Direct Tax Reforms of India: History and Evolution

Shashank V Shetty, MBA Student,

Dr. Dhilipan C, Professor,

CMS Business School, JAIN (Deemed-to-be University), Bengaluru, India

ABSTRACT

In the Indian context, this study looks at a number of aspects of revenue mobilisation, taxpayer behaviour, and tax administration. The study finds important patterns and connections in the dynamics of tax collecting by applying quantitative analytical techniques such a regression analysis, ratio analysis, CAGR (compound annual growth rate) analysis, and correlation analysis. The results of regression analysis highlight the impact of the economy on tax collection, showing a robust positive connection between GDP and direct tax revenue. Throughout a 22-year period, ratio analysis shows rising efficiency patterns in tax collecting processes, while CAGR analysis shows a steady increase in the taxpayer base, especially among small- and medium-sized firms and individual taxpayers. Moreover, an examination of the Tax Effort Ratio suggests that direct taxes are making a larger contribution to overall tax revenue, which is indicative of changes in the composition of income. Positive correlations between various direct tax types and overall tax revenue are revealed by correlation analysis, highlighting the interdependence of tax collecting dynamics. The study admits its limitations, which could affect the finding's generalisation and interpret. These limitations include data limits, methodological difficulties, and contextual issues. However, the knowledge gained has significant implications for additional study areas, decision-making by managers, and policy formation with regards to improving the efficiency of tax administration, encouraging compliance with taxes, and supporting sustainable financial governance in India. In order to tackle these issues and develop proven methods for enhancing the results of tax administration and fostering equitable economic growth, interdisciplinary cooperation, involvement of stakeholders, and continuous surveillance and evaluation are advised.

1.INTRODUCTION

History of Taxation

The term 'tax' originates from the Latin word taxare or taxo, which means 'to assess the value of something'. Governments impose taxes to support the functioning of the state, and they are collected for the exchange of goods or services. Taxes generate revenue for the government and play a vital role in any form of administration.

The strength of an economy depends on the effectiveness of its tax system. A fair tax system can boost a country's economic growth and lead to prosperity, ultimately resulting in increased happiness and productivity among its citizens. A well-designed tax policy contributes to GDP growth and is considered sound when it fulfils the functions of allocation, distribution, and stabilization in the economy.

There are two main types of taxes: direct and indirect. Direct taxes, such as income and property tax, are paid directly to the government by individuals or entities. Indirect taxes, on the other hand, are paid through intermediaries. An example of an indirect tax in India is the service tax imposed by the government.

Types of Direct Taxes

The various types of direct tax that are imposed in India are mentioned below:

- **Income Tax:** Income tax obligations vary based on a person's age and income level. The government of India establishes various tax slabs to determine the required amount of Income Tax. Income Tax Returns (ITR) are required to be filed by the taxpayer annually. Depending on their ITR, people can be eligible for an income tax refund or may be responsible for paying taxes. If people fail to file their ITRs, they will be subject to heavy penalties.

- **Wealth Tax:** The yearly tax payment is contingent upon both the property's market value and ownership status. If someone possesses real estate, they are required to pay wealth tax regardless of whether the property brings in money or not. Wealth tax is a requirement for business taxpayers, Hindu Undivided Families (HUFs), as well as individuals based on their residential status. Assets such as gold reserve debt instruments, stock holdings, real estate, and commercial property rented for longer than 300 days are all excluded from wealth tax payment provided the real estate is possessed for business or professional purposes.

- **Estate Tax:** It is also known as taxes on inheritance and is paid according to the amount of money left in a person's estate upon or after their death.

- **Corporate Tax:** Local companies must pay corporate tax, in addition to their shareholders. In India, foreign firms that generate revenue are also required to pay the tax on corporations. Taxable income includes dividends, royalties, interest, technical service fees, and asset sales proceeds.

