From Zero to 0.4%: Impact of UPI Merchant Discount Rate (MDR) on Indian Merchants – A Case Analysis of the October 2026 Framework

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ABSTRACT

For almost seven years, shopkeepers in India have been accepting UPI payments without paying any fee to accept them. In September 2026, the Government of India and NPCI changed this system. From 15 October 2026, a new fee structure started. Under this, a 0.4% fee called MDR will be charged on certain shop payments (P2M) above Rs 2,000, with a maximum limit of Rs 300 per transaction for payments of Rs 75,000 and above. Payments between two individuals (P2P), shop payments up to Rs 2,000, small shopkeepers in the P2PM category who receive up to Rs 1 lakh per month, and UPI AutoPay payments will remain free. Essential services will pay a flat fee of Rs 5 and stock market related payments will pay 0.02%, capped at Rs 300. This paper uses a case-study method along with simple calculations based on secondary data to understand how this fee affects different groups - street vendors, small local shops, medium-sized retailers, essential service providers and financial market players. It also explains the roles of RBI and NPCI. The study finds that (i) street and very small vendors are mostly protected from the fee; (ii) the main burden falls on retailers selling high-value goods with low profit margins, where the fee can take away about one-eighth of their profit on UPI sales; (iii) the Rs 2,000 threshold and the Rs 300 ceiling can change customer and shopkeeper behaviour and create uneven impacts; (iv) lower fee slabs protect essential services and small investments; (v) GST charged on this fee can mostly be claimed back as input credit, so the extra tax burden is limited; and (vi) the new income from this fee helps UPI apps and banks but may also make big players even stronger. The paper also compares percentage-based and fixed-fee models, discusses what may happen next, and gives suggestions for shopkeepers, UPI companies, NPCI, RBI and the Government.

Keywords: UPI; Merchant Discount Rate; P2M; P2PM; small merchants; RBI; NPCI; digital payments; payment economics; flat-rate MDR; GST; UPI companies; India

INTRODUCTION

UPI is now the most widely used retail payment system in India. In August 2026 alone, it handled 2,451 crore transactions valued at Rs 29.9 lakh crore (Ministry of Finance, 2026). A major reason for this rapid growth was a policy decision taken at the end of 2019: from 1 January 2020, banks and payment system operators were not allowed to charge any MDR on UPI, RuPay debit cards and UPI QR payments (CBDT, 2019). Because of this, shopkeepers could accept payments for free, while the cost of operating the network was borne by banks, payment service providers and, through government incentive schemes, by the public exchequer.

This arrangement has now been changed. On 14 September 2026, the Government announced new rules under the Payment and Settlement Systems Act, 2007, and on 15 September 2026, NPCI released a circular and FAQs to implement the new MDR system from 15 October 2026 (PayU, 2026; Business Standard, 2026a).

According to the Government, the aim of this framework is to keep UPI free for customers and small vendors while generating revenue to support infrastructure, improve cybersecurity and encourage innovation (Ministry of Finance, 2026). For shopkeepers, however, this means they now have to bear a cost for accepting payments that was zero for many years.

This paper looks at the new framework from the shopkeeper's perspective. It focuses on six main questions:

- RQ1. Which types of transactions and sectors will have to pay MDR, at what rates, and which ones will remain free?
- RQ2. How big is the cost burden for different types of sellers, such as street vendors, small retailers, large merchants, essential-service providers and financial market intermediaries?
- RQ3. What are the roles of RBI and NPCI in creating, monitoring and managing this framework?
- RQ4. What behavioural, competitive and policy-related issues can this framework create, and how can they be handled?
- RQ5. Does MDR lead to a double taxation effect because of GST, and who ultimately bears this cost?
- RQ6. What are the challenges and impacts for UPI companies, and what could be the way forward?

The main value of this paper is practical: it provides a clear classification of where MDR applies and where it does not, an easy-to-understand schedule for calculating fees, and real-life examples of different types of merchants that teachers, students and professionals can easily use and adapt.

Policy Background and How UPI Pricing Has Changed

Before 2020, merchants accepting UPI payments from customers (P2M) could be charged an MDR of up to 0.30% (Entrepreneur India, 2026). Then, the Finance (No. 2) Act, 2019 brought in two important changes. It added Section 269SU to the Income-tax Act, 1961, which made it compulsory for businesses with a yearly turnover above Rs 50 crore to offer certain electronic payment options. It also added Section 10A to the Payment and Settlement Systems Act, 2007, which stopped banks and payment system providers from charging any fee on those payment modes. Following this, CBDT Notification 105/2019 announced that RuPay debit cards, BHIM-UPI and UPI QR codes would be covered under this rule from 1 January 2020 (CBDT, 2019; PwC India, 2020). The Finance Minister at that time said this step was meant to support Indian payment systems over foreign payment gateways (The Tribune, 2019).

