



Case For Rationalising the GST Structure on Carbonated Beverages

Economic Rationale and Fiscal Impact

Carbonated beverages¹ suffer GST at the top rate of 28% and are further saddled with compensation cess of 12%, resulting in an aggregate tax rate of 40%. The GST impact is unaffected by considerations such as sugar or fruit content and appears to be lacking in a sound determining principle. Whilst the non-alcoholic beverage industry has been a significant contributor to the economy in terms of investments, employment and value addition, the GST structure has hindered the way in which the industry can grow (and, by extension, its positive spillovers to the economy).

This paper examines the current GST structure on carbonated beverages and outlines the potential for growth arising from a rationalisation of the GST structure.

This paper is divided into 5 sections -

Section I – Current Tax Treatment of Carbonated Beverages

Section II - Fillip to Industry Growth through Rationalisation of GST Structure

Section III – Analysing the Fiscal Impact of Rationalisation

Section IV - Conclusions and Recommendations

Section I – Current Tax Treatment of Carbonated Beverages

There are two aspects to the current GST structure applicable to carbonated beverages: (i) the top GST rate of 28%; and (ii) the compensation cess of 12%. We consider both of these aspects in turn.

28% GST Rate: The 28% GST rate was created for ‘sin’ goods i.e., goods / services which the government considered to be luxury items or as having a deleterious impact to consumers. In the case of carbonated beverages, both of these underlying assumptions seem to be inapplicable. The consumption pattern for carbonated beverages shows a marked shift towards low and medium-income group consumers. Furthermore, carbonation is a process of preservation that is not harmful to health. Volume-wise, carbonation comprises only between 0.3 – 0.6% of the beverage. Also, it may be noted that currently soda/ aerated waters, not containing added sugar or other sweetening matter or flavour² are currently taxed at a lower rate of 18%. If the issue is high content of sugar, then it is unclear why other products with high sugar content are taxed at significantly lower rates such as sugar confectionary products (5% GST), chocolate (18% GST), ice cream (18% GST), etc.

Additional Compensation Cess: Compensation cess was introduced as a temporary measure to compensate states for revenue loss on account of implementation of the GST regime. The category of goods attracting compensation cess includes chewing tobacco, pan masala,

¹ Note: In this report the term ‘carbonated beverages’ includes all non-alcoholic beverages currently taxed at 40% (28% GST + 12% compensation cess)

² Waters, including natural or artificial mineral waters and aerated waters, not containing added sugar or other sweetening matter or flavoured – taxed at 18% GST



pollution causing coal and briquette. It seems wholly discriminatory and inappropriate to club carbonated beverages along with this category of undesirable goods for the purposes of levy of compensation cess over and above the highest GST rate of 28%. It may also be noted that there are luxury goods like air conditioners are taxed at 28% GST without the additional 12% compensation cess.

Section II – Fillip to Industry Growth through Rationalisation of GST Structure

The current GST structure has deterred the industry from growing to its full potential and has had a host of other undesirable consequences such as disproportionately laying the GST burden on lower-income groups, encouraging sales of spurious / counterfeit products that are not only harmful but also escape the tax net, eliminate scope for investment in research and product innovation, etc. This section now considers the benefits that may stem from a more rational GST structure for carbonated beverages.

- **Growth of Investment:** The non-alcoholic beverage industry has already made significant investment in various parts of the country. Reduced indirect tax on output can promote further investments by the industry (which should translate to additional spillover effects to the economy) and encourage the entry of new players and start-ups in the segment. Given the appropriate impetus, the industry estimates a planned investment of ~INR 83,000 Cr. (~\$10 Bn) in over the next 5-6 years.
- **Consumer Savings:** A decrease in the GST applicable to carbonated beverages can translate into consumer savings which can help in increasing expenditure in other sectors. As per the latest Household Consumption and Expenditure Survey 2022-23 (HCES)³, out of every INR 100 of Monthly Per Capita Consumption Expenditure (MPCE) spent on food – INR 9.62 and INR 10.64 – is being spent on beverages and processed food by rural and urban India respectively. Beverages and processed food are the highest expenditure category both for rural and urban India.
- **Value Addition:** The FICCI Cascade⁴ study conducted in 2022 estimated an output multiplier of 2.035 and value-added multiplier of 1.971 for carbonated beverages, which speaks to the economic value added in the economy from a per-rupee increase in output in the domestic beverage industry. Value addition will benefit value chain beneficiaries such as farmers⁵ and retailers⁶. Rationalisation of the GST structure will encourage companies to invest in backward linkages with farmers, thus attracting massive investment in supply chain and value chain infrastructure. As per industry estimates, with the incremental output produced – the total output produced by all industries in response to

³ https://www.mospi.gov.in/sites/default/files/publication_reports/Factsheet_HCES_2022-23.pdf

⁴ FICCI Cascade-TARI: Illicit Markets A Threat to our National Interests (2022)

⁵ As per the 2022 ICRIER Report, farmers in the supply chain generate approx. 50 – 75% of income from fruits supplied to non-alcoholic beverage companies

⁶ The Confederation of All India Traders (CAIT) estimates that non-alcoholic beverage sales constitute 30% of total sales for small retailer / kirana stores.



the incremental output of the carbonated beverages industry will be INR 2,970 Cr in 2025 and reaching INR 6,373 Cr. in 2030. The estimate of the additional value added to the product or service as a result of this economic activity will be INR 2,876 in 2025 to reaching INR 6,172 in 2030.

