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Impact of Income Tax on Indian Economy

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Abstract

Income tax, as a direct tax levied by the Central Government, plays a crucial role in shaping India's economic development by generating revenue, reducing income inequality, and financing public welfare programmes. This paper examines the concept, importance, trends, and patterns of income tax in India, along with its broader economic impact on consumption, savings, investment, and fiscal stability. The study also introduces the newly enacted Income-tax Act, 2025, which replaces the Income-tax Act, 1961, and represents a shift towards a simplified, technology-driven, and taxpayer-friendly direct-tax framework effective from 1 April 2026. Based on secondary data drawn from RBI publications, government reports, and Economic Survey 2025-26, the analysis shows substantial growth in personal income tax and non-corporate tax collections between FY 2022 and FY 2025, outpacing overall GDP growth. The findings highlight income tax's growing significance in strengthening India's fiscal framework and supporting sustainable economic growth.

Keywords; *Income Tax, Indian Economy, Tax Reforms, Income-tax Act 2025, Fiscal Stability.*

INTRODUCTION

Income Tax is a direct tax because it is charge on a person and the person is liable for payment of tax. It is a Central Tax. It is collected and charge by Central Government. Assessee earn the income in previous year and pay the tax in assessment year. In the Income Tax a assessee earn the income through five heads of Income: Income from salary, Income from house property, Income from Business and profession, Income from capital gain, Income from other source. Assessee pay the tax according to Income Slab. Agriculture Income is fully exempted from Tax. The main object of charging Income tax is to increase the income of Central Government and formulation of capital. Government of a nation requires money to fulfil its obligations towards the nation such as to maintain law and order, to save the country against foreign aggression and invasion and to maximize welfare of its citizens (Sadath & Hajra Begum, 2026).

The Income-Tax Act 2025 came into force on 1 April 2026 and replaced the Income-Tax Act 1961, for tax years beginning on or after that date. The Income Tax Department describes it mainly as a simplification and restructuring of Income-tax law, rather than a completely new taxation system. In this tax system use the word Tax year in the place of previous year and Assessment year, it contain 536 section and 16 schedules.

Importance of Income Tax and its Features

Income tax is an important source of revenue for the Government of India and plays a major role in the economic development of the country. The revenue collected through income tax is used to finance essential public services such as education, healthcare, transportation, defence and social welfare programmes. It also supports the development of infrastructure and other public facilities (M & Jha, 2025).

Income tax contributes to reducing economic inequality through a progressive tax structure, under which individuals with higher incomes generally contribute

a larger share of their earnings. It also encourages financial discipline and promotes transparency in economic activities. Regular tax compliance helps expand the formal economy and improves the government's ability to plan and implement development programmes.

Furthermore, income tax provides financial stability to the government by generating relatively predictable revenue. Effective tax administration and digitalisation have improved tax collection, compliance and transparency. Thus, income tax is not only a means of raising government revenue but also an important instrument for promoting social welfare, economic stability, equitable income distribution and sustainable national development (Behera et al., 2019).

The main characteristics of Income Tax are as follows:

- i. Direct Tax
- ii. A Central Government Tax
- iii. Payable by each and every assessee.
- iv. Limit of exemption
- v. Tax on Net Taxable Income of the previous year
- vi. Computation of Tax according to various slab and rate
- vii. Payment of Income Tax in the current tax year
- viii. Grouping of Income in various slab.

Trends and Patterns of Income Tax in India

Income tax in India has shown a gradual upward trend over the years, supported by economic growth, rising incomes and improvements in tax administration. The number of taxpayers has increased due to greater financial awareness, digitalisation and the expansion of formal employment and business activities. The introduction of the Permanent Account Number (PAN), online income-tax filing and electronic payment systems has improved tax compliance and transparency.

A major trend is the increasing use of technology in tax administration. Initiatives such as e-assessment, faceless assessment and data-based monitoring have reduced direct interaction between taxpayers and officials and helped identify tax evasion. The government has also simplified tax filing procedures and introduced different tax-regime options to encourage voluntary compliance (Rajasree, 2018).

