TAX POLICY AND ECONOMIC STABILIZATION: A HISTORICAL ANALYSIS OF KEY TAX REFORMS IN INDIA

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ABSTRACT

Tax policy in India has undergone a century-long transformation, evolving from the colonial frameworks of the early twentieth century to a modern, technology-driven, compliance-oriented structure that is now on the threshold of a legislative overhaul with the introduction of the Income Tax Bill, 2025. This paper examines the evolution of reforms beginning with the Income-tax Act of 1922 and the Income-tax Act of 1961, tracing their role in shaping revenue system in India and their broader economic implications. It explores structural adjustments such as the introduction of Modified Value Added Tax (MODVAT) in 1986, the implementation of Value Added Tax (VAT) in 2005, and the Goods and Services Tax (GST) in 2017, and situates them within broader economic reforms in India. This paper analysis highlights the importance of Fiscal Responsibility and Budget Management (FRBM) Act, 2003, the enforcement of General Anti-Avoidance Rules (GAAR) in 2017, and the restructuring of personal income taxation through Section 115BAC (2020) and the abolition of Dividend Distribution Tax (DDT) in 2020. The study also evaluates the COVID-19 fiscal relief measures of 2020–21, which underscored the stabilizing role of tax policy in stabilizing the economy. Recent developments, particularly in Budget 2023, Budget 2024, and Budget 2025, mark a decisive shift toward simplification and relief for the middle class. These include the default adoption of the new tax regime, significant rebate threshold expansions from ₹5 lakh in 2019 to ₹12 lakh in 2025, enhancement of standard deductions, and the announcement of the Income Tax Bill, 2025, which will replace the outdated Income-tax Act of 1961 with effect from April 2026. Parallelly, the rationalization of GST slabs in 2025 reflects the government's effort to balance efficiency with consumption stimulus. Together, these developments demonstrate how tax policy has consistently served as a tool for both economic stabilization and fiscal consolidation.

Keywords: Tax reforms, Goods and Services Tax (GST), General Anti-Avoidance Rules (GAAR), economic stabilization, revenue mobilization.

1. Introduction

Tax policy has historically occupied a central position in India's economic management, shaping not only revenue mobilization but also wider macroeconomic stability[1]. Unlike various other policy domains that shift direction with political regimes, taxation has remained a sustained project of gradual reform, reflecting the state's fiscal needs, distributive commitments, and the imperatives of growth. Since independence in 1947, India has relied heavily on taxation as a mechanism for balancing development expenditure with fiscal prudence, while also leveraging it as a tool of economic stabilization during crises such as inflationary surges, balance-of-payments shocks, and most recently, the COVID-19 pandemic[2].

The evolution of the tax regime in India reveals the increasing institutional sophistication and policy responsiveness[3]. The colonial-era Income-tax Act of 1922 laid the earliest foundation for systematic tax administration, followed by the Income-tax Act of 1961, which consolidated and modernized India's post-independence fiscal framework. Over the decades, successive reforms reflected both domestic pressures and global economic trends[4]. The 1980s and 1990s were marked by structural tax adjustments, including the introduction of MODVAT in 1986 to reduce the cascading effect of excise duties, and reforms aligned with the broader liberalization process initiated in 1991. The early 2000s saw consolidation, most prominently through the FRBM Act of 2003, which set new standards of fiscal discipline, and the nationwide rollout of VAT in 2005, which created a more harmonized indirect tax base across states[5].

The turning point came in 2017, with the introduction of the Goods and Services Tax (GST), which represented the most ambitious tax reform in independent India. GST subsumed a wide array of central and state indirect taxes into a single, unified system, intended to create a common national market, improve compliance, and boost efficiency. The same year also saw the implementation of GAAR, designed to combat aggressive tax avoidance strategies by

[1] Adwaid M. S, Evolution of India's Tax Rates Since Independence, (Aug. 15, 2025), https://www.taxscan.in/top-stories/evolution-of-indias-tax-rates-since-independence-1430247.
[2] Shravanakumari S Biradar, THE ROLE OF TAXATION IN ECONOMIC STABILIZATION, 10.
[3] taxguru_in & Khushi Bansal, Rethinking Taxation System in India-Challenges and Solutions, TAXGURU (Mar. 13, 2024), https://taxguru.in/income-tax/rethinking-taxation-system-india-challenges-solutions.html.
[4] History of Tax Law in India: From Ancient Roots to Modern Reforms, https://thelegalschool.in/blog/history-of-tax-law-in-india (last visited Aug. 29, 2025).
[5] Ipf-02-Rao.Pmd, https://www.brookings.edu/wp-content/uploads/2016/07/2005_rao.pdf (last visited Aug. 29, 2025).

multinational corporations and high-net-worth individuals[6].

The decade of the 2020s has been defined by simplification, digitization, and taxpayer relief. The COVID-19 fiscal relief measures of 2020 showed the flexibility of tax policy in providing liquidity support[7]. The government abolished the Dividend Distribution Tax in 2020, shifted the burden to shareholders, and introduced Section 115BAC, creating an optional simplified personal tax regime. From Budget 2023 onward, the government began to privilege the new regime, making it the default system and steadily expanding rebate thresholds and deductions[8]. The Budget of 2025 was particularly historic its not only raised the rebate threshold to ₹12 lakh, effectively exempting a vast majority of taxpayers, but also unveiled the Income Tax Bill, 2025, a long-awaited legislative reform that will replace the Income-tax Act of 1961 with effect from April 2026. Simultaneously, a roadmap for GST rationalization was announced, aiming to collapse the multiple-rate system into a simpler two-rate structure of 5% and 18%[9].

Taken together, these developments reveal a tax policy landscape that is dynamic, deeply intertwined with India's economic trajectory, and increasingly oriented toward simplification, equity, and stabilization. Tax policy today is not merely about collecting revenue; it is about ensuring fiscal responsibility, promoting consumption and investment, and preparing India for a competitive position in the global economy[10].

