UPI Merchant Discount Rate Framework Introduces Select Charges on High-Value Merchant Transactions from October 2026

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Recent Developments:

- The **National Payments Corporation of India (NPCI)** has introduced a revised **Merchant Discount Rate (MDR)** framework for specified **Person-to-Merchant (P2M) UPI transactions**, effective from **15 October 2026**.
- Under the framework, an **MDR of 0.4%** will apply to eligible P2M UPI transactions above **?2,000**, while **Person-to-Person (P2P)** transactions will remain completely free irrespective of transaction value.
- The framework has been introduced under the **Payment and Settlement Systems Act, 2007**, following deliberations by the **UPI Steering Committee**, with the stated objective of ensuring the long-term sustainability of the UPI ecosystem.
- The government has clarified that MDR is **not a tax or a government charge**; it is a fee within the payment ecosystem that is distributed among participating entities such as banks and payment service providers.

Understanding Merchant Discount Rate:

Meaning of MDR:

- **Merchant Discount Rate** is a fee associated with processing eligible digital payments made to merchants, with the amount being distributed among participants involved in the payment ecosystem.
- MDR is different from a **consumer transaction fee**, because the new framework places the prescribed charge on eligible merchant transactions rather than directly charging individuals for making UPI payments.
- The framework therefore attempts to create a revenue mechanism for the digital payment ecosystem while retaining free access for individuals and protecting specified small merchants.

P2P and P2M Transactions:

- **P2P transactions** refer to payments between individuals, such as transferring money from one bank account to another through UPI, while **P2M transactions** refer to payments made by individuals to merchants.
- All P2P UPI transactions will remain **free irrespective of transaction value**, while eligible P2M transactions above ?2,000 will come under the revised MDR framework.
- Approximately **96% of P2M transactions** are expected to remain unaffected because transactions up to ?2,000 and specified small-merchant transactions continue to receive zero-MDR treatment.

Key Features of the New MDR Framework:

Standard P2M Transactions:

- Eligible **P2M UPI transactions above ?2,000** will attract an MDR of **0.4%**, with the charge shared among relevant payment ecosystem participants.

- For transactions of **?75,000 and above**, the MDR will be **capped at ?300 per transaction**, preventing the percentage-based charge from increasing indefinitely with transaction value.
- The MDR framework therefore differentiates between low-value transactions, high-value transactions and specified sectoral categories.

Exemptions for Individuals and Small Merchants:

- **P2P UPI transactions** will remain free irrespective of transaction amount, ensuring that ordinary person-to-person transfers are outside the MDR framework.
- **P2M transactions up to ?2,000** will continue to attract zero MDR, preserving the free digital-payment model for a large share of routine merchant transactions.
- Small merchants receiving up to **?1 lakh per month through UPI QR codes under the P2PM category** will continue to receive zero MDR on their UPI transactions.
- The small-merchant protection is particularly relevant for **street vendors, neighbourhood shops and micro-businesses**, where payment costs can affect already narrow operating margins.

Sector-Specific MDR:

- Transactions above ?2,000 in essential and relatively thin-margin sectors such as **railways, telecommunications, insurance, fuel and agricultural inputs** will attract a flat MDR of **?5 per transaction** instead of the standard 0.4% rate.
- The sector-specific approach seeks to provide greater **cost predictability** for essential services and businesses where percentage-based charges could create comparatively higher transaction costs.

Capital Market Transactions:

- Payments related to **mutual funds, securities, stockbrokers and dealers** will attract a lower MDR of **0.02%**, subject to a maximum of **?300 per transaction**.
- The differentiated rate recognises the role of digital payments in expanding participation in **formal financial markets** while maintaining a lower payment cost for capital-market transactions.

Rationale and Significance:

Sustainability of Digital Payment Infrastructure:

- UPI has developed into a major component of India's **digital public infrastructure**, but its continued expansion requires sustainable funding for payment infrastructure, technological development, cybersecurity and operational resilience.
- The new MDR framework creates a revenue stream from specified higher-value merchant transactions while keeping P2P payments and most merchant transactions free.
- The framework is therefore intended to balance **digital-payment affordability** with the **financial sustainability of payment-system participants**.

Financial Inclusion:

- The framework protects low-value transactions and eligible small merchants, which are particularly important for **financial inclusion** and digital-payment adoption among micro-enterprises.
- A dedicated fund equivalent to **5% of total MDR collections** will be created to promote UPI adoption among small merchants and support wider acceptance of digital payments.
- Revenue generated from eligible larger transactions is also expected to support expansion of payment infrastructure in **rural and semi-urban areas**.