The pattern of income-tax collection is influenced mainly by individual income, corporate profits, employment levels and economic conditions. Corporate income tax and

personal income tax remain important sources of direct-tax revenue. Overall, the income-tax system in India is moving towards greater digitalisation, wider taxpayer participation, improved compliance and more efficient revenue collection.

Impact of Income Tax on Indian Economy

Income tax is one of the major sources of revenue for the Government of India. It is direct tax imposed on the income of individuals, firms, companies and other taxpayers. The revenue collected through Income tax helps the government finance public expenditure and implement economic and development programmes (Kumar, 2025).

- i. Increase in Government Revenue.
- ii. Reduction in Income Inequality.
- iii. Impact on Consumption
- iv. Impact on Saving and Investment.
- v. Impact on Business and Economic Growth.
- vi. Control of Inflation.
- vii. Employment Generation
- viii. Promotion of Social Welfare
- ix. Fiscal Stability.
- x. Reduction in disposable income.

New Income-tax Act, 2025

The Income-tax Act, 2025 is a major reform of India's direct-tax framework, introduced to replace the Income-tax Act, 1961 with a simpler and more modern law. The new Act aims to simplify the language and structure of income-tax provisions, reduce complexity and minimise disputes between taxpayers and tax authorities. It comes into force from 1 April 2026, while the earlier 1961 Act continues to govern tax years beginning before that date (Verma, 2025).

Important Key Points of the Income-tax Act, 2025

- i. **Replacement of the 1961 Act:** The Income-tax Act, 2025 replaces the six-decade-old Income-tax Act, 1961 from 1 April 2026.
- ii. **Simplified structure:** The new law reorganises and simplifies provisions to make them easier for taxpayers and professionals to understand.
- iii. **Reduced complexity:** Repetitive and complicated provisions have been rationalised to reduce confusion and interpretation-related disputes.
- iv. **Modern tax framework:** The Act is designed to better accommodate digital transactions, modern business practices and evolving economic activities.
- v. **Tax-year concept:** The new framework uses a clearer concept of the "tax year", replacing the

complicated distinction between “previous year” and “assessment year” for the new regime.

- vi. **Tax administration:** Greater emphasis is placed on efficient, technology-based tax administration and compliance.
- vii. **Reduction in litigation:** Clearer drafting and definitions are intended to reduce interpretational disputes and provide greater certainty to taxpayers.
- viii. **Continuity for earlier years:** Taxpayers continue to be governed by the 1961 Act for tax years that began before 1 April 2026.
- ix. **Interaction with Budget 2025 reforms:** The new framework operates alongside major tax changes announced in Budget 2025, including revised individual tax slabs under the new regime.
- x. **Focus on compliance:** The overall reform seeks to make tax compliance simpler, improve transparency and strengthen certainty in the Indian income-tax system.

Overall, the Income-tax Act, 2025 represents a shift towards a simpler, clearer, technology-oriented and taxpayer-friendly direct-tax system in India.

OBJECTIVE OF THE STUDY

There are many objectives of the study:

1. To study the concept of Income Tax
2. To study trends and patterns of Income tax in India.
3. To study the importance of Income Tax.
4. To study the new Tax Act 2025.
5. To study the impact of income tax on economy of India.

LITERATURE REVIEW

(Singh, 2026) By affecting revenue systems, investment flows, and taxpayer behaviour, tax reforms are crucial in determining a country's economic course. With an emphasis on simplicity, openness, and economic effectiveness, tax changes in India have changed significantly, especially after the country's economic liberalisation in 1991. The country's fiscal system has been reorganised by the implementation of the Goods and Services Tax (GST), a decrease in corporate tax rates, the digitalisation of tax administration, and specific incentives for entrepreneurs. This paper considers the effects of tax reforms on the Indian economy, with a particular emphasis on entrepreneurs and individual taxpayers. It also examines how these reforms may affect foreign investment, global competitiveness, and compliance with international tax laws. Even while changes have boosted formalisation,

improved compliance, and made conducting business easier, issues including policy unpredictability, compliance complexity, and digital inequities still exist. The study comes to the conclusion that even though India's tax reforms have greatly modernised the tax system, further improvement is required to guarantee stability, inclusiveness, and sustained economic progress.

