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## Taxation System in India and the \$5-Trillion Economy

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### ABSTRACT

This paper examines how India's taxation system can act as a catalyst in achieving the \$5-trillion economy vision. The study addresses three objectives: (i) analyzing the contribution of taxation to GDP and revenue mobilization; (ii) reviewing government reforms and initiatives that strengthen efficiency, compliance, and formalization; and (iii) assessing key challenges, opportunities, and future pathways for taxation-led growth. Adopting a descriptive-analytical approach and relying on secondary data (Union Budget, Ministry of Finance, CBDT, CBIC, RBI, IMF, World Bank), the paper synthesizes trends in direct and indirect taxes over the last two decades. Results indicate that taxation contributes significantly to India's developmental finance, with gross tax revenue rising from 10.2% of GDP in 2010 to 11.5% in 2023. Landmark reforms such as Goods and Services Tax (GST), corporate tax rationalization, faceless assessments, and digital compliance frameworks have expanded the tax base and improved efficiency. Yet, challenges persist in widening the taxpayer net, ensuring equity, tackling evasion, and harmonizing federal-state fiscal relations. If India deepens tax reforms, strengthens digital rails, and balances revenue needs with competitiveness, taxation can serve not

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just as a revenue tool but as a multiplier of investment, formalization, and inclusive growth—precisely the conditions needed to accelerate progress toward the \$5-trillion economy.

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## 1.1 Introduction

India has set itself the ambitious goal of becoming a \$5-trillion economy in the near future, symbolizing rapid economic expansion, improved global competitiveness, and inclusive prosperity. Achieving this milestone requires strong and sustainable public finances. The taxation system stands at the heart of this endeavor, serving not only as a mechanism for revenue collection but also as a strategic policy lever to influence investment, consumption, redistribution, and formalization of the economy.

Historically, India's taxation framework has undergone continuous transformation—from colonial-era systems to post-independence reforms, the 1991 liberalization, and landmark structural shifts such as the implementation of the Goods and Services Tax (GST) in 2017. Alongside, direct tax policies have been rationalized to attract investments and improve compliance, while the integration of digital tools has aimed at transparency and accountability.

A robust taxation system contributes to the \$5-trillion target in three ways: (i) ensuring steady public revenues to fund infrastructure, social welfare, and human capital investments; (ii) incentivizing private sector dynamism through rational, stable, and competitive tax rates; and (iii) deepening formalization, thereby expanding the productive capacity of the economy. Thus, taxation is not merely a fiscal necessity but a growth enabler, central to India's developmental aspirations.

Beyond its fiscal role, taxation is a powerful instrument for shaping economic behavior and long-term development pathways. By incentivizing investment through corporate tax cuts, promoting consumption through indirect tax reforms, and steering resources toward priority sectors via targeted exemptions or credits, the tax system directly influences macroeconomic outcomes. Moreover, taxation enhances formalization, as seen in the integration of GST and digital compliance, which has brought millions of enterprises into the tax net. This integration not only widens the base but also strengthens transparency, reduces informality, and builds citizen trust in state institutions. In the context of India's \$5-trillion aspiration, therefore, the taxation system must evolve beyond mere revenue collection to serve as a growth multiplier, encouraging competitiveness, equity, and sustainable development simultaneously.



## 1.2 Review of Literature

Scholarly work on taxation and economic growth often revolves around the balance between efficiency, equity, and revenue sufficiency. Barro (1990) established that excessive taxation can distort incentives and slow growth, whereas well-structured taxes can finance productive public investment. Stiglitz (2015) emphasized the role of progressive taxation in ensuring social equity without harming competitiveness.

Indian literature reflects similar debates. Chelliah Committee Reports (1991) and Kelkar Committee (2002) laid the foundation for modern tax reforms, highlighting the need for simplicity, broadening the tax base, and lowering rates. Rao & Rao (2009) examined the growth implications of indirect tax reforms, underlining GST's potential to unify markets. More recent studies (e.g., Gupta & Jena, 2019; OECD, 2022) show that India's digital tax compliance architecture—e-filing, GSTN, faceless assessments—has substantially improved efficiency and widened the taxpayer base.

