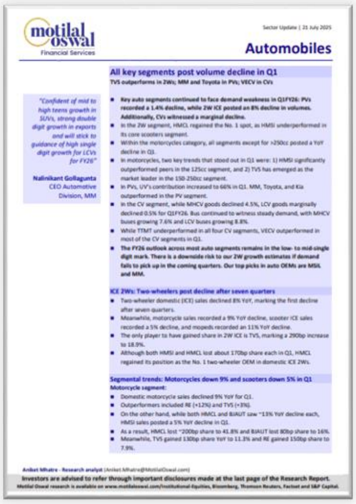
Sector Update | 25 August 2025

Automobiles



GST 2.0: Proposed rationalization likely before festive

Definition of 'luxury' to determine potential beneficiaries

We hosted a GST expert on 25th Aug'25 to understand his views on the proposed GST rate rationalisation and some of the impending dynamics around its implementation. Here are a few notable points highlighted by the expert:

- **The GST Council is expected to meet on 3rd-4th Sep'25 to finalize the new rate structure. If finalized, the new rates can be notified in a few days.**
- **This GST Council meet is likely to have been preponed to ensure that the industry does not lose the crucial festive season sales (beginning in Sep'25).**
- **The cess, which is likely to have been levied to compensate states, could be discontinued as the five-year window agreed for the cess had expired long ago.**
- **The losses to the government on account of this rate rationalization are likely to be funded by: a) expectations of a marked rise in consumption after this rationalization, and b) a potential rise in taxes for certain categories of sin goods like tobacco.**
- **It is highly possible that SUVs and premium 2Ws (350cc and above) are likely to be classified as luxury, and hence may fall under the 40% GST rate.**
- **It remains to be seen whether or not the government introduces an anti-profiteering clause on OEMs to ensure the rate cut benefit is passed on to consumers.**
- **Segmental beneficiaries include small cars (SUVs likely to be taxed higher) and 3Ws and CVs (as benefits for 2Ws would be partially offset by ABS mandate).**

We will wait for the final guidelines before changing our estimates and recommendations. Our top OEM picks in the sector remain Maruti Suzuki, Hyundai India and M&M, and our top auto ancillary picks are Endurance, SAMIL and Happy Forgings.

Key takeaways from expert session

Overview

- Currently, GST operates in four slabs of 5%/12%/18%/28%. The auto sector in general falls in the 28% slab with an additional compensation cess based on various classifications, pushing tax rates higher.
- The Finance Ministry has recently proposed a simplified GST rate structure, in which it seeks to remove the 28% (merge it with 18%) and 12% slabs (merge it with 5%) and keep a 40% peak slab for few "sin goods".
- If this were to be approved, the 18% slab would contribute to the majority of GST collections (80%), 5% would be for essential goods and 40% for a few sin goods.

What could be the potential timelines?

- As of now, the GoM has approved this three-slab structure, which will now have to be approved by the GST Council, which is scheduled to meet on 3rd-4th Sep'25. The GoM's approval would also indicate that a lot of groundwork has already taken place to ensure a smooth implementation by the government.
- As per the expert, the GST Council meeting, which was scheduled for the third week of Sep'25 earlier, seems to have been preponed to ensure that in case there is a need to deliberate one more time, another meeting can be held in the third week of Sep'25.
- Once this proposal is passed by the GST Council, the rate change can be notified in a few days and the implementation date can be announced.

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- Thus, there is a high likelihood that the decision is likely to be taken before this year's festive season, which would also mean that OEMs would not lose out on festive sales.

What about cess compensation to states?

- With the GST rate rationalization, there is a high probability that the cess levied as compensation to states is likely to be discontinued.
- When the GST was implemented, the Central Govt had promised states that they would be compensated for their loss from the new regime via cess over a period of five years after the GST implementation.
- This five-year window had already expired in 2022 and there was an extension given for a further period to collect cess until Mar'26.
- Thus, the government is likely to consider discontinuing the cess with this major reform.

How is the government likely to fund the revenue deficit?