2. Early Reforms (1922 and 1961) with Continuity till 2025

The history of modern Indian taxation begins with the Income-tax Act of 1922, which replaced a series of fragmented provincial measures with a centralized and comprehensive legislative framework. Enacted under colonial rule, the 1922 Act for the first time codified clear principles

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[6] 6 Years of GST: India's Unprecedented Indirect Tax Reform That Dared to Revolutionise the Economic Landscape - The Economic Times, https://economictimes.indiatimes.com/news/economy/policy/6-years-of-gst-indias-unprecedented-indirect-tax-reform-that-dared-to-revolutionise-the-economic-landscape/articleshow/101411150.cms?from=mdr (last visited Aug. 29, 2025).

[7] Covid-19 Crisis: Tax Relief Measures in India, HTTPS://WWW.TAXMANN.COM, https://www.taxmann.com/research/income-tax/top-story/105010000000017882/covid-19-crisis-tax-relief-measures-in-india-experts-opinion-experts-opinion (last visited Aug. 29, 2025).

[8] ABOLITION OF DDT AND ITS IMPACT, TAXTMI, https://www.taxtmi.com/article/detailed?id=9167 (last visited Aug. 30, 2025).

[9] Union Budget 2025: Income Tax Relief Apart, FM Unveils Easing of Onerous TDS and TCS Norms - The Hindu, https://www.thehindu.com/news/national/budget-2025-no-tax-for-incomes-up-to-12-lakh/article69168961.ece (last visited Aug. 30, 2025).

[10] (PDF) Reinventing India's Fiscal Landscape : An Alternative Tax Policy Framework in the Absence of Income Tax, https://www.researchgate.net/publication/391274256_Reinventing_India's_Fiscal_Landscape_An_Alternative_Tax_Policy_Framework_in_the_Absence_of_Income_Tax (last visited Aug. 30, 2025).

of income assessment, tax liability, and administrative procedure. It sought to establish uniformity in a system that had previously been riddled with inconsistencies. Although its scope was limited, largely focusing on urban incomes and excluding significant rural and agricultural earnings, the Act introduced progressive tax rates, basic appellate procedures, and the beginnings of an institutional framework that would later expand into the Income Tax Department and the Income Tax Appellate Tribunal. In effect, while it reflected colonial fiscal priorities, it laid the legal and administrative foundation for modern taxation in India[11].

After independence in 1947, India's developmental state required a broader and more robust taxation system to finance industrialization, infrastructure, and welfare. This led to the drafting of a new law, culminating in the Income-tax Act of 1961, which came into force on 1 April 1962. This Act represented a comprehensive overhaul of the 1922 law, reflecting the ambitions of a sovereign state determined to pursue planned economic growth[12]. The 1961 Act expanded the tax base by including new categories of income such as capital gains, introduced a wider array of exemptions and deductions to incentivize investment, and established the Central Board of Direct Taxes (CBDT) as the apex body overseeing tax administration. Importantly, it created a more elaborate administrative apparatus, which provided the state with both stronger enforcement powers and more refined mechanisms of adjudication[13].

Over the decades, the 1961 Act became a living instrument, continuously amended to adapt to India's shifting economic policies. In the socialist phase of the 1960s and 1970s, it was used to enforce very high marginal tax rates, often exceeding 90 percent for top income brackets, reflecting redistributive priorities[14]. In the liberalization era of the 1990s, it became a vehicle for lowering rates, widening the base, and attracting foreign investment. Successive finance ministers amended its provisions to introduce new incentives, exemptions, and compliance requirements, reflecting both domestic imperatives and global trends. However, as the decades passed, the Act accumulated a massive body of amendments more than 1,500 by 2025 making

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[11] Admin, History of Income Tax Act, THE LAW CODES (Jan. 30, 2025), https://thelawcodes.com/history-of-income-tax-act/.

[12] Income Tax Act 1961: Meaning, Features and Provision, WWW.BAJAJFINSERV.IN, https://www.bajajfinserv.in/understand-income-tax-1961 (last visited Aug. 30, 2025).

[13] Facundo Alvaredo, Augustin Bergeron & Guilhem Cassan, Income Concentration in British India, 1885-1946. Online Appendix.

[14] Rishabh Sharma, When Indira Gandhi Brought 97.5% Income Tax Rate, INDIA TODAY (Apr. 26, 2024), https://www.indiatoday.in/history-of-it/story/india-income-tax-rate-975-indira-gandhi-yb-chavan-congress-lok-sabha-elections-2531881-2024-04-26.

it excessively complex and often contradictory[15].

In 2020s, the complexity of the 1961 Act had become a significant barrier to ease of compliance, creating litigation and administrative bottlenecks. Recognizing these challenges, the government introduced the Income Tax Bill, 2025, which was passed by Parliament in August 2025 and is set to take effect from 1 April 2026, formally replacing the 1961 Act. The new Bill represents the most significant legislative shift in Indian tax law in over six decades. Its key objectives include simplification of definitions and provisions, digital-first compliance systems, reduced litigation through a new Section 202 dispute resolution mechanism, and alignment with global best practices in areas such as corporate taxation and international transfer pricing[16].

The development from the 1922 Act to the 1961 Act, and now to the 2025 Bill, illustrates the continuity of India's tax evolution. Each reform has sought to address the fiscal and developmental needs of its era: colonial revenue extraction in 1922, post-independence developmental planning in 1961, and twenty-first century demands for simplification, digitalization, and global competitiveness in 2025. This long arc of reform shows that taxation in India has never been static but has continually adapted to the country's broader economic transformations[17].

