so the immediate arithmetic points to a revenue dip. The bet behind **GST 2.0** is that a lower, cleaner rate structure lifts **consumption**, widens **compliance** and improves buoyancy enough to recover the short-term loss. Whether collections settle near the **Revenue Neutral Rate (RNR)**, the single rate that would leave total revenue unchanged, is now the central empirical test.

The Federal Dimension After the Cess

States surrendered significant taxing powers to join GST and were protected for years by the **compensation cess**. With that cess now discontinued, the safeguard that underwrote their consent has gone. Protecting **states' revenues** therefore becomes a live design task rather than an automatic feature, and the trust at the heart of the Council depends on getting it right.

FEATURE	OLD STRUCTURE (PRE-2025)	GST 2.0 (FROM 22 SEP 2025)
Working rates	0, 5, 12, 18, 28 plus cess	0, 5, 18 plus special 40
Disputes	Frequent **classification disputes**	Fewer rate boundaries, fewer disputes
Inverted duty	Common in several sectors	Reduced as rates converge
Demerit goods	28 per cent plus cess	Single **40 per cent** rate
State safeguard	**Compensation cess**	Cess ended, must be redesigned

HOW TO THINK ABOUT THIS (ANALYTICAL FRAME)

Use the **simplicity versus buoyancy versus equity** triangle. A good indirect tax wants to be simple to administer, buoyant enough to fund the state, and progressive enough not to burden the poor. The old four-slab design chased equity at the cost of simplicity; **GST 2.0** deliberately trades a little of that fine-grained equity for large gains in simplicity and administrability, relying on the exempt and 5 per cent rates to shield essentials. A second frame is **cooperative federalism as a constraint**: because the **GST Council** decides by consensus and weighted vote, the reform is only as durable as the states' continued buy-in, which now hinges on how their finances are protected after the cess. The right answer reads the reform as a calculated rebalancing of these tensions, not the elimination of any one of them.

THE DIAGRAM IN WORDS

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Old four slabs -> disputes + inverted duty + high compliance cost -> 56th Council, Sep 2025 -> GST 2.0: 0, 5, 18 plus 40 -> cess ends -> bet on consumption + compliance to lift buoyancy -> protect state finances via the GST Council -> simpler, more durable GST
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WAY FORWARD

1. **Prove the buoyancy bet.** Track whether the lower rates lift **consumption** and **compliance** enough to offset the short-term revenue loss, and be ready to fine-tune the 5 and 18 per cent bands if collections drift well below the **Revenue Neutral Rate**.
2. **Rebuild the state safeguard.** With the **compensation cess** gone, design a transparent revenue-sharing or shortfall mechanism through the **GST Council** so that no state is left worse off, preserving the cooperative-federalism compact.
3. **Finish the inverted-duty cleanup.** Use the converged rate structure to correct the remaining cases where inputs are taxed above outputs, releasing working capital in sectors such as textiles and fertiliser.
4. **Complete the unfinished agenda.** Resolve residual classification disputes, and over time bring items still outside GST, notably **petroleum** products, into the net so the base broadens and the case for even fewer slabs can be considered on firm revenue footing.

PYQ LINKAGE AND PRACTICE

GST is a recurring GS3 theme. UPSC has asked about the rationale and structure of GST as an instrument of fiscal federalism and about resource mobilisation. The **Article 279A** Council and the idea of cooperative federalism have also surfaced in polity-economy overlap questions, which the **GST 2.0** redesign makes freshly examinable.

Practice question: "GST 2.0 has simplified the rate structure and ended the compensation cess. Examine whether this reform can raise revenue buoyancy while protecting the fiscal autonomy of the states." Discuss. (250 words, 15 marks)

Sources: Business Standard opinion, GST Council

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