

Business Standard

How India's latest cigarette tax hike could boost the illegal market

As cigarette taxes rise sharply from February, sellers say smokers are already switching to cheaper, smuggled brands, exposing how price hikes may reshape India's smoking behaviour

Abhijeet Kumar New Delhi | Jan 16, 2025



Illicit cigarettes already account for 26.1 per cent of India's cigarette market, according to data from Euromonitor International, making India the fourth-largest illicit cigarette market globally in terms of volume. | (Photo: Shutterstock)

When the Centre formally notified a new tax framework for tobacco on the last day of 2025, it framed the replacing of the goods and services tax ([GST](#)) compensation cess with a health and national security cess as a part of a broader restructuring of indirect taxes on so-called 'sin goods', with the government signalling that the overall tax incidence on tobacco will be kept broadly unchanged even as the compensation cess, introduced at the time of the GST rollout, is phased out after serving its purpose.

The intent of the move was clear — to curb consumption and raise revenues. However, it may be strengthening a parallel market of cigarettes that policymakers and enforcement agencies have struggled to contain for a long time.

"Those who want to smoke will smoke. They will just switch," said Vijay Jaiswal, who runs a paan shop near Delhi University's north campus.

But isn't the question that when the legal duty-paid cigarettes see a rise in prices, the prices of illegal, non-duty paid cigarettes also rise, even though not by the makers, but by the sellers themselves?

Jaiswal confirmed that even illegal cigarettes are seeing price increases. "But they will still remain cheaper than regular cigarettes," he added. "Most of these are smoked by young college students who smoke heavily and want cheaper options."

That dynamic of prices rising across the board, but illicit cigarettes remaining cheaper, sits at the heart of a growing concern among analysts, enforcement agencies and policymakers as India prepares for one of its sharpest cigarette tax increases in years.

What is the size of illicit cigarettes in India?

Illicit cigarettes already account for 26.1 per cent of India's cigarette market, according to data from Euromonitor International, making India the fourth-largest illicit cigarette market globally in terms of volume. Industry body Tobacco Institute of India (TII) estimates illicit cigarettes now amount to nearly one-third of legal cigarette volumes.

The share has more than doubled from 12.6 per cent in 2012, a period marked by repeated tax increases and tightening regulations. Industry estimates put the annual tax loss to the exchequer at Rs 21,000-23,000 crore (till 2024).

The government's revised excise structure, coupled with the shift from 28 per cent to 40 per cent GST on cigarettes, translates into an effective 40-50 per cent tax increase on several cigarette categories from February 1, 2026.

But at the retail end, the adjustment has begun earlier.

"Distributors have already increased prices. The packets are costing us more," said Rajesh Kumar, who sells cigarettes near a university hostel in north Delhi. "We are forced to increase prices by two to five rupees per stick even before the new rules come into effect."

Kumar said consumer behaviour is already shifting. "Those who want to smoke will continue to smoke no matter how much the prices increase," he said. "But the young ones, college students especially, will move to Esse Light or Gudang Garam type cigarettes because they are comparatively cheaper."

A price shock with predictable consequences

Brokerage houses tracking listed cigarette companies say the magnitude and abruptness of the tax increase mark a clear break from the calibrated approach followed over the past eight years.

Kotak Institutional Equities described the move as "two steps back", warning that steep price hikes risk undoing the gradual recovery in legal cigarette volumes achieved after FY18. Nomura, in a separate note, pointed to the FY13-18 period, when repeated duty increases failed to lift revenues as legal volumes shrank and illicit trade expanded.

Ravi Singh, chief research officer at Master Capital Services, said higher taxes will almost certainly push up retail prices and trigger an immediate behavioural response. "When prices go up, many smokers, especially price-sensitive ones, tend to cut back or quit rather than pay more," he said.

The impact will not be uniform. "Premium brands might see smaller declines because their customers are less sensitive to price, but mass-market segments will be hit harder," Singh said, adding that lower-income smokers, a large part of the Indian market, are the most likely to reduce consumption or switch to cheaper variants when prices rise sharply.