The zero-fee policy did not stop the discussion on whether the system was sustainable. In August 2022, RBI released a Discussion Paper on Charges in Payment Systems. In it, RBI said it had not given any directions on UPI fees and asked for opinions from stakeholders on different options, including different pricing based on slabs (RBI, 2022). At that time, the Government said it had no intention of charging any fee on UPI services (Saikrishna & Associates, 2022). A small exception came in April 2023, when NPCI introduced an interchange fee of up to 1.1% on shop payments above Rs 2,000 made through wallets (prepaid payment instruments) using UPI, with different rates for different categories; UPI payments directly from bank account to bank account continued to remain free (The Quint, 2023; IIT Bombay, 2023).

Table 1: Milestones in UPI merchant pricing

Date	Milestone
Before 2020	P2M UPI transactions could attract MDR of up to 0.30% (Entrepreneur India, 2026).
1 Jan 2020	MDR barred on UPI, RuPay debit and UPI QR payments through Section 10A of the PSS Act and Section 269SU / Rule 119AA of the Income-tax framework (CBDT, 2019).
Aug 2022	RBI Discussion Paper on Charges in Payment Systems invites views on cost recovery and tiered charges (RBI, 2022).
1 Apr 2023	NPCI introduces interchange of up to 1.1% for PPI (wallet) based UPI merchant payments above ₹2,000 (The Quint, 2023).

Sep 2025	NPCI raises per-transaction P2M limits to ₹5 lakh (daily ₹10 lakh) in specified categories such as insurance, capital markets, travel and government e-marketplace payments (News on AIR, 2025).
14–15 Sep 2026	Government notification under the PSS Act (14 Sep) and NPCI circular with FAQs (15 Sep) announce the new MDR framework (PayU, 2026; Ministry of Finance, 2026).
15 Oct 2026	Revised MDR framework takes effect.

Source: Compiled by the author from the sources cited in the table.

The main reason given for this change is cost. According to industry estimates shared by the Government, running the UPI system — including servers, internet, fraud prevention and technical support from banks — costs around Rs 20,000 crore every year, and the current government incentive is seen only as temporary support, not a long-term solution (Ministry of Finance, 2026).

RBI's analysis in 2022 had already pointed out that processing a merchant payment of Rs 800 cost the participants about Rs 2 (Kapron, 2026). At the same time, the average transaction amount has been decreasing — it was Rs 1,217 in August 2026 — which makes it difficult to recover costs only through a percentage-based fee without a minimum threshold (Kapron, 2026).

Research Design and Method

This study uses a qualitative and descriptive case-based approach. It is based on secondary data such as the FAQs issued by the Ministry of Finance (Department of Financial Services) on 15 September 2026, reports on the NPCI circular, RBI publications, CBDT notifications and expert commentaries. In cases where a rule has been reported by secondary sources but the original circular was not available for direct verification, the paper clearly mentions that it needs to be verified.

The merchant examples given in Section 6 are not based on real businesses. They are hypothetical cases created to represent typical types of merchants. Their sales volume and profit margins are assumed only for the purpose of illustration, while the MDR rates, limits and caps used are as per the actual framework.

The fees are calculated on the total transaction amount, in the same way as shown in the Government's own examples (Ministry of Finance, 2026). Since the framework will come into effect only from 15 October 2026, this analysis is done beforehand: it estimates the expected impact and does not include any data after implementation.

Institutional Setup: RBI, NPCI and the Financial System

A UPI payment made to a merchant involves several regulated participants. The MDR is not a tax taken by the Government; it is shared among the players in the payment system, such as the merchant's bank, the customer's bank and the payment app providers (Raman Academy, 2026; Ministry of Finance, 2026). Table 2 gives a summary of the role of each participant.

Table 2: Institutional roles in the UPI MDR framework

Institution	**Role in the MDR framework**
Ministry of Finance (DFS)	Notifies the legal change under the PSS Act (14 Sep 2026), funds and designs incentive schemes, and published the official FAQs (Ministry of Finance, 2026; PayU, 2026).

Institution	Role in the MDR framework
Reserve Bank of India (RBI)	Regulates payment systems under the PSS Act; published the 2022 discussion paper on charges; publicly described the framework as an important step towards a sustainable UPI ecosystem and is to be consulted on the small-merchant fund (RBI, 2022; The Tribune, 2026; Ministry of Finance, 2026).
NPCI	Operates UPI. Its UPI and Services Steering Committee decides operational parameters, fee distribution and category caps; issued the 15 Sep 2026 circular and FAQs (Ministry of Finance, 2026).
Acquiring banks, PSPs, payment aggregators	Onboard merchants, classify them (for example P2PM versus P2M), monitor monthly inward credits and apply the notified MDR. Merchants may also face a separate PSP or gateway fee on top of the network MDR (India Policy Hub, 2026).
Issuer banks and UPI apps	Share in the MDR pool; UPI apps are barred from charging consumers any platform or transaction fee (Ministry of Finance, 2026).
Capital-market intermediaries (AMCs, brokers, dealers, investment platforms)	Act as merchants in the capital-market category and receive a concessional 0.02% MDR with a ₹300 cap (Ministry of Finance, 2026).

Source: Compiled by the author from the sources cited in the table.

The MDR Framework: Classification of Transactions and Sectors

P2P, P2M and P2PM

P2P transactions are money transfers between individuals, like transferring money to your own account or splitting bills with friends. These remain completely free for both sender and receiver, no matter the amount (Ministry of Finance, 2026).