- **Capital Gains Tax:** It is a type of direct tax that must be paid as a result of revenue received from investments or asset sales. Capital assets include investments in homes, businesses, bonds, farms, stocks, and artwork. Tax can be divided into two categories: long-term and short-term, depending on how long it is held. Short-term gains are any assets—aside from securities—that are offered for sale within 36 months of their acquisition. If any money is received against the sale of property that have already been owned for longer than 36 months, it is deducted from long-term assets.

Tax Rate for the Different Types of Direct Tax

Income Tax:

Someone will be placed in a specific tax slab based on their age and income. The following lists the three separate tax slabs:

For resident individuals and Hindu Undivided Families (HUFs) who are below the age of 60 years:

Tax slab	Income tax
Up to Rs.2.5 lakh	Nil
From Rs.2,50,001 to Rs.5,00,000	5% of the total income that is more than Rs.2.5 lakh + 4% cess
From Rs.5,00,001 to Rs.10,00,000	20% of the total income that is more than Rs.5 lakh + Rs.12,500 + 4% cess
Income of above Rs.10 lakh	30% of the total income that is more than Rs.10 lakh + Rs.1,12,500 + 4% cess

For senior citizens who are above the age of 60 years and below the age of 80 years:

Tax slab	Income tax
Up to Rs.3 lakh	Nil
From Rs.3,00,001 to Rs.5,00,000	5% of the total income that is more than Rs.3 lakh + 4% cess
From Rs.5,00,001 to Rs.10,00,000	20% of the total income that is more than Rs.5 lakh + Rs.10,500 + 4% cess
Income of above Rs.10 lakh	30% of the total income that is more than Rs.10 lakh + Rs.1,10,000 + 4% cess

For resident Indians who are above the age of 80 years (Super Senior Citizen):

Tax slab	Income tax
Up to Rs.5 lakh	Nil
From Rs.5,00,001 to Rs.10,00,000	20% of the total income that is more than Rs.5 lakh + 4% cess
Above Rs.10 lakh	30% of the total income that is more than Rs.10 lakh + Rs.1,00,000 + 4% cess

On February 1st, 2020, Nirmala Sitharaman, the finance minister, proposed a new tax regime in addition to the previously listed existing tax levels. It is important to remember that the additional revenue tax system is an option that can be chosen in place of the current one. The income tax slabs under the new regime for the fiscal year 2020–21 can be summarised up as follows:

New Income Tax Slab for Individuals

Income Tax Slab	Tax Rate
Up to Rs.2.5 lakh	Nil
From Rs.2,50,001 to Rs.5,00,000	5% of the total income that is more than Rs.2.5 lakh + 4% cess
From Rs.5,00,001 to Rs.7,50,000	10% of the total income that is more than Rs.5 lakh + 4% cess
From Rs.7,50,001 to Rs.10,00,000	15% of the total income that is more than Rs.7.5 lakh + 4% cess
From Rs.10,00,001 to Rs.12,50,000	20% of the total income that is more than Rs.10 lakh + 4% cess
From Rs.12,50,001 to Rs.15,00,000	25% of the total income that is more than Rs.12.5 lakh + 4% cess
Income above Rs.15,00,001	30% of the total income that is more than Rs.15 lakh + 4% cess

Note: The income tax rates mentioned above are optional.

Corporate Tax:

The tax rates for domestic and international companies are mentioned below:

Domestic companies:

- The corporation tax rate is 25% if the company's annual revenue falls lower than Rs. 250 crores. However, a 30% corporate tax is applied if the company's revenue exceeds Rs. 250 crores.
- If the income that is taxable falls between Rs. 1 crore and Rs. 10 crores, a 10% surcharge is applied.
- If the business's taxable profits exceed Rs. 10 crores, a 12% surcharge will be applied.
- There is a cess on corporation tax of 4%.

International companies:

- Businesses that make less than Rs. 1 crore are subject to a 41.2% corporation tax. A 3% educational cess and a 40% basic tax are included in the business tax.

- Businesses that make in excess of Rs. 1 crore are subject to a 42.024% corporate tax. The corporation tax consists of a 3% education cess, a 2% surcharge, and a 40% base tax.
- In addition to the standard tax, businesses that make in excess of Rs. 10 crore are subject to a 5% surcharge.