Yet challenges remain: India's tax-to-GDP ratio, at around 11–12%, is lower than the OECD average (34%) and BRICS peers like Brazil (33%). Studies suggest that enhancing compliance, reducing litigation, and ensuring stable tax policy can increase revenue mobilization without raising rates. This literature positions taxation as both a constraint and an opportunity in India's growth story.

Scholars have also emphasized the significance of tax buoyancy in sustaining long-term growth. Tanzi and Zee (2000) argued that developing economies need a tax system that can respond elastically to GDP growth without constant rate changes, ensuring fiscal sustainability. In India's case, empirical studies (Khan & Sen, 2011) found that tax buoyancy improved following liberalization but remained volatile due to reliance on indirect taxes. The introduction of GST and the expansion of digital compliance frameworks have been highlighted as steps toward improving elasticity and stabilizing revenues. Such reforms are critical because consistent and predictable revenue flows allow the government to finance infrastructure and human capital investments that underpin sustained economic expansion.

## 1.3 Objectives of the Study

1. To analyze the contribution of taxation to India's GDP and developmental finance in the context of the \$5-trillion economy.
2. To examine government initiatives and reforms that strengthen tax efficiency, compliance, and competitiveness.



3. To assess the key challenges and opportunities in taxation for supporting sustainable, inclusive growth.

## **1.4 Methodology**

The present study is descriptive in nature and relies on secondary data. Sources include Union Budget documents, Ministry of Finance reports, Reserve Bank of India bulletins, Economic Surveys, Central Board of Direct Taxes (CBDT) and Central Board of Indirect Taxes & Customs (CBIC) data, NITI Aayog reports, IMF, World Bank, and OECD publications. The approach is analytical, focusing on trends in revenue mobilization, structural reforms, and their implications for India's growth trajectory.

## **1.5 Contribution of Taxation in India**

### **1.5.1 Tax-to-GDP ratio and revenue trends**

India's tax-to-GDP ratio improved from 10.2% in 2010 to 11.5% in 2023, though still below global benchmarks. Direct taxes (income and corporate tax) contribute about 55% of gross tax revenue, while indirect taxes (mainly GST, customs, excise) account for the rest. This composition highlights the increasing role of direct taxation in progressive redistribution while maintaining efficiency through broad-based indirect levies.

### **1.5.2 Direct taxation and investment climate**

The corporate tax cut in 2019 (from 30% to 22% for existing companies and 15% for new manufacturing firms) positioned India as a competitive investment destination. Faceless assessments, expanded TDS/TCS coverage, and widening of the PAN–Aadhaar-linked taxpayer database have further increased compliance. Individual income tax reforms, including optional simplified regimes, aim to encourage transparency and reduce litigation.

### **1.5.3 Indirect taxation and GST reform**

The Goods and Services Tax (GST), introduced in 2017, subsumed multiple cascading state and central taxes into a unified structure. Despite initial challenges, GST has increased efficiency, improved logistics, and created a nationwide common market. Collections crossed ₹1.8 lakh crore per month in 2024, reflecting buoyancy and compliance improvements. However, issues of rate rationalization, compensation to states, and compliance costs for small businesses remain.



### 1.5.4 Digital taxation and formalization

India has pioneered digital public infrastructure in taxation. Initiatives like GSTN, e-invoicing, faceless assessments, and e-filing platforms have reduced corruption, improved efficiency, and broadened the taxpayer base. Internationally, India has also been active in negotiations on digital economy taxation, ensuring fairness in revenue allocation from global tech giants.

### 1.5.5 Taxation and inclusive growth

Through progressive income taxation, redistribution is enhanced, funding welfare programs such as MGNREGA, PM-KISAN, and health and education schemes. Indirect taxes, while regressive in nature, are offset by targeted subsidies and direct benefit transfers enabled by JAM trinity (Jan Dhan–Aadhaar–Mobile). Thus, taxation supports inclusive growth while sustaining macroeconomic stability.