(Datt et al., 2022) Using data from the Income Tax Department for the years 2011–18, examine the progressivity and redistributive implications of India's income tax system. Fitting Lorenz and tax concentration curves to this data, we discover that the redistributive impacts of income taxes are small among tax assesseees and negligible among adults, even if they show high levels of progressivity. Additionally, we find that lowering income thresholds for top marginal tax rates offers more revenue and redistributive potential than lowering exemption limits or raising top marginal tax rates, and that closing the gap between statutory and actual average tax rates will not significantly improve redistributive effects.

(H D, 2024) India has significantly improved its tax systems in recent years in an effort to boost revenue, accelerate economic growth, and attract investment. The country's tax system has made some progress, as seen by the rise in the ratio of total taxes to GDP. However, while evaluating these policies, one must carefully consider how they contribute to budgetary consolidation and how they align with the goals of tax reform. In addition to attaining some equality, simplicity, and efficiency, it entails evaluating the sustainability of the load of these expenses and revenues on the government. A thorough evaluation may be made using a variety of indicators, including revenue produced, effects on different income groups, and tax collecting efficiency. It evaluates the durability and efficacy of the changes, indicates the degree to which the intended goals were accomplished, and determines if they lead to a more equitable distribution of wealth. It assists policymakers in determining areas that require improvement and in making the required changes to guarantee that the reforms continue to be successful and long-lasting. Reducing income disparity or evaluating the tax system's progressivity might provide insight into the changes' viability.

(Jalan, 2019) Without revenue, the government cannot carry out all of its functions. It must carry out a lot of tasks that involve a lot of public expenditure. Public revenue is needed to pay for this expenditure. Public revenue is largely derived from taxes. The concept of taxes is not new. It has been imposed since the beginning of time. About 3.3% of

India's entire population submitted returns in 2010–11, compared to 39% in Singapore, 46% in the USA, and 75% in New Zealand. In order to enhance public revenue, the government is always working to bring an increasing number of individuals within the taxation framework. To increase India's income tax base, a number of tax reforms were implemented in the tax structure. This essay primarily addresses the effects of several tax reforms on income tax revenue as well as its patterns and trends in India throughout the post-reform era. The analysis is based on income tax data spanning 28 years, from the financial years 1991–1992 to 2018–2019.

(Asthana & Dixit, 2019) The relationship between tax rates and economic progress is one of the most talked-about topics in economics. The majority of governments worldwide use taxes as a key instrument in their efforts to promote long-term economic development and growth. The government levies two different kinds of taxes: direct taxes and indirect taxes. Both are crucial to the growth of the Indian economy. The Goods and Services Tax, or GST, is an indirect tax. The implementation of GST has had both positive and bad effects. This study focuses on the effects of GST on the Indian economy. Long-term economic development in India was shown to be significantly impacted by corporate income tax, but personal income tax had no influence at all. Since taxes are one of the main sources of revenue for all governments worldwide, it is essential to understand which tax components are important in order to achieve long-term economic growth and, consequently, to avoid economic deficits.