Capital Gains Tax

- The taxation of capital gains that are short- is based on standard tax slabs.
- Long-term capital gains are subject to a 20% tax if the indexation advantage is taken into account when computing capital gains tax.
- Long-term gains on capital are subject to a 10% tax if the initial capital gains taxes is calculated without taking the indexation benefit into account.

Wealth Tax

- Wealth Tax is imposed based on net worth. The total of all taxable property less the total amount of debt outstanding can be used to determine net wealth.
- Net wealth is calculated using the formula Net Wealth = (Sum of All Assets) - (Sum of All Debt).
- Every year, on March 31, the worth of net wealth is taken into account just before the assessment year.
- That being said, wealth tax was actually eliminated as of 1 April 2016 for wealth owned as of 31 March 2016.

1.3 LITERATURE REVIEW

Suranjali Tandon and R. Kavita Rao (2017) Their study analyses the results of a laboratory test carried out in 2015 to assess compliance in India. Responses from 133 participants to changes in key policy instruments such as tax rates, penalties and audit probability have been evaluated by the experiment. They've found that different responses are generated by changes in policy parameters among taxpayers. The only policy instrument which produces a relatively uniform response is the probability of an audit. Further, the results show that individuals can be divided into those who respond to change in audit probability and those who respond to other policy variables, suggesting that no single policy would be adequate to induce suitable behavioural changes in all taxpayers.

Brian Roach (2010) This paper examines the historical development of taxation in the United States, focusing on the complexity and contentious nature of the federal income tax. The federal tax system

encompasses various other taxes such as social insurance, corporate, excise, estate, and gift taxes. It is worth noting that social insurance and excise taxes are regressive, while corporate, estate, and gift taxes are progressive in nature. Additionally, the US tax system comprises state and local taxes, particularly sales, income, and property taxes. Notably, nearly 70% of the total tax revenue in the country is collected at the federal level. The income tax stands as the largest federal tax, followed closely by social insurance taxes. At the non-federal level, property taxes hold the greatest significance, trailed by sales and income taxes.

William G. Gale and Andrew A. Samwick (2014) This research paper explores the impact of changes to the individual income tax on long-term economic growth. The effectiveness of a tax change in promoting economic growth heavily relies on its structure and financing. While reducing tax rates may motivate individuals to work, save, and invest, if these tax cuts are not accompanied by immediate spending cuts, they are likely to lead to an enlarged federal budget deficit. In the long run, this deficit will diminish national savings and cause interest rates to rise. The overall effect on growth is uncertain, but several estimates suggest that it may be minimal or even negative. On the other hand, measures to broaden the tax base can offset the negative impact of tax rate reductions on budget deficits. However, these measures also reduce their direct effect on labour supply, saving, and investment, consequently affecting growth. Nonetheless, they do reallocate resources towards sectors that have the highest economic value, thereby increasing efficiency and potentially expanding the overall size of the economy.

Pradip Kumar Das (2019) This paper aims to analyse the historical development of taxation in India and elucidate the structure of different types of direct taxes, namely income tax, agricultural tax, and professional tax, imposed by the government. It highlights that the administrative aspect of direct taxes has frequently been disregarded, leading to a loss in revenue and the emergence of various issues such as tax evasion and income undervaluation.

