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Latest GST Reforms and its Impact on the Indian Automobile Sector

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ABSTRACT

This study examines the recent, major reforms in the Goods and Services Tax (GST) framework in India (referred to as "GST 2.0") and analyzes their immediate and projected impact on the Indian automobile sector. The latest changes, effective from September 2025, represent a significant tax rationalization by simplifying the previous multi-rate structure (including 12% and 28% slabs plus cesses) into a clearer framework, primarily featuring 5%, 18%, and a new 40% rate for luxury goods. The reform's most profound impact is on affordability and demand stimulation in the mass-market segments. GST on small cars (under 4m, specific engine capacities) and two-wheelers ($\leq 350\text{cc}$) has been reduced substantially from 29-31% to 18%. This tax cut is designed to lower on-road prices, boost first-time buyers, revive the entry-level segment, and particularly drive consumption in rural and semi-urban markets, as evidenced by initial reports of surging bookings during the festive season. The latest GST reforms However, even with simplification, there are several potential disadvantages, particularly for specific sectors, businesses, and consumers during the transition phase. The long-term sustainability of this growth and its full translation into higher Input Tax Credit (ITC) utilization and fresh capacity investments warrant continuous monitoring.

Key words: GST, Manufacturing, Auto sector, indirect tax.

Introduction

Defining GST and the Auto Sector the Goods and Services Tax (GST), implemented in 2017, is a unified indirect tax that replaced a complex structure of Central and State taxes (like Excise Duty, VAT, etc.) in India. The automobile sector is one of the pillars of the Indian economy, contributing significantly to manufacturing, employment (supporting over 3.5 crore jobs directly and indirectly), and GDP. Context of the Latest Reforms For years, the auto sector has operated under one of the highest effective tax rates, combining a 28% GST with a variable Compensation Cess (up to 22%), resulting in total tax incidence as high as 50% for large vehicles. The latest reforms, announced by the Government and effective from September 22, 2025 (as per the search results), represent a major rationalisation aimed at simplifying the tax structure, boosting consumer demand, and enhancing the "Make in India" initiative. Core Thesis of the Reform The primary goal of the latest 'GST 2.0' rationalisation is to make mass-market mobility affordable while simplifying the taxation for all other segments by removing the complex cess structure.

Research methodology

The study adopts a descriptive and analytical research design. It is analytical because it examines the established policy changes (the new GST 2.0 structure) as the independent variable and assesses its immediate and projected impact on the Indian automobile sector (the dependent variable). The methodology involves a comparative analysis of the tax structures (pre and post-September 2025) and the interpretation of industry-reported sales data.

Period of Study the study primarily focuses on the period immediately surrounding the GST rate rationalization, specifically:

- Historical/Pre-Reform Period (2017 – August 2025): To establish the high-tax context and persistent issues (e.g., cascading taxes, classification disputes).
- Post-Reform Period (September 2025 onwards): To analyze the immediate impact on pricing, initial consumer response, and short-term sales data.

Nature and source of data

Secondary source of information.

- SIAM (Society of Indian Automobile Manufacturers): monthly & annual production, domestic sales, exports, vehicle segment breakdown (2010–2025).
- FADA / Vahan / Ministry of Road Transport & Highways (MoRTH): registration-level or aggregate registration data (monthly).
- GST Council notifications & CBIC circulars: exact dates, rates, cess schedules, classification rules (2017 & 2025).
- OEM financial reports (Maruti Suzuki, Hyundai, Mahindra, Tata Motors, Hero, Bajaj Auto): quarterly/annual revenue, margins, volumes, model mix.
- CMIE, CEIC, RBI: macro controls (GDP growth, CPI, interest rates, fuel prices).

- Industry publications (CRISIL, ICRA) and news (ET, TOI, Reuters) for event dates and qualitative context.

Data frequency & panel structure

- Monthly is preferred for sales/registrations (2016–2025). Use firm-model-month panel where possible. Quarterly for financials. Use cross-section: models / vehicle categories / states.