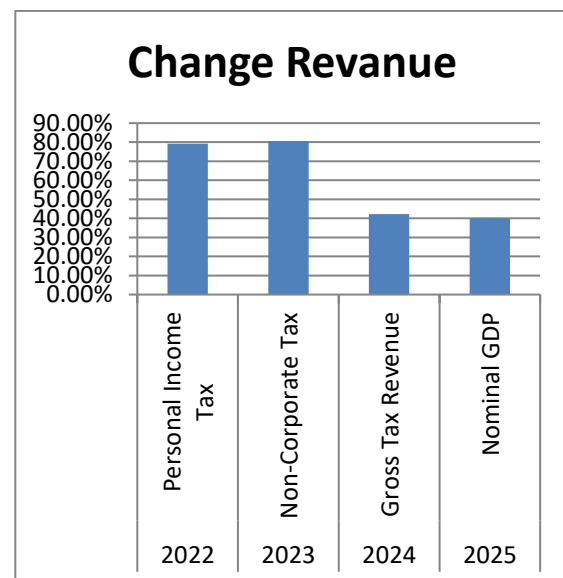
(Yadav, 2023) Government functions cannot be carried out in any form without income. There are too many tasks that must be completed and involve a significant amount of government expenditure. To cover this expenditure, tax revenues will be needed. Taxation is one of the primary sources of public revenue. The origins of taxes are not recent. It has been imposed since the beginning of time. In order to enhance public revenue, the government is taking a number of steps to increase the number of individuals who pay taxes. The tax system in India has undergone several reforms in an effort to broaden the income tax base. The main focus of this research is on how various tax reforms have affected income that is collected through taxes, as well as trends and patterns that have emerged in India during the reform period. This analysis considers income tax data from 1991–1992 to 2018–2019. In other words, a span of 28 years.

RESEARCH METHODOLOGY

The research is based on Secondary data which is collected from Handbook of Statistics on the Indian Economy published by Reserve Bank of India, Report published by Department of Revenue, Ministry of Finance Government of India, Directorate of Economics and Statistics, Planning Commission publication, Various Issue of Budget, Various Committee Reports, Economic Surveys, book, website etc. To study the trend pattern of Income tax, linear regression model has been used. To analyze the growth of Income tax percentage, ratios, combined average growth rate etc method are used. The study cover the period of 20 year.

DATA ANALYSIS AND INTERPRETATION

Recent Economic Survey data show that personal income tax collection increased from ₹ 6.69 lakh crore in FY 2022 to Rs. 11.99 lakh crore in FY 2025. Non-corporate taxes increased from Rs. 6.96 lakh crore to ₹ 12.57 lakh crore over the same period.



Source: Economic Survey 2025-26 Ministry of Finance Government of India.

Table No. 01

Indicator	Financial Year 2022	Financial Year 2025	Change
Personal Income Tax	Rs. 6.69 lakh crore	Rs 11.99 lakh crore	+79.2%
Non-Corporate Tax	Rs 6.96 lakh crore	Rs 12.57 lakh crore	+80.6%

Gross Tax Revenue	Rs 27.09 lakh crore	Rs 38.53 lakh crore	+42.2%
Nominal GDP	Rs 235.97 lakh crore	Rs 330.68 lakh crore	+40.1%

(Source & calculation are based on Economic Survey 2025-26 data.)

Growth in personal Income tax collection increased substantially between FY 2022 and FY 2025 - 11.99 (make the graph)

CONCLUSION

The study establishes that income tax remains a vital pillar of India's fiscal system, contributing significantly to government revenue generation, reduction of income inequality, and financing of essential public services such as education, healthcare, and infrastructure. Data analysis reveals that personal income tax collection grew by 79.2% and non-corporate tax by 80.6% between FY 2022 and FY 2025, both exceeding the 42.2% growth in gross tax revenue and 40.1% growth in nominal GDP, reflecting improved compliance, digitalisation, and administrative efficiency. The progressive structure of income tax continues to promote equitable income distribution, while technology-driven initiatives such as e-assessment and faceless assessment have enhanced transparency and reduced evasion. The introduction of the Income-tax Act, 2025, marks a significant reform aimed at simplifying tax provisions, minimising litigation, and modernising the taxation framework to accommodate evolving economic activities. Overall, income tax continues to serve as both a critical revenue instrument and a tool for promoting social welfare, economic stability, and long-term sustainable development in India.

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