- The losses at the government level on account of this rate rationalization are likely to be funded by: 1) expectations of a marked rise in consumption after this rationalization, and 2) possibility of a rise in taxes for certain categories of sin goods like tobacco.
- It remains to be seen how would the Central Government looks to compensate States for the potential revenue loss

Auto: Segment-wise rates expectations

- The auto sector broadly attracts a 28% GST rate currently.
- However, cess was levied based on various sub-segments. For example, in the PV segment, small cars (diesel-petrol engines less than 1200cc and length less than 4m) had a 28% GST and a 1% compensation cess, bringing the total to 29%. Similarly, sedans are taxed at 31%, hybrids at 43%, MUVs/XUVs at 48%, and SUVs at 50%. EVs were taxed at 5% and tractors at 12%.
- These rates were based on various classifications of engine size, vehicle length, ground clearance, etc. Further, GST rates were different depending on fuel types, i.e., petrol, diesel, hybrid, EVs, etc. These different rates led to lot of confusion. For instance, strong hybrids and mild hybrids were taxed differently.
- The current proposal would lead to a convergence of these rates, making the model simpler to understand – 5% for EVs and tractors, most of the auto segments (including small cars, 2Ws up to 350cc, 3Ws and CVs),which today attract 28% would reduce to 18%, and luxury vehicles likely to remain categorized in the higher 40% slab.
- It is expected that SUVs, which currently attract GST rates between 43% and 50%, would now fall under the new 40% rate. If the cess is removed, then even SUVs are also likely to benefit from the GST rate cut, albeit to a lower extent compared to other segments like cars, 2Ws, 3Ws, etc.
- In case of 2Ws, deliberations are on as to whether to classify the >350cc motorcycle segment as luxury and move it to the 40% GST rate. It is not clear how the government will define "luxury" (whether 350cc and above are included or even 250cc and above get included).

- Depending on the above definition, this segment is likely to get impacted as GST rate for the same would rise to 40%.
- In case of tractors, the segment has an inverted duty structure, with the finished goods attracting a 12% rate and the bulk of components falling under the 18% rate. In this segment, the GST rate is likely to be reduced to 5%, under the proposed new structure.

Factors to watch out for

- Currently, fleet operators have two options for GST – i) 5% without input tax credit (ITC), or ii) 12% with ITC. If the government mandates a 5% fixed rate without ITC, then operators who opt for 12% would lose out on the tax credit. It needs to be seen where this rate settles for fleet operators.
- There is another adverse impact that could arise due to this rate rationalization. A lot of OEMs enjoy state-level incentives, which are based on GST collections by the state from those OEMs. With the reduction in GST collections, it remains to be seen if states look to lower these incentives to OEMs.
- Further, the GST rate rationalization exercise is likely to be successful only if the rate cut is passed on entirely to consumers. If OEMs look to absorb part of this benefit in the form of reduction of discounts, etc., then the full benefit of this move will not be visible. Hence, it remains to be seen whether the government reinstates the anti-profiteering mandate, that has already expired, post the proposed GST rate cut.
- Dealer-level inventory losses after this rate change are likely to be borne by OEMs. However, it is more of a timing issue than a major direct impact. Also, fast-moving models will not be materially impacted by this move as they would get liquidated soon. However, slow-moving models may see some impact as there could be inventory of these models in the system, which will be compensated over a period.
- There will just be one cut-off date for the new GST structure to be implemented. OEMs would need to accordingly target to liquidate old stock.

Exhibit 1: Segment-wise current GST rates

Segments	Sub segments	GST	Cess	Total
PVs petrol, CNG, LPG	❖ Up to 4 mtr and up to 1200cc	28	1	29
PV diesel	❖ Up to 4 mtr and up to 1500cc	28	3	31
PV	❖ Up to 1500cc	28	17	45
PV	❖ above 1500cc	28	20	48
PV	❖ >4mtr and >1500cc and >1700mm ground clearance	28	22	50
PV hybrid	❖ Up to 4mtr and 1200cc petrol	28	0	28
PV hybrid	❖ above 4mtr or above 1200cc petrol	28	15	43
Two Wheelers	❖ up to 350cc	28	0	28
Two Wheelers	❖ >350cc	28	3	31
Three Wheelers		28	0	28
CVs	❖ 10-13 seater	28	15	43
CVs	❖ > 13 seater and CV goods	28	0	28

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