3.1 Correlation Analysis

Financial Year	Corporate Tax	Personal Income Tax	Other Direct Tax	Total Tax
2000-01	₹ 35,696.00	₹ 31,764.00	₹ 845.00	₹ 68,305.00
2001-02	₹ 36,609.00	₹ 32,004.00	₹ 585.00	₹ 69,198.00
2002-03	₹ 46,172.00	₹ 36,866.00	₹ 50.00	₹ 83,088.00
2003-04	₹ 63,562.00	₹ 41,386.00	₹ 140.00	₹ 1,05,088.00
2004-05	₹ 82,680.00	₹ 49,268.00	₹ 823.00	₹ 1,32,771.00
2005-06	₹ 1,01,277.00	₹ 63,689.00	₹ 250.00	₹ 1,65,216.00
2006-07	₹ 1,44,318.00	₹ 85,623.00	₹ 240.00	₹ 2,30,181.00
2007-08	₹ 1,93,561.00	₹ 1,20,429.00	₹ 340.00	₹ 3,14,330.00
2008-09	₹ 2,13,395.00	₹ 1,20,034.00	₹ 389.00	₹ 3,33,818.00
2009-10	₹ 2,44,725.00	₹ 1,32,833.00	₹ 505.00	₹ 3,78,063.00
2010-11	₹ 2,98,688.00	₹ 1,46,258.00	₹ 1,049.00	₹ 4,45,995.00
2011-12	₹ 3,22,816.00	₹ 1,70,181.00	₹ 990.00	₹ 4,93,987.00
2012-13	₹ 3,56,326.00	₹ 2,01,840.00	₹ 823.00	₹ 5,58,989.00
2013-14	₹ 3,94,678.00	₹ 2,42,888.00	₹ 1,030.00	₹ 6,38,596.00
2014-15	₹ 4,28,925.00	₹ 2,65,772.00	₹ 1,095.00	₹ 6,95,792.00
2015-16	₹ 4,53,228.00	₹ 2,87,637.00	₹ 1,079.00	₹ 7,41,945.00
2016-17	₹ 4,84,924.00	₹ 3,49,503.00	₹ 15,286.00	₹ 8,49,713.00
2017-18	₹ 5,71,202.00	₹ 4,20,084.00	₹ 11,452.00	₹ 10,02,738.00
2018-19	₹ 6,63,572.00	₹ 4,73,179.00	₹ 967.00	₹ 11,37,718.00
2019-20	₹ 5,56,876.00	₹ 4,92,717.00	₹ 1,088.00	₹ 10,50,681.00
2020-21	₹ 4,57,719.00	₹ 4,87,560.00	₹ 1,897.00	₹ 9,47,176.00
2021-22	₹ 7,12,037.00	₹ 6,96,604.00	₹ 3,781.00	₹ 14,12,422.00
2022-23	₹ 8,25,834.00	₹ 8,33,307.00	₹ 4,545.00	₹ 16,63,686.00

	Corporate Tax	Personal Income Tax	Other Direct Tax	Total Tax
Corporate Tax	1			
Personal Income Tax	0.954984578	1		
Other Direct Tax	0.458535483	0.420302322	1	
Total Tax	0.989283709	0.988009528	0.451474183	1

Interpretation

The data presented above examines the relationship between the various forms of direct taxes that are gathered in India. According to the data, it appears like:

- **Positive Correlation Among All Direct Taxes:** The categories of corporate tax, personal income tax, and other direct taxes show a positive correlation with total tax. This implies that the other two forms of direct tax collection often rise in tandem with the growth of one. This is probably because an expanding economy would typically spur more of all kinds of economic activity, which would raise company profits and individual incomes and consequently increase the amount of tax revenue received from these sources.

- **Higher association Among Corporate Tax and Total Tax:** Based on visual analysis, it seems that Corporate Tax and Total Tax have the largest positive association. This implies that, in contrast to personal income tax or other direct taxes, corporate tax collections typically follow total tax collections more closely. This could be because of a variety of things, like the fact that earnings from businesses are more susceptible to changes in the economy than individual earnings or other forms of income, or since corporate tax is one of the Indian government's main sources of tax revenue.

- **Year-to-Year Fluctuations:** It's critical to recognise that there may be annual variations in the association between these variables. For instance, while individual income tax collection increased in FY 2019–20, corporate tax collection appears to have decreased from the prior year. This might

be the result of certain economic occurrences or policy adjustments that favour one kind of tax over another.

Limitation

- **Restricted Data Scope:** Only correlations between various direct taxation and total tax are taken into account in this analysis. An all-encompassing understanding of the variables affecting tax income would be possible by incorporating more economic data, such as GDP growth.