Consumer Protection:

- MDR is designed as a merchant-side payment ecosystem charge, and the government has stated that customers should **not bear the MDR cost**.
- Banks have been advised to ensure that merchants do not pass the MDR burden to customers through additional charges for UPI payments.
- UPI application providers are also prohibited from imposing platform fees or hidden charges within the applicable framework.

Broader UPSC Dimensions:

Indian Economy and Digitalisation:

- The revised MDR framework illustrates the challenge of balancing **rapid digitalisation with commercial sustainability** in India's payment ecosystem.
- A completely free payment infrastructure can encourage adoption, but long-term operation also requires sustainable mechanisms for **technology, cybersecurity, innovation and network expansion**.
- The framework represents an attempt to move towards a more sustainable UPI ecosystem without imposing a universal charge on users.

Financial Inclusion and Rural Economy:

- UPI has enabled small businesses and informal-sector participants to accept digital payments without requiring conventional card-payment infrastructure.
- Continued zero-MDR protection for eligible small merchants can support the digital formalisation of **street vendors, micro-enterprises and neighbourhood businesses**.
- Expansion of UPI infrastructure in rural and semi-urban regions can improve access to formal digital payment channels and reduce dependence on cash-based transactions.

Regulatory and Institutional Framework:

- The framework operates within the legal framework of the **Payment and Settlement Systems Act, 2007**, demonstrating the importance of statutory support for India's digital-payment architecture.
- **RBI, Ministry of Finance, Department of Financial Services and NPCI** have distinct institutional roles in the broader payment ecosystem, covering regulation, policy, implementation and network operations.
- The framework also highlights the importance of coordination between public institutions and private payment ecosystem participants in maintaining a resilient digital-payment system.

Challenges and Way Forward:

Key Challenges:

- The introduction of MDR may increase the payment-processing cost for some eligible merchants, particularly businesses operating with low profit margins.
- The framework requires effective monitoring to ensure that merchants do not indirectly transfer MDR costs to consumers through higher prices or additional payment charges.
- Continued expansion of UPI will require sustained investment in **cybersecurity, fraud prevention, grievance redressal and technological resilience**.
- Clear communication is necessary to prevent confusion between **MDR, taxes, platform fees and consumer charges**.

Way Forward:

- The MDR framework should be accompanied by strong **consumer protection, merchant awareness and transparent disclosure** of applicable charges.

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- Small merchants should receive adequate incentives and technical support to maintain digital-payment acceptance without facing disproportionate compliance costs.
- Continuous monitoring of transaction patterns can help policymakers assess whether the ?2,000 threshold and sector-specific rates remain appropriate as the digital-payment ecosystem evolves.
- Greater investment in cybersecurity, interoperability and digital literacy can strengthen the resilience of India's **digital public infrastructure**.

Value Addition for UPSC:

Key Terms:

- **Digital Public Infrastructure (DPI):** Foundational digital systems that enable large-scale delivery of public and private services.
- **Merchant Discount Rate (MDR):** Fee associated with processing eligible merchant transactions through digital payment systems.
- **P2P:** Person-to-Person digital payment between individuals.
- **P2M:** Person-to-Merchant digital payment for goods or services.
- **Financial Inclusion:** Access to affordable and useful financial services for individuals and businesses.
- **Digital Financial Inclusion:** Extension of formal financial services through accessible digital technologies.

Prelims Facts:

- **UPI:** Unified Payments Interface.
- **NPCI:** National Payments Corporation of India.
- **MDR:** Merchant Discount Rate.
- **P2P:** Person-to-Person.
- **P2M:** Person-to-Merchant.
- **Legal Framework:** Payment and Settlement Systems Act, 2007.
- **Standard MDR:** 0.4% for eligible P2M transactions above ?2,000.
- **High-Value Cap:** ?300 per transaction for transactions of ?75,000 and above.
- **Essential Sectors:** Flat ?5 MDR for eligible transactions above ?2,000.
- **Capital-Market Rate:** 0.02%, capped at ?300.
- **Small-Merchant Threshold:** Up to ?1 lakh monthly UPI QR receipts under the specified P2PM category.
- **Small-Merchant Fund:** 5% of total MDR collections.
- **Implementation Date:** 15 October 2026.

Mains Linkages:

- **Essay:** Balancing innovation, inclusion and sustainability in India's digital economy.
- **Case Study Dimension:** Designing digital-payment policies that protect vulnerable participants while ensuring the financial sustainability of digital infrastructure.