- **Employment / Job Multiplier:** The Input-Output model estimates that for every INR1 crore of output produced in the non-alcoholic beverage sector, a total of 8.9 additional jobs are created in the economy on account of direct and indirect linkages⁷. Various studies have estimated that every job created in manufacturing has a multiplier effect in creating 2–3 jobs in the services sector⁸. As per our estimates, the incremental job creation on account of the incremental industry output will range from c. 56,000 jobs in 2025 and increasing to more than 1,20,000 jobs in 2030.
- **Tax Multiplier:** A tax multiplier captures the net impact of change in tax revenue pursuant to a change in tax rate on nominal output. Based on a GST Multiplier of 1.08⁹, this would lead to an immediate increase in GDP and the multiplier effect will mean that GST will be payable on the increased GDP as well. Assuming this GST multiplier, a GST reduction of 12% on carbonated beverages would lead to an immediate increase in GDP by about INR 1,899 Cr. to 3,912 Cr. for the period between 2025 – 2030.
- **Improving compliance and tax base:** A large number of sellers are not registered for GST or are under the composite scheme albeit their share in overall value is not particularly large. A reduction in GST rate could nudge increase in compliance and a broadening of the tax base, which in turn could lead to reductions in leakages and evasion. As per industry estimates, leakages in GST collections are currently in the range of approx. 20% annually, which the industry believes can come down to approx. 15% in the short-medium term following a rationalisation exercise.

Section III – Analysing the Fiscal Impact of Rationalisation

When forming an assessment as to the fiscal impact of a rationalisation exercise on the GST structure applicable to carbonated beverages, the following points may be kept in mind:

- GST revenue collection for the sales/output for the 'Business As Usual' (BAU) scenario (at 40% tax rate) and increased sales/output at 28% GST are calculated to estimate revenue impact.
- Industry estimates that a reduction in the GST rate by 12%/removal of compensation cess will spur demand and enable the industry to grow at a higher rate of ~24% year-on-year, which in turn will create room for more output to be taxed.
- The industry is expected to fully pass on the benefit of tax reduction to the end consumer in the form of reduction in MRP in line with the anti-profiteering clause.

⁷<http://in-beverage.org/wp-content/uploads/2023/08/Final-Report-ICRIER85.pdf>

⁸<https://www.cii.in/sectors.aspx?SectorID=S000000001>

⁹https://www.nipfp.org.in/media/medialibrary/2014/02/WP_2013_125.pdf



- The price elasticity of demand for carbonated beverages is estimated to be around $(1.6)^{10}$ which means that demand for such products is elastic and highly sensitive to price changes i.e., with reduction in prices on account tax reduction the demand will increase. Interestingly, it has been observed that the price elasticity for low and no sugar carbonated beverages was much higher – showing higher sensitivity of demand to price.
- With a substantial part of the carbonated beverage industry being informal/unorganised, reduction in GST can help to plug tax leakage from the current range of approx. 20% annually to approx. 15% annually in the short-medium term.
- Reduction in GST can be regarded as creating consumer savings that can be deployed on other products. This is where the tax multiplier becomes relevant. Using a GST multiplier of 1.08^{11} , there would be an increase in GDP through increased expenditure, which in turn will attract tax.
- It is currently estimated that the industry will invest an additional ~INR 83,000 Cr. (\$10 Billion) for the period between 2025-2030¹². The industry is bullish that rationalisation of GST will give a further impetus to investment by existing players and new entrants.
- The increased investments by the industry will include capital expenditure on plant and machinery, capital goods and manpower, which will attract GST at 18%.

When these factors are considered, it is seen that a reduction in GST rate of 12%/removal of compensation cess does not dramatically impact the government revenue – there may be an initial loss (which is estimated to be approx. INR 277 Cr. in 2025), which is followed by a revenue surplus from 2026 onwards ranging from INR 591 Cr. to INR 32 Cr. Overall the revenue impact for the government is minimal and can be considered as a broad revenue surplus or at least neutral with multiple spill over effects for the economy.

Section IV – Conclusions and Recommendations

As mentioned at the very outset, the current GST structure presents two problems: (i) carbonated drinks are treated as ‘sin’ goods and have been placed in the highest GST bracket of 28%; and (ii) carbonated drinks continue to be burdened with a 12% compensation cess. The combination of these factors results in a highly inequitable and discriminatory GST structure that has impaired the growth of the industry and had knock-on effects on other critical sectors that are intimately connected with the non-alcoholic beverage industry.

This paper has articulated the logic to show that apprehensions about GST revenue loss on account of rate rationalisation are unfounded. In fact, the estimate of fiscal impact does not account for further cycles of the multiplier effect, which would invariably translate to even higher benefits to the economy and revenue gains. Also, a more wholesome rationalisation exercise could involve a broad-based review of taxation on food products such as chocolates, sugar-based confectionary items, chips, wafers and other high fat, sugar and salt (HFSS) foods with a view towards lowering the tax to a more equitable rate of 18%, thereby

¹⁰ Pack wise elasticities of all carbonated beverage category products taken as input to estimate price elasticity of demand.]

¹¹ https://www.nipfp.org.in/media/medialibrary/2014/02/WP_2013_125.pdf

¹² Industry Estimates



minimising disparities and ensuring level playing field within this category of food products and broadening the tax base in a way that can allow higher revenue for the government.

In light of the foregoing analysis and findings, it is recommended that the GST Council and the Central Government urgently consider replacing the current 28% GST + 12% compensation cess structure on carbonated beverages with an appropriate lower standalone rate without compensation cess.