- **Correlation vs. Causality:** Although there are positive correlations in the data, this does not establish causality. It is possible that additional elements that haven't been taken into account influence the various tax groups.

- **Time Restrictions:** The analysis does not indicate how long the correlation data were collected. Extended periods of time have the ability to uncover hidden patterns and anomalies that might otherwise go unnoticed in shorter time frames.

- **Strength of connection:** The data mentions a "positive correlation," but it doesn't state how strong it is. A more accurate picture of the degree of relationship between the variables could be obtained using a statistical measure such as the correlation coefficient.

- **Data Aggregation:** A high amount of data aggregation may be possible. Overall national statistics may not always be as informative as correlations within certain sectors or industries.

3.3 Regression Analysis

Financial year	Net Collection of Direct Taxes (Rs. Crore)	GDP Current Market Price (Rs. Crore)
2000-01	₹ 68,305.00	₹ 21,02,376.00
2001-02	₹ 69,198.00	₹ 22,81,058.00
2002-03	₹ 83,088.00	₹ 24,58,084.00
2003-04	₹ 1,05,088.00	₹ 27,54,621.00
2004-05	₹ 1,32,771.00	₹ 32,42,209.00
2005-06	₹ 1,65,216.00	₹ 36,93,369.00
2006-07	₹ 2,30,181.00	₹ 42,94,706.00
2007-08	₹ 3,14,330.00	₹ 49,87,090.00
2008-09	₹ 3,33,818.00	₹ 56,30,063.00
2009-10	₹ 3,78,063.00	₹ 64,57,352.00
2010-11	₹ 4,45,995.00	₹ 76,74,148.00
2011-12	₹ 4,93,987.00	₹ 90,09,722.00
2012-13	₹ 5,58,989.00	₹ 1,01,13,281.00
2013-14	₹ 6,38,596.00	₹ 1,13,55,073.00
2014-15	₹ 6,95,792.00	₹ 1,25,41,208.00
2015-16	₹ 7,41,945.00	₹ 1,35,67,192.00
2016-17	₹ 8,49,713.00	₹ 1,53,62,386.00
2017-18	₹ 10,02,738.00	₹ 1,70,98,304.00
2018-19	₹ 11,37,718.00	₹ 1,88,86,957.00
2019-20	₹ 10,50,681.00	₹ 2,00,74,856.00
2020-21	₹ 9,47,176.00	₹ 1,98,00,914.00
2021-22	₹ 14,12,422.00	₹ 2,36,64,637.00
2022-23	₹ 16,63,686.00	₹ 2,72,40,712.00

SUMMARY OUTPUT

Regression Statistics

Multiple R	0.99220879
R Square	0.98447828
Adjusted R Square	0.98373915
Standard Error	57769.7487
Observations	23

ANOVA

	df	SS	MS	F	Significance F
Regression	1	4.44515E+12	4.44515E+12	1331.943312	1.75238E-20
Residual	21	70084221383	3337343875		
Total	22	4.51524E+12			

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	-41990.80297	21045.03849	-1.995282783	0.059148709	-85756.35637	1774.750435	-85756.35637	1774.750435
GDP Current	0.059295369	0.001624718	36.49579855	1.75238E-20	0.055916583	0.062674154	0.055916583	0.062674154

Interpretation

- The model's R-squared value of 0.9837 indicates that it accounts for 98.37% of the variance in the dependent variable, illustrating a strong fit.

- The R-squared value after adjustment is 0.9645, which considers the quantity of independent variables in the model and indicates a high level of fit.

- The F-statistic's p-value being less than 0.05 suggests that the model is statistically significant, indicating that the connection between the independent and dependent variables is probably not random.

- The independent variables' coefficients show statistical significance, indicating a significant relationship with the dependent variable

- The positive and statistically significant coefficient for the GDP indicates a direct and positive relationship between GDP Current and direct tax. In simple terms, as the direct tax goes up, so does the GDP.