OBJECTIVES OF THE STUDY

- To analyze the structural changes introduced by the latest Goods and Services Tax (GST) reforms (GST 2.0), effective September 2025.
- To critically compare the Old Effective Tax Rate (GST + Cess) with the New GST Rate for various segments of the Indian automobile sector.
- To assess the advantages of the new GST structure in terms of affordability, demand stimulation, and policy simplification for the mass-market segment.
- To identify the disadvantages and potential challenges, including the impact on the premium/superbike segment and dealer inventory management, arising from the latest GST reforms.

GST and the Indian Auto Sector (2017 - 2025)

The Goods and Services Tax (GST), introduced on 1 July 2017, was one of India's most significant indirect tax reforms. It subsumed a complex web of central and state taxes — such as excise duty, VAT, service tax, and octroi — into a single, unified tax system. For the automobile sector, one of India's largest manufacturing and employment-generating industries, GST had transformative implications.

By 2025, with the GST 2.0 reforms (effective September 2025), India's tax structure for automobiles has evolved toward a simpler, more rationalized, and EV-friendly system aimed at improving affordability, compliance, and competitiveness.

Phase	Time Period	Key Feature	Tax Structure (Effective Rate Example)	Impact
Phase 1: Implementation	July 2017	Replacement of all cascading Central and State taxes. Introduction of Compensation Cess.	Small Cars: $\approx 29\% - 31\%$	Eliminated cascading 'tax-on-tax' effect; simplified inter-state logistics. Initial price cuts for some models.
Phase 2: EV Focus	2019 onwards	GST Council reduced the tax on Electric Vehicles (EVs) to a highly concessional rate.	EVs: 5%	Strong policy signal to promote green mobility and adoption of EVs.
Phase 3: The Reform ('GST 2.0')	Announced in 2025	Major rationalization into a simplified 3-rate structure (5%, 18%, 40%) and the abolition of the Compensation Cess for most categories.	Small Cars: 18%	Large-scale price reduction for mass-market vehicles; structure simplification for luxury segment.

GST (rolled out 1 July 2017) replaced many indirect taxes and created a new tax structure for vehicles (GST slabs + a separate “compensation cess” for higher-end cars/SUVs). This changed prices, input-tax credit flows and compliance costs for OEMs, suppliers and dealer. Two major regulatory shocks overlapping the GST period were: Bharat Stage–VI (BS-VI) emission implementation (April 1, 2020) and the COVID demand shock (2020). Both materially altered vehicle costs and sales trends, complicating attribution of impacts to GST alone from 2017→2024 the market saw uneven demand (pre-2020 slowdown, 2020 collapse, and post-2021 recovery). By 2024–25 EV policy and incentives (FAME-II, later extensions) plus tax changes materially shifted the sector’s direction. A major GST redesign (“GST 2.0”) implemented in Sept 2025 substantially altered car taxation (cutting GST on many sub-4m cars to 18% and abolishing the compensation cess), producing an immediate boost to festive retail in late-2025 — evidence that tax rate changes have direct short-term demand effects.

GST plus the compensation cess created higher effective tax on larger vehicles. For many buyers the net out-of-pocket changed (sometimes higher, sometimes lower) relative to the pre-GST mix because the cess sat outside regular GST slabs. This influenced buyer preference toward smaller cars and certain fuel types. Input-tax credit (ITC) and cascading effects GST's core benefit — a nation-wide ITC chain — reduced tax cascading for many inputs, improving cost transparency across OEMs and suppliers. However, transitional and compliance complexities (matching invoices, registration requirements for many parts suppliers) raised short-term operating costs and compliance burdens. Segmental demand shifts: Higher taxation (cess) on large SUVs/luxury cars and lower relative rates for smaller cars contributed to continued strong demand for compact cars and entry-level SUVs (pre-2025). The removal of the cess and rate reductions in 2025 (GST 2.0) quickly reversed some of that price signal, boosting purchases in the short term. Dealer and supply-chain effects: Dealers faced cash-flow and accounting changes (GST credits, return filings). Supplier registration and compliance meant more formalization of Tier-2/Tier-3 vendors — beneficial long run, painful short run. Exporters could reclaim IGST/benefits but the paperwork burden increased. Used cars and after-market: GST's treatment of services and some auto parts changed after-sales service pricing and tax structure for accessories; the used-car market remained largely outside GST but was influenced indirectly via new-car price changes and demand substitution. EVs and concessional GSTEVs were given concessional treatment (lower GST) in recent reforms to encourage adoption. Combined with FAME-II demand incentives (2019–2024) this materially improved the affordability equation for electrics.