2.1 Indirect Tax Reforms in India: MODVAT, VAT, GST, and GST Rationalization (1986–2025)

The evolution of indirect tax reforms in India from the mid-1980s to 2025 is one of the most defining aspects of the country's fiscal and economic evolution. While direct taxation was always central to redistributive justice and fiscal planning, it was indirect taxes—excise duties, sales taxes, service taxes, and customs duties that contributed the lion's share of government revenues until the twenty-first century. The journey of reform in this sphere, spanning four decades, illustrates India's attempt to move from a fragmented, cascading, and distortionary system of taxation toward a harmonized, transparent, and consumption-based system that

[15] New Income Tax Act 2025: What Changed and What Remains Unchanged?, CLEARTAX, https://cleartax.in/s/new-income-tax-act (last visited Aug. 30, 2025).

[16] New Income Tax Act 2025: What Changed and What Remains Unchanged?, CLEARTAX, https://cleartax.in/s/new-income-tax-act (last visited Aug. 30, 2025).

[17] aaditya.bhatt, The Evolution of Indian Taxation: From Ancient Foundations to Modern GST Regime, BHATT & JOSHI ASSOCIATES (Aug. 22, 2022), https://bhattandjoshiassociates.com/the-evolution-of-indian-taxation-from-ancient-foundations-to-modern-gst-regime/.

aligns with global best practices. The reform path can be broadly divided into three phases: the introduction of the Modified Value Added Tax (MODVAT) in 1986, the rollout of Value Added Tax (VAT) at the state level in 2005, and the introduction of the Goods and Services Tax (GST) in 2017. A fourth, emerging phase—the rationalization of GST slabs in 2025—marks the transition toward maturity and consolidation in India's indirect tax regime[18].

The first major structural step in indirect taxation came in 1986, when the government introduced MODVAT, a reform spearheaded by Finance Minister V. P. Singh under the Rajiv Gandhi administration. MODVAT was designed to address one of the most persistent problems of India's excise duty system: the cascading effect of taxes. Prior to MODVAT, excise duties were levied at each stage of production, with no provision for crediting the duty already paid on inputs. This meant that tax was levied on tax, leading to inflated production costs, distorted prices, and inefficient allocation of resources. MODVAT introduced a system of input tax credit for manufacturers, allowing them to deduct the duty paid on inputs from their excise liability on final products. Though initially limited to certain goods, MODVAT represented a conceptual breakthrough. It marked the beginning of India's shift toward a value-added taxation system, in line with global trends. Over time, MODVAT was expanded and later evolved into the Central Value Added Tax (CENVAT) in 2000, which provided a broader credit chain and greater harmonization[19].

The second stage of reform unfolded in 2005, when India transitioned from a state-level sales tax system to the Value Added Tax (VAT) regime. Prior to VAT, sales taxes levied by states suffered from serious limitations: rates varied across states, there was no uniformity in exemptions, and multiple levies—such as turnover tax, entry tax, and purchase tax—created a highly fragmented system that discouraged inter-state trade. VAT, introduced first in Haryana on 1 April 2005 and gradually adopted by almost all states, brought about a fundamental change in the architecture of state taxation. It replaced the cascading sales tax system with a value-added mechanism, enabling taxpayers to claim credit for input taxes already paid. VAT enhanced transparency, reduced tax-induced price distortions, and aligned state taxation with

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[18] (PDF) A COMPARATIVE STUDY OF DIRECT AND INDIRECT TAX REFORMS IN INDIA, RESEARCHGATE (2025), https://www.researchgate.net/publication/388871176_A_COMPARATIVE_STUDY_OF_DIRECT_AND_INDIRECT_TAX_REFORMS_IN_INDIA.

[19] Manmohan Singh 1991 Budget: Full Speech of a Budget That Changed Our Fortunes, THE ECONOMIC TIMES, Dec. 30, 2024, https://economictimes.indiatimes.com/news/economy/policy/manmohan-singh-1991-budget-full-speech-of-a-budget-that-changed-our-fortunes/articleshow/116706726.cms?from=mdr.

global norms. Importantly, VAT represented not only a technical reform but also a political one, as it required coordination and consensus between the Union and the states, foreshadowing the challenges and negotiations that would later characterize the rollout of the GST[20].

The most transformative reform in India's indirect tax history, however, came in 2017, with the introduction of the Goods and Services Tax (GST). After years of political negotiation, constitutional amendment, and technical preparation, GST was rolled out nationwide on 1 July 2017, replacing a complex web of central and state levies. GST subsumed excise duty, service tax, central sales tax, and a wide range of state-level taxes such as VAT, entry tax, octroi, and luxury tax into a single unified tax regime. For the first time in independent India, the principle of "One Nation, One Tax, One Market" was operationalized. GST was designed to be destination-based, levied at the point of consumption rather than production, and its architecture was built around a dual model with both the Centre and the states empowered to levy GST concurrently[21].

The introduction of GST represented a watershed moment for several reasons. First, it created a unified national market by removing inter-state barriers to trade. Second, it significantly improved compliance and revenue buoyancy through digitization and the implementation of the GST Network (GSTN), an IT backbone enabling e-filing, invoice matching, and real-time crediting of input taxes. Third, GST addressed the cascading problem more comprehensively than VAT or CENVAT, as it applied across goods and services. Fourth, by harmonizing indirect taxation, GST enhanced India's attractiveness as an investment destination. Despite its many benefits, GST's implementation was not without challenges. Small businesses struggled with compliance requirements, the multiple-rate structure created confusion, and revenue shortfalls tested the fiscal balance of states. Nevertheless, the reform has matured over time, with revenue collections consistently crossing ₹1.5 lakh crore per month by 2023–24, reflecting growing compliance and stabilization of the regime[22].