P2M transactions are payments made to merchants, and this is the only category where MDR can be charged.

P2PM (Person-to-Person-Merchant) is a category for small shopkeepers who receive UPI payments directly into their personal bank accounts through a QR code. If they receive up to Rs 1 lakh per month, they continue to pay zero MDR and do not need GST registration to be eligible. If their incoming payments cross Rs 1 lakh for three months in a row, they will be shifted to the P2M category (Ministry of Finance, 2026).

Transactions and sectors where MDR applies

Table 3 shows the transactions and sectors where MDR will be charged. The list of sectors is based on the Government's FAQs and news reports; the exact scope of these "specified" categories is to be confirmed from the NPCI circular.

Table 3: Transactions and sectors attracting MDR (from 15 October 2026)

Category / sector	Condition	MDR	Remarks
General P2M (retail, e-commerce, electronics, apparel, restaurants, services and other non-concessional sectors)	Payment above ₹2,000 to a P2M merchant	0.4% of transaction value	Capped at ₹300 per transaction for payments of ₹75,000 and above.

Category / sector	Condition	MDR	Remarks
Railways, telecom services, insurance premiums, fuel	Payment above ₹2,000	Flat ₹5 per transaction	Replaces the 0.4% rate; named expressly by NPCI/Government.
Public utilities (electricity, water, piped gas)	Payment above ₹2,000	Flat ₹5 per transaction	Designated industry-programme category (Ministry of Finance, 2026).
Agricultural inputs	Payment above ₹2,000	Flat ₹5 per transaction	Reported by secondary sources (Insights on India, 2026); verify in circular.
Education fees (school, university, entrance examinations)	Payment above ₹2,000	Flat-fee or capped rate under an industry programme	Exact rate not published as a single headline figure; confirm with the acquiring bank.
Capital markets (mutual funds, securities, stockbrokers, dealers, investment platforms, broker wallet top-ups)	UPI payment to a capital-market entity	0.02% of value	Capped at ₹300 per transaction.

Source: Ministry of Finance (2026); Business Standard (2026a); Insights on India (2026). Compiled by the author.

Transactions and sectors in the no-MDR range

Table 4: Transactions and sectors with no MDR

Transaction / sector	Treatment
All P2P transfers (any amount), including self-transfers	No charge to payer or receiver.
All P2M payments of ₹2,000 or less, in every sector	Zero MDR, including for large merchants and essential sectors. These account for more than 95% of P2M volume (Ministry of Finance, 2026).
P2PM small merchants and street vendors (up to ₹1 lakh a month via UPI QR)	Zero MDR on every credit, whatever the ticket size.
UPI AutoPay / mandates (utility bills, OTT subscriptions, recurring investments)	No prescribed MDR.
Consumers' use of any UPI app	No platform fee or transaction fee may be charged to users.
Credit-linked UPI (RuPay credit card on UPI, pre-sanctioned credit lines)	Outside this MDR; governed by separate credit-product rules (Ministry of Finance, 2026).

Source: Ministry of Finance (2026); Business Standard (2026a). Compiled by the author.

Fee schedule and the effect of the cap

Since 0.4% of ₹75,000 equals ₹300, the cap begins to bind exactly at that value. Beyond it, the effective rate falls as the ticket size rises, which makes the structure regressive in effective-rate terms for very large payments. Table 5 shows the fee for selected ticket sizes and the card benchmark: the Government notes that standard credit-card MDR typically ranges from 1.5% to 2.5% and debit-card MDR is capped at 0.90% (Ministry of Finance, 2026).

Table 5: Illustrative MDR by ticket size (general P2M category unless stated)

Ticket (₹)	UPI MDR (₹)	Effective rate	Flat-₹5 sector (₹)	Debit card at 0.90% (₹)
2,000	0	0.00%	0	18.00
2,500	10.00	0.40%	5	22.50
3,000	12.00	0.40%	5	27.00
10,000	40.00	0.40%	5	90.00
50,000	200.00	0.40%	5	450.00
75,000	300.00	0.40%	5	675.00
1,00,000	300.00	0.30%	5	900.00
2,00,000	300.00	0.15%	5	1,800.00

Source: Author's calculations using the rates and cap in Ministry of Finance (2026). Debit-card figure uses the 0.90% ceiling as an upper benchmark; actual card MDR varies by merchant and ticket size.

Two important points need to be noted here. First, MDR is charged on the entire transaction amount, not just on the amount above Rs 2,000. For example, a payment of Rs 2,000 attracts no charge, but a payment of Rs 2,001 will attract a fee of about Rs 8. Second, for capital market payments, the Rs 300 cap is reached only when the transaction is Rs 15 lakh (0.02% of 15 lakh), but the per-transaction UPI limit for capital market payments is Rs 5 lakh (News on AIR, 2025). So in practice, the maximum MDR for capital market transactions will be around Rs 100.