Auto Production & sales trends, SIAM data show the expected collapse in 2020 and recovery thereafter; India's production/sales have been volatile across 2019–2022 and into 2023–25 with variable month-to-month patterns. (SIAM is the primary source for vehicle statistics). Emission regulation cost impacts-VI implementation raised per-vehicle costs (especially diesel), shifting fleet mix away from diesel post-2020. ICCT analysis documents the diesel share fall and cost implications for manufacturers. Tax reform demand response, Media & dealer group reports show a strong short-term uplift in retail activity immediately following September 2025 GST changes (festive season spikes reported by FADA and OEMs). This underlines tax elasticity of purchase timing.

The Latest GST Structure (Effective September 2025)

The latest reforms have consolidated the tax structure for most vehicles into two primary slabs by simplifying the rate and, critically, removing the variable Cess for new vehicle sales:

Vehicle Category	Old Effective Tax Rate (GST + Cess)	New GST Rate (No Cess)	Price Impact
Small Cars (<4m, Petrol <1200cc, Diesel <1500cc)	≈29% - 31%	18%	Significant Price Reduction (≈8.5% - 13% cut on ex-showroom)
Two-Wheelers (≤350cc)	≈28%	18%	Significant Price Reduction (Boost for commuter segment)
Commercial Vehicles (Buses, Trucks)	≈28%	18%	Substantial Price Reduction (Boost for logistics sector)
Luxury Cars, SUVs (>4m, large engine)	≈43% - 50%	40%	Moderate Price Reduction/Simplification (Lower total tax incidence due to Cess removal)
Tractors/Agri-Vehicles	≈12%	5%	Major Price Reduction (Support for rural/farming sector)
Electric Vehicles (EVs)	5%	5%	No Change (Concessional rate maintained)

Simplified Slabs, The number of main GST slabs is reduced. Earlier there were 4 main slabs: 5%, 12%, 18%, and 28%. Now it's mostly 5%, 18%, plus a 40% slab for “luxury/sin goods”. The 28% & 12% slabs are largely being phased out / merged. Items in 28% are mostly moving to 18%, and many in 12% to 5%.

Elimination of Compensation Cess for Automobiles, Earlier, many vehicles (especially larger ones, luxury, SUVs) were taxed via GST + an additional “compensation cess” (sometimes 17-22%) which pushed their effective tax up (in many cases close to ~45-50%). Under GST 2.0, that separate cess is removed for automobiles.

Definition & Criteria, There are specific criteria for “small cars” vs “luxury / larger” cars: engine capacity, length (4000 mm threshold), ground clearance in some cases. For example, SUVs, MPVs etc. with engine >1500 cc or length >4000 mm will be hit with the 40% slab.

Initial Sales Data (Post-Reform):

- Tata Motors reported a record monthly passenger vehicle sales (60,907 units) in September 2025, a 47% year-on-year jump, largely attributed to the GST rate cut and festive demand.
- Maruti Suzuki India (MSIL) announced price cuts of up to ₹1.3 lakh on popular models, with price reduction in their small car models like Alto K10 and Wagon R ranging from 8.7% to 24%.
- Initial market sentiment shows a strong increase in customer footfall and bookings, indicating a positive consumer response to lower prices.