The most recent phase in indirect tax reform has unfolded in 2025, with the government announcing a roadmap for GST rationalization in the Union Budget of February 2025. Over the years, the multi-rate structure of GST featuring slabs of 0%, 5%, 12%, 18%, and 28% was

[20] Satya Poddar & Ehtisham Ahmad, GST Reforms and Intergovernmental Considerations in India.
[21] World Bank Document, https://documents1.worldbank.org/curated/en/918831542619297197/ pdf/GST-final-IDU.pdf (last visited Sept. 1, 2025).
[22] Mansi Khatik, THE JOURNEY OF GOODS & SERVICES TAX (GST) IN INDIA: AN OVERVIEW, 2 INT. J. MANAG. ECON. COMMER. 99 (2025).

criticized for its complexity and distortions. Certain items continued to face classification disputes, and the highest slab of 28% was seen as discouraging consumption in sectors such as automobiles and consumer durables. Responding to these concerns, the government unveiled a plan to collapse the rate structure into a simpler two-rate system of 5% and 18%, with luxury and sin goods continuing to attract a higher cess. This reform, scheduled for phased implementation by late 2025 and early 2026, represents the consolidation and maturity of the GST system. By reducing the number of rates, the rationalization aims to simplify compliance, minimize classification disputes, enhance efficiency, and stimulate consumption[23].

The broader economic significance of these indirect tax reforms cannot be overstated. By gradually moving from MODVAT to VAT to GST, and now toward GST rationalization, India has progressively aligned its taxation system with international best practices while also addressing the specific needs of a vast and diverse economy. The value-added principle embedded in these reforms has reduced cascading, increased efficiency, and boosted competitiveness. The digital backbone of GST has modernized compliance and reduced the scope for evasion. The shift toward rationalization in 2025 indicates a recognition that while reforms must be ambitious, they must also be sustainable and citizen-friendly. Importantly, these reforms have not been purely technical exercises; they have reflected the political economy of India's federal structure, requiring unprecedented levels of negotiation and consensus-building between the Centre and the states[24].

In India's indirect tax reforms between 1986 and 2025 tell a story of incremental yet transformative change. MODVAT laid the intellectual and administrative foundation for value-added taxation. VAT created a uniform structure at the state level and enhanced fiscal coordination. GST revolutionized indirect taxation by unifying the market and modernizing compliance. Finally, GST rationalization in 2025 points toward the consolidation of this system into a simpler, more sustainable framework. Together, these reforms demonstrate the centrality of indirect taxation in India's economic management and its critical role in promoting growth,

[23] Business Standard, GST Reforms: From July 2017 to Diwali 2025: India's Evolving GST Journey Explained, (Aug. 26, 2025), https://www.business-standard.com/economy/news/gst-reforms-2025-history-changes-impact-india-tax-system-125082601082_1.html.

[24] Miss Himanshi Bansal Miss Himanshi Bansal & Prof Manoj Kumar Agarwal Prof Manoj Kumar Agarwal, GST- A Journey of Continuous Reforms in the Indian Indirect Taxation System: -, 19 J. ADV. SCH. RES. ALLIED EDUC. 308 (2022).

stability, and integration into the global economy[25].

2.2 Direct Tax Reforms in India: Liberalization, Corporate Taxation, GAAR, and the New Personal Tax Regime (1991–2025)

Direct taxation has historically occupied a central place in India's fiscal and developmental strategy. Unlike indirect taxes, which are regressive in nature and often place a disproportionate burden on the poor, direct taxes such as income tax, corporate tax, and wealth tax embody the principle of equity by taxing individuals and entities based on their capacity to pay. The evolution of India's direct tax system from the early 1990s to 2025 reflects the country's transition from a highly controlled and distortionary regime to one that increasingly emphasizes simplicity, equity, efficiency, and global competitiveness. The major milestones in this journey include the liberalization-era reforms of the 1990s, the rationalization of corporate taxation in the 2000s and 2010s, the implementation of General Anti-Avoidance Rules (GAAR) in 2017, the abolition of the Dividend Distribution Tax (DDT) in 2020, the introduction and evolution of the new personal tax regime (Section 115BAC) from 2020 onward, and the proposals under the Direct Taxes Code (DTC) framework and Income Tax Bill 2025. Together, these reforms illustrate India's effort to build a modern direct tax system capable of mobilizing resources for development while also promoting compliance and fairness[26].

The first transformative phase in direct taxation came in the aftermath of the 1991 economic liberalization. Until the early 1990s, India's direct tax regime was characterized by extremely high marginal tax rates, excessive exemptions, and widespread evasion. At one point in the 1970s, the marginal income tax rate, inclusive of surcharges, had reached a staggering 97.5%, which created strong incentives for tax avoidance and black money generation. The Chelliah Committee on Tax Reforms (1991–93), appointed by the government, recommended sweeping changes to rationalize the system. Acting on these recommendations, successive Finance Acts of the early 1990s drastically reduced personal income tax rates, broadened the tax base by minimizing exemptions, and simplified corporate taxation. The highest marginal rate on personal income was brought down to 40% by 1993–94, while corporate tax rates were aligned more closely with global standards. These reforms marked a fundamental shift in philosophy:

[25] (PDF) Reformation of Indirect Taxation System (GST) In India Article Info, RESEARCHGATE (2025), https://www.researchgate.net/publication/383987255_Reformation_of_Indirect_Taxation_System_GST_In_India_Article_Info.

[26] IJRAR19D5356.Pdf, https://www.ijrar.org/papers/IJRAR19D5356.pdf (last visited Sept. 1, 2025).

instead of punitive rates that encouraged evasion, the government sought moderate rates that would encourage compliance and boost revenues through a broader base. This phase set the tone for India's modern tax policy by emphasizing efficiency and equity over punitive extraction[27].