Percentage-based MDR vs Flat MDR

MDR can be charged either as a percentage of the transaction value or as a fixed amount per transaction. This framework uses both methods and also sets a maximum limit on the percentage rates: 0.4% (with a maximum of Rs 300) for general P2M payments, a flat Rs 5 for essential sectors, and 0.02% (with a maximum of Rs 300) for capital markets (Ministry of Finance, 2026). Table 6 shows how much a merchant has to pay under each type of fee for payments above Rs 2,000.

Table 6: Fee under percentage, flat and capped structures (₹)

Ticket (₹)	General: 0.4% (cap ₹300)	Essential sectors: flat ₹5	Capital markets: 0.02% (cap ₹300)
3,000	12.00	5.00	0.60
25,000	100.00	5.00	5.00
75,000	300.00	5.00	15.00
1,00,000	300.00	5.00	20.00
5,00,000	300.00	5.00	100.00

Source: Author's calculations using the rates in Ministry of Finance (2026). Capital-market payments above ₹5 lakh exceed the specified UPI per-transaction limit (News on AIR, 2025).

Percentage-based MDR:

This type of fee is based on the value of the transaction and the value of the sale for the merchant, and it helps the system's earnings grow as UPI transaction values grow. Its main drawback is that the actual cost of processing a payment does not depend much on the amount. RBI's analysis in 2022 showed that processing an Rs 800 merchant payment cost about Rs 2 (Kapron, 2026), and a payments industry executive mentioned that server cost is around 20 paise per transaction (Dason, 2026).

So, a 0.4% fee on a Rs 50,000 payment, which comes to Rs 200, is much higher than the actual extra cost of processing it, and it affects merchants who sell high-value products with low profit margins the most (Case 3).

Flat-rate MDR

A fixed fee matches the per-transaction cost more closely, gives merchants clarity on what they will pay, and its effective percentage goes down as the bill amount increases. For example, Rs 5 is about 0.17% of Rs 3,000 and only 0.01% of Rs 50,000. Its disadvantages are that it generates less income for the payment system on large transactions, it is not linked to the risk involved in the transaction value, and merchants close to a category limit may try to get themselves classified under the lower-fee category.

Capped percentage (hybrid model)

The Rs 300 cap keeps the percentage-based system for regular amounts but limits the charge on very large payments. This gives large-value sellers more certainty about costs, but the effective percentage goes down as the transaction value increases, as shown in Section 5.4.

Break-even points

The 0.4% rate becomes Rs 5 at Rs 1,250, which is below the Rs 2,000 limit. So any payment that falls under MDR will always be cheaper in a flat Rs 5 sector compared to the general category (where it is Rs 8 or more). The 0.02% rate for capital markets becomes Rs 5 at Rs 25,000: below this amount, investors pay less than Rs 5, and above it they pay more (for example, Rs 20 on Rs 1 lakh). In simple terms, the framework uses flat fees where bill amounts are high but profits are low, and a very low percentage where the goal is to encourage more retail investors to participate.

Case Analysis: Impact on Merchants

Six hypothetical examples show how the framework will work in practice. Each example explains its assumptions, calculates the monthly MDR, and interprets the result.

Case 1: Street tea vendor (P2P-merchant / P2PM category)

A tea vendor sells tea for an average of Rs 30 per cup and makes about 100 UPI sales a day for 26 days. His total monthly UPI income is around Rs 78,000, which is less than the Rs 1 lakh limit for P2PM. So, MDR = Rs 0. Even if his sales increase and cross Rs 1 lakh for three months in a row and he is moved to the P2M category, all his payments are still below Rs 2,000, so they will remain free. Therefore, street vendors are protected both by their category and by their small ticket size. The only practical risk is wrong classification by banks, so vendors should make sure all QR payments come into one correctly tagged account.

Case 2: Neighbourhood grocery (Kirana) store

The store gets Rs 4 lakh a month through UPI with an average bill of Rs 250, and has about 10 bulk orders of Rs 2,500 during festivals. Only the bulk orders will attract MDR: 10 x (0.4% x Rs 2,500) = Rs 100 per month,

which is about 0.025% of its total UPI income. This amount is very small, so there is no reason for the store to discourage UPI payments. This supports the Government's statement that more than 95% of P2M transactions are below the threshold (Ministry of Finance, 2026).

Case 3: Mid-sized electronics retailer

This retailer makes 300 UPI sales a month with an average bill of Rs 18,000, so total UPI sales are Rs 54 lakh. MDR per sale is 0.4% x Rs 18,000 = Rs 72, which comes to Rs 21,600 per month (Rs 2.59 lakh per year). If his net profit margin is 3%, his profit on this turnover is Rs 1.62 lakh, so MDR takes away about 13% of his net profit from UPI sales. Since merchants cannot charge MDR to customers (Ministry of Finance, 2026), this cost has to be absorbed or covered through discounts from suppliers. For comparison, a 0.90% debit card MDR on the same sales would be Rs 48,600 and a 1.5% credit card MDR would be Rs 81,000. So UPI is still cheaper than cards, but the retailer is now moving from a zero-cost to a paid system – this is the biggest relative impact among all cases.