## 1.6 Government Initiatives and Policies Supporting Taxation’s Role in the \$5-Trillion Goal

1. **GST Reform:** Creating a unified indirect tax system that improves logistics and market integration.
2. **Corporate Tax Rationalization (2019):** Reducing rates to attract investment.
3. **Faceless Assessment & Appeals:** Enhancing transparency and reducing harassment.
4. **Digital Compliance Infrastructure (GSTN, e-filing, e-invoicing):** Expanding taxpayer base and minimizing evasion.
5. **Direct Tax Code (proposed):** Simplifying structures for individuals and businesses.
6. **Fiscal Responsibility & Budget Management (FRBM):** Ensuring fiscal discipline to balance growth with stability.
7. **International Taxation Initiatives (BEPS, Pillar One & Two):** Protecting revenue in a digitalized global economy.

Together, these measures raise tax buoyancy, improve investment climate, and expand fiscal space for infrastructure and social investment—precisely the conditions necessary to accelerate toward the \$5-trillion economy.



## 1.7 Key Challenges and Opportunities in Taxation for a \$5-Trillion Economy

### 1.7.1 Key Challenges

- Low tax-to-GDP ratio compared with peers.
- High compliance burden for MSMEs.
- GST structural complexities and rate rationalization issues.
- Widening tax gap due to informal sector dominance.
- Litigation and disputes reducing efficiency.
- Fiscal federalism tensions (Centre–State revenue sharing).
- Risk of regressive impact from indirect taxes.

### 1.7.2 Key Opportunities

- Expanding taxpayer base through digital formalization.
- Harnessing GST data analytics for compliance and policy.
- Enhancing direct tax progressivity for equity.
- Leveraging global tax reforms to protect revenue from MNEs.
- Using stable tax policies to attract foreign direct investment.
- Linking taxation with green growth (carbon taxes, incentives for renewables).
- Strengthening cooperative federalism for smoother GST and fiscal transfers.

## 1.8 Conclusion

The taxation system is central to India’s journey toward a \$5-trillion economy. It provides not just fiscal resources but also a framework for shaping investment, formalization, and equity. Evidence shows that India’s tax revenues have been buoyant in recent years, supported by reforms in GST, corporate taxes, and digital compliance. However, persistent challenges—low tax-to-GDP ratio, compliance burdens, and federal tensions—need careful policy attention.



The pathway forward requires rationalizing GST rates, simplifying direct taxes, deepening digital integration, and ensuring cooperative federalism in revenue sharing. Tax policy must also balance competitiveness with equity, encouraging private investment while safeguarding resources for inclusive development. By embedding taxation within a transparent, digital-first, and equity-oriented framework, India can ensure that its fiscal architecture not only funds growth but actively drives it making the \$5-trillion economy vision both achievable and sustainable.

Furthermore, the path to a \$5-trillion economy requires taxation to strike a delicate balance between growth and equity. While rationalizing corporate tax rates attracts investment and boosts competitiveness, progressive direct taxation ensures that the gains of growth are distributed more equitably across society. This dual role of taxation—stimulating capital formation while funding welfare—positions it as both a driver of prosperity and a safeguard against inequality. For a diverse country like India, where regional and income disparities remain significant, a carefully designed tax system can ensure that fiscal consolidation does not come at the expense of inclusivity.

Equally important is the role of technology and data analytics in shaping the future of India's taxation system. Leveraging artificial intelligence, blockchain, and big data can further improve compliance, detect evasion, and personalize taxpayer services, thereby enhancing trust and efficiency. As India integrates with global value chains, international tax cooperation—through frameworks like OECD's BEPS and Pillar Two—will be vital to safeguard revenues from digital multinationals. By embedding these innovations and cooperative frameworks into its tax policy, India can transform taxation from a traditional revenue tool into a dynamic growth engine, ensuring that the fiscal foundation for the \$5-trillion economy is both strong and sustainable.

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