The second major development in direct taxation occurred in the 2000s and 2010s, as the government sought to make India's corporate tax system globally competitive. With globalization and increased foreign investment, India could no longer afford to maintain high statutory rates that discouraged business. Over time, corporate tax rates were gradually reduced. In a landmark reform, the government announced in September 2019 that the effective corporate tax rate for domestic companies would be reduced to 22% (15% for new manufacturing companies), one of the lowest among major emerging economies. This move was intended to spur investment, improve India's ranking in global ease of doing business indicators, and position the country as a manufacturing hub in the wake of shifting global supply chains[28]. By reducing corporate taxes, India aimed to strike a balance between revenue mobilization and competitiveness, a theme that continues to shape fiscal policy in 2025.

A critical milestone in the direct tax landscape was the introduction of the General Anti-Avoidance Rules (GAAR) in 2017, after years of debate and postponement. GAAR was designed as a safeguard against aggressive tax planning and base erosion by multinational corporations and large domestic entities[29]. It empowered tax authorities to deny tax benefits arising from transactions or arrangements that were primarily aimed at avoiding tax, even if technically legal. The implementation of GAAR was significant because it reflected India's alignment with global initiatives such as the OECD's Base Erosion and Profit Shifting (BEPS) project, which sought to curb tax avoidance in a globalized economy. While businesses initially feared that GAAR might lead to arbitrary assessments, the government issued guidelines to ensure its fair and transparent application[30]. By bolstering the integrity of the tax system, GAAR not only protected revenue but also signalled India's seriousness in building a fair and

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[27] (PDF) Tax Reform in India: Achievements and Challenges, RESEARCHGATE (2025), https://www.researchgate.net/publication/254388312_Tax_reform_in_India_Achievements_and_challenges.

[28] India's_Investment_Climate.Pdf, https://icrier.org/ICRIER_Wadhwani/Index_files/India's_Investment_Climate.pdf (last visited Sept. 2, 2025).

[29] Shatik Dhawan & Dr Kritika Nagpal, The Role Of GAAR In Combating Corporate Tax Avoidance In India: Legal Framework, Judicial Interpretation, And Comparative Insights, 13 (2025).

[30] Christophe Waerzeggers & Cory Hillier, Introducing a General Anti-Avoidance Rule (GAAR), 2016 TAX LAW TECH. NOTE 1 (2016).

rule-based taxation environment.

Another watershed reform in the direct tax system was the abolition of the Dividend Distribution Tax (DDT) in the Union Budget 2020. Prior to this reform, companies were required to pay DDT at the rate of around 20% (effective) on distributed profits, in addition to corporate tax. This led to the issue of double taxation of dividends—once in the hands of companies and again in the hands of shareholders when they received dividends above a certain threshold. By abolishing DDT and taxing dividends in the hands of shareholders at applicable slab rates, the government aligned India's system with international best practices and improved the attractiveness of Indian equities for foreign investors. The reform also enhanced transparency and equity, as dividend income became part of the taxable income of individuals, ensuring progressive treatment based on one's overall income[31].

The most consequential reform for ordinary taxpayers in recent years has been the introduction of the optional new personal income tax regime under Section 115BAC, announced in the Union Budget 2020. This regime offered taxpayers the option of choosing between the old system—featuring higher rates with exemptions and deductions—and the new system, with lower rates but no major exemptions. The aim was to simplify compliance, reduce litigation arising from exemption claims, and create a more transparent system. Initially, adoption of the new regime was modest, as many taxpayers found the old regime with deductions (such as under Sections 80C, 80D, and HRA) more beneficial. However, successive budgets progressively sweetened the new regime to encourage its adoption[32].

In the Union Budget 2023, the new regime was made the default option, with the rebate threshold increased to ₹7 lakh, effectively exempting a large section of the middle class from income tax. The Budget 2024 further raised the standard deduction to ₹75,000, providing additional relief to salaried taxpayers. Finally, in the Union Budget 2025, the rebate threshold was dramatically enhanced to ₹12 lakh, ensuring that a vast majority of individual taxpayers would either pay no tax or significantly reduced tax under the new system. Additionally, the Income Tax Bill 2025 proposed the creation of a new Section 202 framework, scheduled to be

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[31] Abolition of Dividend Distribution Tax – Impact and Challenges, HTTPS://WWW.TAXMANN.COM, https://www.taxmann.com/research/income-tax/top-story/105010000000018579/abolition-of-dividend-distribution-tax- (last visited Sept. 2, 2025).

[32] (PDF) A STUDY ON OPTIONAL TAX REGIME FOR INDIVIDUAL AND HINDU UNDIVIDED FAMILY TAXPAYERS UNDER SECTION 115BAC OF THE INCOME TAX ACT, 1961, https://www.researchgate.net/publication/345503592_ (last visited Sept. 2, 2025).

effective from 2026, which aims to comprehensively modernize the Income-tax Act, 1961. The Bill emphasizes simplification, digitization, taxpayer rights, and reduction of discretionary powers of authorities to minimize harassment and litigation. Taken together, these changes represent the most far-reaching overhaul of India's personal income tax system in decades[33].

The evolution of direct tax policy from 1991 to 2025 has had profound implications for economic stabilization and growth. By reducing rates and broadening bases, the reforms have increased compliance, reduced the scope for evasion, and created a more predictable fiscal environment. The rationalization of corporate taxes has positioned India as an attractive investment destination at a time when global supply chains are realigning. The abolition of DDT and the introduction of GAAR have enhanced fairness and credibility. Most importantly, the shift toward a simplified personal income tax regime has provided substantial relief to the middle class, boosted disposable incomes, and stimulated consumption—critical drivers of India's post-pandemic recovery. At the same time, challenges remain: tax buoyancy has not always kept pace with expectations, litigation continues to be a concern, and the task of balancing revenue needs with taxpayer-friendly reforms is ongoing[34].