Case 4: Jeweller with high-value sales

A jeweller makes 40 UPI sales a month of Rs 90,000 each (Rs 36 lakh total). Since each sale is above Rs 75,000, the cap applies: 40 x Rs 300 = Rs 12,000 per month, which is an effective rate of 0.33%. If the bill is Rs 2 lakh, the effective rate would drop to 0.15%. The cap gives cost certainty to high-value sellers, but it also means that a high-ticket seller pays a lower percentage than a mid-ticket seller in Case 3, which is a regressive feature as noted in Section 5.4.

Case 5: Petrol pump (essential sector)

A petrol pump receives 1,500 UPI payments per month above Rs 2,000, with an average of Rs 3,000 (Rs 45 lakh total). Under the general rate, the fee would be Rs 12 per sale, or Rs 18,000 per month. Under the concessional flat rate of Rs 5, it is 1,500 x Rs 5 = Rs 7,500 per month, saving Rs 10,500, with an effective rate of about 0.17%. Fuel business has very low margins, and this concession keeps UPI cheaper than cards. The same benefit applies to railway tickets, mobile recharges, insurance premiums and utility bills above Rs 2,000.

Case 6: Online broker / mutual fund platform (financial markets)

An investment platform gets 10,000 UPI payments per month averaging Rs 25,000 (Rs 25 crore total). At the capital market rate of 0.02%, each payment costs Rs 5, so monthly MDR is Rs 50,000. Under the general 0.4% rate, it would have been Rs 100 per payment, or Rs 10 lakh per month. So the concessional rate is twenty times cheaper, which matches the stated aim of encouraging more retail investors to enter formal financial markets (Ministry of Finance, 2026). Small SIP investments done through AutoPay do not attract any MDR at all.

Table 7: Summary of merchant cases

Merchant (hypothetical)	UPI receipts / month	MDR rule applied	Monthly MDR (₹)	Effective rate on UPI receipts
1. Street tea vendor	₹78,000	P2PM / ≤₹2,000	0	0.00%
2. Kirana store	₹4,00,000	0.4% on 10 bulk orders	100	0.03%
3. Electronics retailer	₹54,00,000	0.4% (no cap)	21,600	0.40%

Merchant (hypothetical)	UPI receipts / month	MDR rule applied	Monthly MDR (₹)	Effective rate on UPI receipts
4. Jeweller	₹36,00,000	₹300 cap	12,000	0.33%
5. Petrol pump	₹45,00,000	Flat ₹5	7,500	0.17%
6. Investment platform	₹25,00,00,000	0.02%	50,000	0.02%

Source: Author's calculations on assumed merchant profiles; rates from Ministry of Finance (2026).

Rough Estimate at Ecosystem Level

As per reports on the NPCI statement, P2P makes up about 70% of total UPI value, P2M makes up about 30%, and about 67% of P2M value comes from payments above Rs 2,000 (Business Standard, 2026a). If we apply these shares to the August 2026 UPI value of Rs 29.9 lakh crore (Ministry of Finance, 2026): P2M value is about Rs 8.97 lakh crore, out of which about Rs 6.0 lakh crore is above the threshold. At a flat 0.4% rate, this gives a maximum possible amount of roughly Rs 2,400 crore per month, or about Rs 28,800 crore per year.

This is only a maximum limit, not a final estimate. It does not consider P2PM exemptions, the Rs 300 cap, the flat Rs 5 charge for essential sectors, the 0.02% rate for capital markets, or any change in user behaviour like shifting to cash or splitting payments into smaller amounts. So the actual collection is likely to be much lower. This figure is mainly useful to compare with the Rs 20,000 crore annual running cost mentioned by the Government and the roughly Rs 2,000 crore per year that the Government was spending as support under the zero-MDR system (Ministry of Finance, 2026; Commerce Insights, 2026). Reports also mention a special fund of about Rs 700 crore per year for small merchants in Tier III to VI regions, whose detailed plan will be finalised with the RBI within three months (Business Standard, 2026a; Ministry of Finance, 2026).

Segment-wise Impact on Merchants

Table 8: Expected impact and likely responses by merchant segment

Segment	Exposure to MDR	Expected impact	Likely adaptive response
Street / small vendors (P2PM)	None up to ₹1 lakh a month; tickets mostly under ₹2,000	No direct cost; benefit from planned small-merchant fund	Continue UPI QR; maintain correct account tagging.
Small retailers and service providers	Only occasional tickets above ₹2,000	Low; fee is small relative to turnover	Track high-ticket sales; negotiate PSP fees.
Mid-sized, high-ticket, thin-margin retailers	Most sales above ₹2,000 at 0.4%	Highest relative shock; can approach 10–15% of net profit	Reprice, offer cash/bank-transfer incentives, review acquirer terms (pass-through is barred).
Large merchants and e-commerce	0.4% with ₹300 cap on large tickets	Moderate; cheaper than cards	Treat UPI as cost-bearing rail; optimise payment mix.

Segment	Exposure to MDR	Expected impact	Likely adaptive response
Essential sectors (rail, telecom, insurance, fuel, utilities)	Flat ₹5 above ₹2,000	Very low	Continue promoting UPI collection.
Financial-market intermediaries	0.02%, capped at ₹300	Very low	Continue UPI onboarding; benefit from higher limits.