G Chokkalingam, founder and head of research at Equinomics Research, said the immediate impact would be visible on both volumes and profitability. "Sales volume could be impacted marginally, around 5 per cent, but realisation may also fall as full transmission of the rate hike will impact volumes badly. In the short term, cigarette segment profit could fall 15-20 per cent," he said.

Why illicit cigarettes gain ground when taxes rise

Cigarette demand in India is widely considered price inelastic, but not immune to price shocks. "Demand is quite highly price inelastic, but not perfectly inelastic," Chokkalingam said. "There could be a marginal impact on volumes in the short term, but over the medium term, after two or three quarters, volumes tend to come back to low single-digit growth," he added.

Singh broadly agrees, but flagged a critical caveat. "A structural risk arises only if taxes rise so fast that affordability collapses or if a significant number of users switch to illicit or unregulated alternatives," he said.

For illicit operators, the same dynamics work in reverse. Higher taxes increase arbitrage, TII said. Smuggled cigarettes evade excise duty and GST, allowing them to be sold at significantly lower prices while still delivering higher margins to illegal networks.

Jefferies, citing data from TII, flagged the fiscal asymmetry at the heart of the problem: legal cigarettes account for barely 10 per cent of tobacco consumption but contribute nearly 80 per cent of tobacco tax. Any migration from legal to illicit cigarettes therefore has an outsized impact on revenues.

Which smuggled brands dominate and why they sell

The illicit market is dominated by foreign brands, many of them globally recognisable. Enforcement agencies and industry bodies routinely cite Davidoff, Dunhill, Mond, ESSE, WIN, Black, Ace, Peacock, Paris, and Manchester, among others, as widely available across Indian cities.

These cigarettes are cheaper not only because they evade taxes, but also because they bypass compliance costs. They do not carry the mandatory 85 per cent pictorial health warnings, making the packs visually more attractive to consumers.

Industry studies suggest packaging plays a role in consumer choice. Since the introduction of large pictorial warnings in 2016, according to a study by Indian Market Research Bureau (IMRB), smokers have shown a preference for non-compliant packs, often perceiving them “safer”. Illicit operators have responded by introducing India-specific variants, including ‘paan’-flavoured cigarettes, tailored to local tastes.

The route smuggled cigarettes take to reach consumers

According to TII, smuggled cigarettes enter India through land borders, sea cargo, air freight and courier routes. The India-Myanmar border in the Northeast has emerged as a key gateway, with frequent seizures reported from Mizoram and adjoining states. The Assam Rifles has flagged cigarette smuggling as a major concern along the porous border.

From entry points, cigarettes move through informal wholesale networks before reaching paan shops and small retailers, where transactions are largely cash-based and enforcement is weakest, several media reports have suggested.

When tax hikes turn counterproductive

There is broad agreement among analysts that modest, predictable tax increases are absorbed by the market. The problem arises when hikes become steep and frequent.

“Tax increases work up to a point,” Singh said. “If taxes rise heavily, prices jump sharply, consumers cut back dramatically or switch to untaxed alternatives, and total revenue can plateau or even fall.”

“Any duty increase beyond 10-15 per cent on existing total tax payments risks becoming counterproductive,” the analyst said. While cigarettes can absorb 5-10 per cent increases above inflation without major disruption, steeper hikes year after year could lead to steady de-growth in volumes and a larger illicit market.

International experience offers a cautionary parallel. In Australia, repeated tobacco tax hikes between 2012 and 2020 pushed illicit tobacco from under 2 per cent to about 14 per cent of the market, with organised crime filling the gap as enforcement struggled to keep pace. “Countries like Australia, New Zealand, UK etc. with high taxes on cigarettes, have seen a huge surge in illicit tobacco trade in recent times,” TII said.

What happens next for smokers?

The new excise levies come into effect on February 1, 2026. The risk, as paan shop sellers see it, is not that smokers will stop but that they will keep switching.

“They will smoke,” Jaiswal said, glancing at his display. “Just not what the government wants them to buy.”

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