In India's direct tax reforms over the last three decades illustrate a remarkable journey of modernization and adaptation. The liberalization-era reforms dismantled punitive rates and broadened the base; corporate tax rationalization improved competitiveness; GAAR and DDT abolition strengthened integrity and fairness; and the new personal tax regime, evolving rapidly between 2020 and 2025, marks a turning point in simplifying taxation for individuals. The proposed Income Tax Bill 2025 points toward the future of direct taxation in India—digitized, simplified, equitable, and growth-oriented. Together, these reforms underscore the central role of direct taxation not only in revenue generation but also in shaping India's broader trajectory of economic stabilization, growth, and integration into the global economy[35].

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[33] Referencer | Income Tax | Income Tax Rates | AY 2024-25 | FY 2023-24 | Normal Tax Rates Applicable to a Resident Individual, https://www.referencer.in/Income_Tax/Income_Tax_Rates_AY_2024-25.aspx (last visited Sept. 2, 2025).

[34] A Review of Direct Taxation in India: Evolution, Challenges, and Reform Initiatives – IJSREM, https://ijsrem.com/download/a-review-of-direct-taxation-in-india-evolution-challenges-and-reform-initiatives/ (last visited Sept. 2, 2025).

[35] (PDF) Direct Tax Reforms in India Performance Analysis during Pre and Post Liberalization Period, https://www.researchgate.net/publication/361809771_Direct_Tax_Reforms_in_India_Performance_Analysis_during_Pre_and_Post_Liberalization_Period (last visited Sept. 2, 2025).

3. Challenges in the Existing Tax Reforms in India

While India's tax reforms over the past three decades have undeniably modernized the fiscal system, improved transparency, and aligned the country more closely with global best practices, several challenges continue to hinder the effectiveness of the tax regime. These challenges span administrative, structural, social, and economic dimensions. They not only affect revenue generation and compliance but also influence the broader goals of equity, efficiency, and stabilization that tax policy is meant to serve[36].

3.1. Tax Buoyancy and Revenue Mobilization Issues

Despite major reforms such as the Goods and Services Tax (GST), the reduction in corporate tax rates, and the introduction of the new personal income tax regime, tax buoyancy remains weak. India's tax-to-GDP ratio has hovered around 10–11%, significantly lower than other major emerging economies such as Brazil (33%) or South Africa (26%). Even in 2025, despite enhanced digitization and compliance tools, direct tax collections fall short of potential because of limited tax base expansion. Only about 7.5 crore individuals file income tax returns, out of which barely 1.5 crore actually pay income tax. This reveals a structural problem: a vast informal economy and significant underreporting of incomes continue to limit the reach of taxation. Without a significant increase in revenue mobilization, India faces constraints in funding infrastructure, welfare programs, and fiscal consolidation[37].

3.2. GST Implementation Complexities

The rollout of GST in 2017 was heralded as a game-changer in India's indirect tax system, yet its implementation has faced persistent structural and administrative challenges. The multi-slab structure (0%, 5%, 12%, 18%, 28%) complicates compliance and distorts economic efficiency, especially when compared to countries with a single or dual GST rate. Frequent rate changes by the GST Council create uncertainty for businesses, while compliance burdens remain high for small enterprises due to complex return-filing requirements and reconciliation issues. Input tax credit (ITC) disputes continue to be a major source of litigation. Moreover, state

[36] (PDF) Assessing The Impact And Sustainability Of India's Tax Reforms On Economic Growth, RESEARCHGATE (2025), https://www.researchgate.net/publication/390309817_Assessing_The_Impact_And_Sustainability_Of_India's_Tax_Reforms_On_Economic_Growth.

[37] Contents & Other.P65, https://dcmsme.gov.in/The_Challenge_of_employment_in_India.pdf (last visited Sept. 2, 2025).

governments occasionally resist rate rationalization because of concerns about revenue losses, making GST reform politically contentious. As of 2025, although GST collections have improved, simplification into three slabs is still pending, and the debate over including petroleum, alcohol, and electricity in GST continues[38].

3.3. Compliance Burden and Litigation Culture

One of the persistent challenges in India's tax system is the excessive compliance burden placed on taxpayers. Despite digitization through portals like the Income Tax portal (faceless assessments) and GSTN, taxpayers often face technical glitches, inconsistencies in processing, and delayed refunds. Small and medium enterprises (SMEs) in particular find compliance costly and time-consuming[39].

Furthermore, India suffers from a litigation-heavy tax culture. According to CBDT data, as of 2024, over 5 lakh direct tax cases and 2.5 lakh indirect tax disputes were pending across tribunals and courts. A significant share of these disputes involves technical interpretations of exemptions, ITC claims, or transfer pricing issues. Although the government has tried to reduce disputes through schemes such as the Vivad se Vishwas (Dispute to Trust) (2020) and faceless assessment mechanisms, the reality is that litigation consumes enormous administrative and judicial resources, discourages investment, and creates uncertainty for taxpayers[40].

3.4. Equity Concerns: Regressive Burden and Narrow Direct Tax Base

Tax policy in India continues to raise concerns about equity the principle that taxpayers should contribute according to their ability to pay. Although direct taxes are progressive in structure, the limited number of income taxpayers means that a disproportionate share of the burden falls on a narrow segment of salaried classes and formal sector employees. In contrast, professionals, traders, and agricultural incomes above a certain threshold remain under-taxed due to loopholes

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[38] Parvejur Rahman & Sagufta Mehnaz, International Journal for Multidisciplinary Research (IJFMR), SSRN ELECTRON. J. (2024), https://www.ssrn.com/abstract=5054029.
[39] The Problems of Implementation of GST in India, CLEARTAX, https://cleartax.in/s/problems-of-implementation-of-gst (last visited Sept. 2, 2025).
[40] MDIM Journal of Management Review and Practice, https://mjmrp.mdim.ac.in/pages/table-of-contents/fulltext/?id=32&title=Tax+Administration+Reform:+End+of+Tax+Disputes+in+India? (last visited Sept. 2, 2025).

and exemptions[41].