Source: Author's analysis based on Sections 5 and 6.

Is There a Double Charge or "Tax on Tax" Effect?

A cascading effect happens when a tax or fee is charged on an amount that already includes another tax or fee. For UPI MDR, two such layers matter: first, GST charged on the MDR itself (which is a tax on a fee), and second, MDR charged on a transaction amount that already includes GST (which is a fee on a tax-inclusive price). A third layer, which is not a tax, happens when a payment aggregator adds its own extra fee over and above the network MDR (India Policy Hub, 2026).

GST on MDR

According to tax experts cited in news reports, 18% GST is applicable on the MDR charged to merchants, because MDR is considered a fee for payment settlement services. This tax is applied only on the MDR amount and not on the full transaction value, and it follows the same system already used for debit and credit card MDR (Business Standard, 2026b; SAG Infotech, 2026). Registered merchants who have GST liability can claim the GST paid on MDR as input tax credit (ITC) as per normal rules, so for them the net extra burden is mostly neutralised; the cost remains only for merchants who deal in exempt goods or cannot claim ITC (Business Standard, 2026b). Merchants who fall within the P2PM limit have to pay neither MDR nor GST on it (Kotak Neo, 2026). Reports also say that the GST Council may review this charge (Kotak Neo, 2026), so this should be confirmed before considering it as final.

MDR on a bill that already includes GST

MDR is calculated on the total amount paid by the customer (Ministry of Finance, 2026). When the bill already includes GST on goods, the merchant ends up paying MDR on money that he has to pass on to the government. Table 9 shows both layers for a Rs 10,000 sale with 18% GST paid through UPI. It assumes that GST on MDR is charged separately over and above the MDR fee; news reports differ on whether it is included inside or charged on top of it.

Table 9: Layers of cost on a ₹10,000 sale paid by UPI (18% GST on goods and on MDR)

Step	Item	Computation	Amount (₹)
1	Pre-tax sale value	–	10,000.00
2	GST on goods	18% × 10,000	1,800.00
3	Bill paid by customer via UPI	1 + 2	11,800.00
4	MDR charged to merchant	0.4% × 11,800	47.20
5	GST on MDR	18% × 47.20	8.50
6	Total deducted from merchant	4 + 5	55.70

7	ITC recoverable (registered, taxable supplier)	= step 5	(8.50)
8	Net cost after ITC	6 – 7	47.20
9	Net cost as % of pre-tax sale (with ITC)	47.20 ÷ 10,000	0.472%
10	Cost as % of pre-tax sale (no ITC)	55.70 ÷ 10,000	0.557%

Source: Author's calculations using the rates reported in Ministry of Finance (2026) and Business Standard (2026b).

Three points can be noted from this. First, the fee-on-tax part is small but real: out of the Rs 47.20 MDR, Rs 7.20 (0.4% of the Rs 1,800 GST part) is charged on the tax amount and this cannot be claimed back, so the stated 0.4% actually becomes 0.472% of the sale amount before tax. Second, GST on MDR is a clear case of tax-on-fee, but for registered merchants who pay GST, it is only a cash-flow issue and not a final cost, because they can get it back as input tax credit. For merchants who cannot claim ITC – for example, those providing GST-exempt services like certain healthcare and education services, or dealers under the composition scheme – it becomes a final cost, raising the effective rate to about 0.56% in this example. Third, if merchants increase prices to recover the fee, that increased price itself attracts GST at the time of sale, so the customer ends up paying about 1.18 times the recovered amount; the rule against directly passing MDR to customers (Ministry of Finance, 2026) does not stop this indirect way of recovering it.

Assessment

The framework does not create a full "tax on tax" burden. The cascading effect is only partial: it is neutralised by ITC for registered taxable merchants, it is very small for the fee-on-tax part, and it is significant mainly for merchants who cannot claim ITC. Consumers do not face any cascading effect because no charge is levied on them. The remaining effect can be reduced by giving clear guidance on who can claim ITC and how acquirers should raise GST invoices for MDR.

What it Means for UPI Companies: Issues, Challenges and Impact

Here, "UPI companies" means all the players who build, route and handle UPI payments: third-party apps (TPAPs) like PhonePe, Google Pay and Paytm, smaller fintech apps like MobiKwik, PSP, issuer and acquiring banks, and payment aggregators and gateways.

Impact on revenue and market structure

Until now, UPI apps earned little or no revenue from merchant payments; as per a MobiKwik executive, server cost alone is about 20 paise per transaction against zero income (Dason, 2026). The new MDR will create a revenue pool that will be shared among five parties: apps and PSP sponsors, issuing banks, NPCI, acquiring banks and payment aggregators (Dason, 2026). Bernstein estimates annual revenue for payment apps of up to US$1.1 billion by March 2028, out of which PhonePe and Google Pay could get about US$900 million due to their market share (Reuters, 2026). Before the announcement, estimates had put PhonePe and Paytm at about Rs 700 crore per year each and Google Pay at about Rs 500 crore, with the exact split among banks, PSPs and acquirers still to be decided (Outlook Business, 2026). These are only estimates and not final figures, and the sharing formula should be confirmed in the NPCI circular.