In general, the regression analysis indicates a significant correlation between the independent variables and the dependent variable. The model accounts for a large proportion of the variance in the dependent variable, and the coefficients for the independent variables are all found to be statistically significant.

Limitation

- **External Validity:** The validity of the model may be restricted to the particular data that were employed. It might not apply to different demographics or eras.

- **Erroneous Variables**: Not every pertinent factor influencing the dependent variable may be taken into account by the model. The results could be influenced by other factors that were left out.

- **Measurement Error:** The model's accuracy may be impacted by mistakes in the way the variables were measured.

- **Outliers:** The existence of extreme data points, or outliers, might distort the findings and should be looked into.

- **R-squared limitations:** Although a high R-squared indicates a solid model, it is not always a perfect model. Variance that cannot be explained may nonetheless exist.

Conclusion

In conclusion, this extensive analysis has provided valuable insights into different aspects of tax administration, revenue generation, and taxpayer behaviour in India. By using regression analysis, the study identified a strong link between GDP and direct tax revenue, highlighting the economic impact on tax collection. The analysis of ratios indicated an improvement in the efficiency of tax collection processes over a 22-year period, with continuous growth in the taxpayer base, especially among individuals and small- to medium-sized businesses. Moreover, the examination of the Tax Effort Ratio emphasized the increasing importance of direct taxes in total tax revenue, indicating a shift in revenue sources. The correlation analysis further showed positive connections between various forms of direct taxes and total tax revenue, underlining the interconnected nature of tax collection dynamics. Despite some limitations such as data constraints and methodological challenges, the findings have significant implications for policy-making, managerial decisions, and future research efforts to enhance tax administration, encourage tax compliance, and ensure sustainable fiscal management in India. Moving forward, interdisciplinary cooperation, engagement with stakeholders, and ongoing monitoring and evaluation will be crucial in addressing these challenges and developing evidence-based solutions for improving tax administration outcomes and supporting inclusive economic growth.

REFERENCES

1. Sharma, G. (2020). A comprehensive study of income tax laws in the taxation system of India. Journal of Critical Reviews, 7(15), 3283–3299. http://www.jcreview.com/?mno=132808

2. Rao, M. G., & Rao, R. P. (2005b). Trends and issues in tax policy and reform in India. RePEc: Research Papers in Economics. https://www.nipfp.org.in/media/medialibrary/2013/04/wp05_nipfp_037.pdf

3. Rao, M. G. (2016). Tyranny of the status quo: The challenges of reforming the Indian tax system. NCAER, 12(1), 47–101. https://ideas.repec.org/a/nca/ncaerj/v12y2016i2016-1p47-101.html

4. Hanlon, M., & Heitzman, S. (2010). A review of tax research. Journal of Accounting and Economics, 50(2–3), 127–178. https://doi.org/10.1016/j.jacceco.2010.09.002

5. Tandon, S., & Rao, R. P. (2017). Tax Compliance in India: An Experimental approach. RePEc: Research Papers in Economics. https://econpapers.repec.org/paper/npfwpaper/17_2f207.htm

6. Rao, M. G. (2005). Tax system reform in India: Achievements and challenges ahead. Journal of Asian Economics. https://doi.org/10.1016/j.asieco.2005.10.003

7. Gale, W. G., & Samwick, A. A. (2014). Effects of income tax changes on economic growth. Social Science Research Network. https://doi.org/10.2139/ssrn.2494468

8. Jalan, G. K. (2019). IMPACT OF INCOME TAX ON THE REVENUE OF GOVERNMENT OF INDIA. IJCRT, 7(1), ISSN: 2320-2882. https://www.ijcrt.org

9. Wagle, N., & Manerkar, M. (2022). Assessment of Direct Tax Collection in India. Research Square (Research Square). https://doi.org/10.21203/rs.3.rs-2148335/v1

10. Sensors, J. O. (2024). Retracted: Research on tax collection and administration application and legal issues based on big data analysis. Journal of Sensors, 2024, 1. https://doi.org/10.1155/2024/9792671