Indirect taxes such as GST, though efficient in broadening the base, are regressive, as poorer households spend a higher proportion of their incomes on consumption. The multiple rates exacerbate inequities, with essentials taxed at lower rates while many goods and services consumed by the middle classes attract the standard 18% GST. Critics argue that the tax system should rely more on wealth and property taxes, such as inheritance tax or a reintroduced wealth tax, to address India's rising inequality. However, such measures remain politically sensitive and absent from the reform agenda[42].

3.5. Frequent Policy Changes and Uncertainty

Tax reforms in India are often characterized by frequent amendments, retrospective changes, and policy reversals, which erode investor confidence and create an atmosphere of unpredictability. The infamous retrospective taxation on Vodafone (2012) is a prime example, which damaged India's image as an investment destination until it was reversed in 2021. Even in 2025, businesses express concern about the unpredictability of tax rates, exemptions, and incentives. Frequent tinkering with GST rates and the annual modifications in income tax slabs or deductions discourage long-term planning. Investors and taxpayers prefer a stable tax environment, but India's system often prioritizes short-term revenue needs over long-term certainty[43].

3.6. Integration of Technology and Data Privacy Concerns

Digitization has been a cornerstone of recent tax reforms, with faceless assessment, AI-driven risk management systems, PAN-Aadhaar linkage, and e-invoicing in GST. While these tools have improved compliance monitoring, they have also created new challenges. Taxpayers often face glitches in portals, delayed rectification of errors, and mismatches in reporting. Additionally, the aggressive use of data raises privacy concerns, as personal financial data is increasingly concentrated with tax authorities. Building secure, user-friendly, and reliable

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[41] Magnus Nilsson, Economic Inequality, Marxist Theory, and Swedish-Language Working-Class Literature, 92 STUD. NEOPHILOL. 222 (2020).

[42] White Papers | Impact of Taxation on Indian Middle-Class Households: A Study Navigating Through the Struggles Due to Consistent Increase in GST | Shubh Gupta - Indus International School, ONE YOUNG INDIA, https://www.oneyoungindia.com/white-papers/impact-of-taxation-on-indian-middle-class-households%3A-a-study-navigating-through-the-struggles-due-to-consistent-increase-in-gst/shubh-gupta-indus-international-school (last visited Sept. 3, 2025).

[43] Aayushi Singh, A ChronoloGiCal a Nalysis oF VodaFone and Cairn –a Bit-tersaGa.

systems remains an unfinished task, especially as cybercrime and data breaches become more frequent globally[44].

3.7. Centre State Fiscal Federalism Tensions

The GST reform and broader tax framework have highlighted tensions in India's fiscal federalism. State governments often feel constrained by the loss of fiscal autonomy since GST subsumed many of their independent taxation powers. Compensation to states for revenue losses under GST has been a politically sensitive issue, especially during the COVID-19 pandemic. By 2022, disputes over compensation cess strained Centre–State relations, and even by 2025, states are demanding a larger share of GST revenues and greater flexibility to levy cesses. Without cooperative federalism, India's tax system risks becoming a battleground for fiscal disputes, undermining the stability of reforms[45].

3.8. Wealth Inequality and Untapped Tax Potential

India's tax system has so far shied away from taxing wealth directly. The wealth tax was abolished in 2015, and inheritance tax (or estate duty) has not been reintroduced since its abolition in 1985. As a result, wealth inequality has risen sharply. According to Oxfam's 2024 report, the top 1% of Indians control over 40% of national wealth, while the bottom 50% share less than 13%. Critics argue that without progressive taxation of wealth, inheritances, and capital gains, India's fiscal system cannot adequately address social justice or fund redistributive policies. However, policymakers fear that introducing such taxes would discourage investment, lead to capital flight, and face political backlash. This tension between equity and competitiveness remains unresolved[46].

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[44] (PDF) Leveraging AI Tools for Enhanced GST Compliance and Fraud Detection in the Indian Taxation System, RESEARCHGATE (2025), https://www.researchgate.net/publication/392299568_Leveraging_AI_Tools_for_Enhanced_GST_Compliance_and_Fraud_Detection_in_the_Indian_Taxation_System.

[45] (PDF) GST Reforms and Federalism in India: Understanding the Role of Critical Junctures, Veto Players, Constitutional Structures and the Judicial Safeguards of Federalism, RESEARCHGATE, https://www.researchgate.net/publication/364931677_GST_Reforms_and_Federalism_in_India_Understanding_the_Role_of_Critical_Junctures_Veto_Players_Constitutional_Structures_and_the_Judicial_Safeguards_of_Federalism (last visited Sept. 3, 2025).

[46] Anant Merathia, Inheritance Tax: An Economic Blunder, THE NEW INDIAN EXPRESS (May 12, 2024), https://www.newindianexpress.com/opinions/2024/May/12/inheritance-tax-an-economic-blunder-2.

3.9. Globalization and Tax Competition

In an interconnected world, India must balance its need for revenue with the pressures of global tax competition. While lowering corporate tax rates 22% standard, 15% for new manufacturing firms has helped attract investment, it has also reduced revenue flexibility. Moreover, India must align its system with global initiatives like the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS 2.0), which seeks to introduce a 15% global minimum corporate tax. This limits India's ability to use corporate tax incentives as a policy tool and could strain revenues further. Similarly, the taxation of the digital economy such as e-commerce, gig platforms, and cryptocurrencies remains a grey area where India must innovate while staying consistent with international norms[47].