Issues and challenges

- High concentration: PhonePe and Google Pay together hold about 80% of UPI value (Reuters, 2026) and about 79% of transactions in May 2026, against NPCI's 30% per-app cap, whose 31 December 2026 deadline looks difficult to enforce (Retail Intel, 2026). Bigger acquirers will earn most of the fee, so MDR may further increase the advantage of large players, although smaller apps may focus on high-value payments to compete (Reuters, 2026).

- Small revenue base: More than 95% of P2M transactions are at or below Rs 2,000, and P2PM exemptions, the flat Rs 5 slab and the Rs 300 cap further reduce earnings (Ministry of Finance, 2026). So revenue per transaction will be much lower compared to cards.
- Operational readiness: Acquirers and gateways will have to classify merchants (P2PM velocity checks and three-month reclassification), apply different slabs as per sector and caps, and bill GST on MDR, all before 15 October 2026 (Ministry of Finance, 2026).
- Merchant pushback and leakage: Merchants may resist, shift back to cash or cards, or split payments below Rs 2,000, which could reduce the expected revenue gain (Retail Intel, 2026).
- No earning from consumers: Apps are not allowed to charge platform fees from consumers (Ministry of Finance, 2026), so all revenue must come from the merchant side, while onboarding in Tier III-VI centres has to be supported by the dedicated fund.
- Separate pricing: Merchants will see the network MDR and the PSP or gateway fee as two separate charges (India Policy Hub, 2026), which will increase price comparison and put pressure on gateway margins.
- Higher service expectations: Since the MDR is justified on the basis of investment in fraud prevention, cyber security and customer service (Ministry of Finance, 2026), companies are now expected to provide better reliability, dispute resolution and security as higher-value payments move to the paid category.

Summary of impact

Table 10: Expected impact and main challenge by UPI participant

Participant	Likely impact	Main challenge
Large TPAPs (PhonePe, Google Pay)	Largest share of the new revenue; funds expansion beyond large cities	Market-share cap and scrutiny of dominance; merchant relations
Mid-size and smaller apps (Paytm, MobiKwik)	New revenue stream; incentive to target high-value payments	Competing with scale; low yield from exempt volumes
PSP, issuer and acquiring banks	Share of MDR to fund infrastructure and operations	System upgrades, merchant classification, compliance
Payment aggregators and gateways	Revenue from higher-value merchants	Unbundled pricing, GST invoicing, margin pressure
NPCI	Funding for resilience, security and innovation	Governing slabs and caps; administering the small-merchant fund

Source: Author's analysis based on the sources cited in Section 10.

DISCUSSION

Behavioural and Policy Issues

The Rs 2,000 threshold effect: A payment of Rs 2,000 is free, but a payment of Rs 2,001 costs about Rs 8. This kind of sharp threshold can cause bunching just below the limit: merchants or customers may split a bill into two payments, or use cash or bank transfer for larger purchases. The incentive is weaker for customers because they pay nothing, but stronger for merchants who have to bear the fee; for example, a merchant may offer a small discount for cash payment above Rs 2,000. Monitoring the pattern of transaction amounts around Rs 2,000 after implementation will show whether this happens.

Regressive cap: The Rs 300 cap protects sellers with high-value bills but reduces the effective percentage as the value goes up; mid-value merchants end up paying the highest percentage (0.4%), as shown in Cases 3 and 4. A policy that makes large payments more predictable ends up putting more burden on the mid-market.

Classification risk: The P2PM exemption depends on monthly inward credits and on velocity checks done by acquirers, with reclassification after three months in a row above Rs 1 lakh (Ministry of Finance, 2026). Vendors who are close to this limit, or who receive money in personal accounts, may face uncertainty and will need clear communication from acquirers.

Pass-through and layered costs: Merchants are not allowed to pass MDR to customers and apps cannot charge platform fees (Ministry of Finance, 2026), but a merchant using a payment aggregator may have to pay both the network MDR and a separate PSP or gateway fee (India Policy Hub, 2026). So the actual cost of accepting UPI may be higher than the headline 0.4%. Informal price increases are also possible even if explicit surcharges are not allowed; the Government's view that shopkeepers have no reason to increase prices is an assumption that should be tested with data.

Competitive position: At 0.4% (capped), UPI is still much cheaper than card MDR benchmarks of up to 0.90% for debit and 1.5-2.5% for credit cards (Ministry of Finance, 2026), and cheaper than the 1.1% wallet interchange introduced in 2023. For most merchants, UPI will remain the lowest-cost digital payment option; for a small shop, the real comparison is with cash, whose costs are less visible.

Sustainability vs inclusion: The framework tries to balance two goals: making the network commercially viable and keeping it accessible to all. By exempting P2P, small-ticket and small merchants, it protects the bottom layer while putting the cost on a small share of high-value transactions – the Government expects only about 4% of merchant transactions by number to attract MDR (India Policy Hub, 2026; Insights on India, 2026). Since high-value payments account for about two-thirds of P2M value (Business Standard, 2026a), the revenue base is still large.