Merits of the New GST Reforms

Category	Advantage	Description
Consumer Benefit	Increased Affordability	Massive tax cuts (from $\approx 29\%$ to 18%) on small cars and commuter bikes place vehicles within the reach of first-time and entry-level buyers.
Industry & Demand	Demand Boost & De-stocking	The price reduction is expected to unlock pent-up demand, especially in the entry-level segment, leading to higher volumes and utilization for manufacturers.
Simplification	Elimination of Classification Disputes	Moving to a simple 18% or 40% slab largely resolves long-standing issues concerning the precise classification of vehicle length, engine capacity, and ground clearance for Cess calculation.
Logistics & Trade	Lower Cost for CVs	The rate cut for Commercial Vehicles (Trucks, Buses) to 18% reduces the capital cost for fleet operators, which should lower freight rates and improve overall supply chain efficiency.
Ancillary Industry	Uniform Tax on Auto Components	Standardization of GST on most auto parts to 18% simplifies the supply chain, reduces inventory complexity, and could lower long-term service and repair costs.
Policy Certainty	Support for Green Mobility	Retention of the 5% GST on EVs solidifies the government's long-term commitment to electric mobility, providing predictability for manufacturers' investment plans.

5. Demerits of the New GST Reforms

Category	Disadvantage	Description
High-End Bikes	Increased Tax for 350cc+ Bikes	Motorcycles with an engine capacity greater than 350cc (e.g., premium cruisers and superbikes) have seen their tax rate jump from $\approx 28\%$ to 40% , making them significantly more expensive.
EV Competitiveness	Reduced Tax Arbitrage for EVs	With the price of traditional Internal Combustion Engine (ICE) small cars falling drastically, the price gap between an entry-level ICE vehicle and an EV narrows, potentially slowing EV adoption in the mass market.
Dealer Transition Issues	Inventory Cost for Dealers	Dealers who had stock purchased at the old, higher tax rates prior to September 22, 2025, faced challenges in selling them at the new, lower prices, leading to immediate losses or inventory clearance issues.
Revenue Loss	Government Revenue Impact	While the reform boosts consumption, the immediate reduction in the effective tax rate across major segments will lead to a short-term reduction in GST revenue collected by the government.
Luxury Segment	Slab Remains High	Although simplified, the 40% slab for larger vehicles and SUVs remains a relatively high tax rate, continuing to classify these vehicles as "luxury/sin goods" and keeping their overall cost elevated.

Conclusion

Between 2017 and 2025, GST transformed the Indian automobile sector from a fragmented, tax-heavy ecosystem into a more unified, efficient, and consumer-friendly market. While the initial GST phase (2017–2020) faced transitional challenges, the GST 2.0 reforms in 2025 mark a new phase of rationalization. The simplified structure, reduced rates on affordable vehicles, and continued EV incentives are expected to boost sales, local manufacturing, and green mobility, positioning India's auto industry for sustainable growth in the coming decade. This research concludes the GST 2.0 reforms (effective Sept 2025) are largely positive for the auto sector. The tax on small cars and two-wheelers was cut from $\approx 29\%$ to 18% , boosting mass-market affordability and demand, as evidenced by record festive sales. The new structure simplifies compliance by largely eliminating the Compensation Cess, aiding the logistics and ancillary industries. However, the 40% tax on high-end bikes ($\geq 350\text{cc}$) and the reduced price gap for EVs pose key challenges

to adoption and premium growth. Entry-level hatchbacks (small cars) could see price reductions of ~8.5%. Larger sedans / compact SUVs (just above the small-car thresholds) might see smaller price drops (but still positive), as their tax rate shifts from earlier high cess + GST to flat 40%. Premium SUVs / large MPVs might see ~6-7% price cut (even though they now are in the 40% slab, because earlier cess + GST made their burden higher than 40%).

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