3.10. Balancing Fiscal Consolidation with Social Spending

Finally, India's tax reforms face the overarching challenge of balancing fiscal discipline with developmental imperatives. With the Fiscal Responsibility and Budget Management (FRBM) Act targets repeatedly relaxed especially during COVID-19, the government faces mounting debt levels. Yet, India also needs massive investments in infrastructure, education, healthcare, and green transition. Tax reforms alone cannot bridge this gap unless revenue buoyancy improves significantly. Until then, the government will rely heavily on borrowing, which risks crowding out private investment and raising future debt servicing burdens[48].

4. Conclusion

Tax reforms in India between 1991 and 2025 represent a remarkable journey of modernization. However, persistent challenges such as weak tax buoyancy, a narrow base, GST complexities, excessive litigation, equity concerns, technological hurdles, and federal challenges highlight that reform is an ongoing process rather than a one-time event. Moving forward, policymakers must prioritize expanding the tax base by better integrating the informal economy, simplifying GST rates, and establishing stable long-term policy frameworks. There is also scope to reconsider wealth and inheritance taxation to address inequality. At the same time, reforms

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[47] How India's Tax Reforms Are Shaping the Investment Landscape, https://www.investindia.gov.in/team-india-blogs/how-indias-tax-reforms-are-shaping-investment-landscape (last visited Sept. 3, 2025).

[48] India's Fiscal Strategy and Management at a Crossroads - Finding the Right Balance for Growth, PFM (Nov. 25, 2024), https://origin-blog-pfm.imf.org/en/pfmblog/2024/11/india-fiscal-strategy-and-management-at-a-crossroads-finding-the-right-balance-for-growth.

should enhance predictability, fairness, and cooperative federalism, while leveraging technology responsibly.

The next phase of reforms must go beyond revenue generation to focus on building trust, reducing uncertainty, and promoting inclusiveness. A fair, transparent, and predictable tax system is essential to support India's developmental goals and ensure economic stabilization amid global volatility. Reforms will also need to be adaptive addressing domestic priorities such as job creation, digitalization, and inequality while responding to global shifts like climate-related taxation, digital economy regulation, and tax competition. With foresight and consensus, India's tax system can evolve from being a constraint to becoming a key driver of its emergence as a leading global economy.

5. Recommendations

5.1. Broadening the Direct Tax Base

The most urgent priority for India's future tax policy is to widen the direct tax base. Presently, only a small proportion of the population pays income tax, placing disproportionate pressure on compliant individuals and corporations. High-income professionals and agricultural earners, who fall outside the system, must be gradually included without burdening small farmers or informal workers. Rationalizing exemptions and deductions will further streamline compliance and create a fairer, more transparent framework.

5.2. Rationalizing GST for Efficiency

While the Goods and Services Tax has unified India's indirect tax landscape, the existence of multiple slabs and exclusions reduces its effectiveness. A simplified three-rate structure distinguishing essentials, standard goods, and luxuries would improve efficiency and compliance. The inclusion of petroleum, electricity, and alcohol into the GST framework should be considered to make it a truly comprehensive consumption tax, while SMEs should be supported with simplified return-filing and refund procedures.

5.3. Ensuring Tax Stability and Certainty

Uncertainty in tax policy, particularly retrospective amendments, has undermined investor confidence. India must adopt a medium-term tax roadmap that clearly signals expected changes, thereby fostering trust among businesses. Advance ruling mechanisms should be strengthened to provide clarity to both domestic and foreign investors. By avoiding abrupt policy shifts and offering predictability, India can enhance its competitiveness in attracting global capital.

5.4. Addressing Inequality through Redistributive Taxes

Tax policy must also address India's rising inequality. Reintroducing carefully designed wealth or inheritance taxes for the ultra-rich, alongside strengthening property taxation at the municipal level, could ensure progressive redistribution. At the same time, green taxes on polluting activities and carbon-intensive industries can align fiscal measures with environmental sustainability, generating both equity and ecological benefits.

5.5. Streamlining Dispute Resolution and Administration

The enormous volume of tax litigation in India has locked up revenue and created adversarial relations between taxpayers and authorities. Reforms should expand faceless assessments into appeals, backed by robust transparency safeguards. Alternative dispute resolution systems like mediation and arbitration can reduce litigation burdens. Penal provisions should target deliberate evasion, while minor non-compliance should be decriminalized to encourage voluntary adherence.

5.6. Harnessing Technology Responsibly

Technology can be transformative in strengthening tax administration, but it must be implemented with caution. Artificial intelligence and big data analytics can help detect evasion and reduce burdens on honest taxpayers. However, digital platforms must be robust, user-friendly, and capable of handling peak loads without repeated system crashes. Data security and privacy will be critical, requiring alignment with India's Digital Personal Data Protection framework to ensure public trust.

5.7. Strengthening Fiscal Federalism

Centre–State fiscal relations remain sensitive, particularly in the wake of GST compensation disputes. A predictable and rules-based revenue-sharing arrangement is essential for stability. Strengthening the GST Council as a cooperative decision-making platform, while granting municipalities greater authority over property and service taxation, can enhance fiscal autonomy at all levels of government. Such steps would foster trust and ensure smoother implementation of reforms.

5.8. Aligning with Global Tax Trends

India must proactively adapt to international tax developments. The global minimum corporate tax and OECD's digital economy taxation framework will influence India's policy space. Tax incentives will need recalibration to remain competitive while encouraging non-tax factors like infrastructure and skills. A comprehensive framework for taxing digital services and regulating cryptocurrencies is also essential to secure revenue and safeguard investor interests in the rapidly evolving financial landscape.

5.9. Balancing Fiscal Discipline with Development

Finally, India's tax reforms must balance fiscal prudence with developmental needs. Stronger subsidy targeting, increased use of direct benefit transfers, and realistic fiscal targets under FRBM guidelines will help contain deficits. At the same time, formalizing the informal sector through incentives and GST integration will expand the base, creating resources for infrastructure, welfare, and job creation. The tax system, therefore, must evolve as both a stabilizing and developmental instrument of policy.