Future Roadmap

The framework is a starting point. Some milestones are already scheduled; others are proposed by the author as sensible next steps. Table 11 separates the two.

Table 11: Roadmap for UPI MDR, 2026–2028 and beyond

Horizon	Milestone / action	Lead	Status
15 Oct 2026	Framework goes live; acquirers apply slabs, caps and P2PM classification	NPCI, banks, PSPs	Announced
By mid-Dec 2026	Framework for the dedicated small-merchant fund finalised with the RBI	NPCI, RBI, DFS	Announced (within three months)
31 Dec 2026	NPCI’s 30% per-app market-share deadline	NPCI	Announced; enforcement uncertain
Early 2027	Possible GST Council review of GST on MDR; ITC guidance for exempt-supply sectors	GST Council	Reported as possible
6–12 months after go-live	Independent review of ticket sizes near ₹2,000, P2PM reclassifications, merchant attrition and price effects	RBI, NPCI	Proposed

2027–28	Calibrate thresholds, caps and sector slabs; consider tapering at ₹2,000; link fund payouts to Tier III–VI onboarding	NPCI, DFS	Proposed
Beyond 2028	Extend a self-funded UPI model as the network expands abroad (live in 11 countries in 2026)	NPCI and partners	Ongoing

Source: Ministry of Finance (2026); Retail Intel (2026); Kotak Neo (2026); Reuters (2026); proposals by the author. Dates for announced items follow the cited sources.

Three scenarios show the uncertainty. In a smooth transition, merchants absorb the fee, acceptance continues and the fund helps small-merchant growth. In a leakage scenario, bunching just below Rs 2,000, shift to cash or cards and hidden price increases reduce revenue and goodwill. In a recalibration scenario, the Government and NPCI change the threshold, cap or sector slabs after review. The key indicators to track are the share of P2M transactions just below Rs 2,000, growth in P2PM and new merchant onboarding, market shares of apps compared to the 30% cap, and complaints about surcharging.

Recommendations

For merchants:

- Divide your UPI sales by ticket size and category to estimate expected MDR before 15 October 2026.
- Confirm with your acquiring bank or PSP your classification (P2PM, P2M, concessional sector) and whether any extra PSP or gateway fee will apply.
- Include the expected MDR in your pricing and margin planning, and compare the net cost of UPI with cards and cash, including cash-handling costs.

For NPCI and RBI:

- Publish a clear, machine-readable list of merchant category codes for each MDR slab, including the rate for education programmes.
- Consider a gradual transition band around Rs 2,000 to reduce the sharp threshold effect, and review whether the Rs 300 cap should be tapered instead of flat.
- Release regular data on ticket-size distribution, P2PM reclassifications and merchant exits after implementation.
- Finalise the small-merchant fund framework within the promised three months, with clear eligibility, and ensure it reaches Tier III-VI centres and vendors under schemes like PM SVA Nidhi.

For UPI companies and acquirers:

- Publish clear rate cards that separately show the network MDR and PSP or gateway fees, and show GST on MDR clearly on invoices.
- Visibly reinvest part of the new revenue in fraud prevention, dispute resolution and merchant onboarding in Tier III-VI areas, as promised in the policy rationale.
- Plan for compliance with the market-share cap and competition scrutiny, while building value-added services for merchants.

For policymakers and educators:

- Get an independent evaluation done 6 and 12 months after implementation, covering merchant acceptance, price impact and behavioural changes.

- Use this framework as a live case study in courses on fintech, financial management and entrepreneurship, where students can calculate MDR for different merchant profiles.

LIMITATIONS AND SCOPE FOR FURTHER RESEARCH

This study is done before implementation and is based on secondary sources, some of which are press reports and expert opinions written within weeks of the announcement. The merchant cases are hypothetical, the GST treatment of MDR and the sharing of MDR among different players are reported but not yet final, and the lists of categories for flat-fee and concessional rates will be final only after verification with the NPCI circular. Future research can use actual merchant-level transaction data, survey small and mid-sized retailers before and after 15 October 2026, measure bunching of ticket sizes around Rs 2,000, and compare India's approach with fee models of instant-payment systems in other countries.

CONCLUSION

India's UPI is shifting from a free-for-merchant model to a calibrated, threshold-based model. The design protects those for whom a payment fee would hurt the most – consumers, street vendors, small merchants and low-value transactions – and gives concessions to essential services and capital-market participation. The analysis in this paper shows that the cost will be felt mainly by mid-sized and high-value merchants who work on thin margins, while street vendors and essential-service providers will be largely unaffected. The success of this framework will depend on transparent classification, effective monitoring by RBI and NPCI, a well-designed support fund, and the ability of merchants to adapt. On the cascading effect, the impact is only partial because GST on MDR can generally be claimed as credit. For UPI companies, the framework opens up a new revenue source but also raises concerns about market concentration and operational readiness, and the way forward depends on the small-merchant fund, the market-share cap and the review after implementation. The next stage of research should move from scenario-based calculations to actual observed data.

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