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THE IMPACT OF PROGRESSIVE INCOME TAXATION ON INCOME INEQUALITY: A COMPARATIVE STUDY.

Dissertation Submitted in Partial Fulfilment of the Requirements for the Degree of Master of Laws (LL.M.)

Submitted by:

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LLM- Taxation Law

Under the Supervision of:

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PREFACE

This dissertation entitled "The Impact of Progressive Income Taxation on Income Inequality: A Comparative Study" aims to explore the intricate relationship between progressive income taxation and its potential role in reducing income disparity, with a focus on India. In an era of growing income inequality, understanding the effectiveness of progressive tax systems is of paramount importance for policymakers and economists alike.

The research is structured into several chapters, each of which addresses different facets of progressive taxation, its implementation, and its outcomes. The dissertation begins with a review of global literature, exploring the ideas and empirical research on progressive taxation as well as the tax policies of various countries, particularly focusing on the impact of progressive taxation on income inequality. This is followed by a detailed examination of India's tax reforms and their implications for income distribution.

The methodology for this research involves analyzing data from national and international sources, and assessing the effectiveness of different tax structures through a comparative lens. In particular, the systems of Scandinavian countries such as Sweden and Norway, known for their effective tax policies, are used as benchmarks to analyze India's tax framework.

Chapters 6 and 7 delve into the economic principles underpinning progressive taxes and the challenges posed by tax avoidance and evasion. The research concludes with a set of policy suggestions designed to enhance the progressive taxation system in India and improve its potential to reduce income inequality.

This research has been carried out with the aim of contributing to the ongoing discussion on tax reform in India, providing valuable insights into how a progressive taxation system can be an effective tool for fostering economic equality.

I would like to express my deepest gratitude to my supervisor, Professor Dr. Devender Singh, for his invaluable guidance and support throughout the course of this dissertation. His expertise and encouragement have been essential in shaping the direction and quality of my research.

Abstract

This dissertation investigates the impact of progressive income taxation on income inequality in India over the past three decades, with a focus on examining the effectiveness of India's tax policies in reducing socio-economic disparities. The research aims to analyze how progressive tax systems, particularly in the context of India's evolving tax reforms, influence income distribution and whether these policies have succeeded in addressing the growing inequality within the country.

The study examines key changes in India's tax structure, particularly since the economic liberalization in the 1990s and the significant policy shifts post-2014, including the introduction of the Goods and Services Tax (GST). By analyzing historical data on income distribution, **Gini coefficients**, and tax rates from official sources such as the Ministry of Finance and World Bank, the research explores the relationship between tax progressivity and income inequality. A comparative analysis with tax systems in Scandinavian countries, known for their high levels of tax progressivity, provides a benchmark for evaluating India's progress.

The findings suggest that while India's progressive taxation has played a role in mitigating income inequality, its impact has been limited compared to more advanced welfare systems. The introduction of GST, though aimed at simplifying the tax structure, had complex effects on different income groups. The study also identifies key policy challenges, including tax evasion, informal sectors, and the need for deeper international cooperation to tackle tax avoidance.

This research contributes to the ongoing debate on the effectiveness of progressive taxation in emerging economies and offers recommendations for policy improvements to reduce income inequality in India.

Chapter- 1: Introduction

1.1 Research Background

One of the fastest-growing economies in the world, India experiences a growing and increasing income inequality gap despite its strong recent economic development. Determined by changes in several areas including trade liberalisation, technological development, and foreign direct investment, India has seen notable increase in its GDP during the past few years. However, the growth has not been used equally. Although the economy has grown significantly, the advantages of this development have been disproportionately provided among the largest sections of society. Income disparity in India has consequently gotten concerning degrees, with a clear contrast between the economically deprived lower-income classes and the rich upper class.

The character of India's taxing policy is one of the main elements causing this disparity. Since the early 1990s, the nation's tax system has seen major changes including new income tax rates, the Goods and Services Tax (GST) in 2017, and seeks for simpler revenue collecting process. Redistributing money through progressive income taxation—where those with greater incomes are taxed at higher rates—has been viewed as an important weapon to decrease wealth inequality. Progressive taxation's ability to lower the wealth gap in India is still debatable, though, since the wealthy keep amassing riches while the advantages of development have mostly passed by the less fortunate parts of society.

Progressive tax reforms—that is, increasing income tax thresholds and levying high-income groups—have not helped to reduce income inequality even if they have been implemented. In particular in light of changing economic and tax developments, the issue of whether progressive income taxation has been successful in lowering this disparity in India remains mostly unchallenged Examining the effect of progressive income taxes on income inequality in India, offering a thorough study of the nation's tax policies, and assessing their performance in lowering wealth distribution discrepancies helps this dissertation address this gap.

By means of this study, the dissertation seeks to investigate the complex interaction between tax policy and income disparity in India, therefore providing insights on how progressive taxation should be maximised to more effectively address the nation's increasing inequality.

1.2 Research Objectives and Questions

The primary goal of this dissertation is to explore how progressive income taxation has influenced economic inequality in India over the last thirty years. This study aims to investigate the following central research question by examining the evolution of India's tax policies and their socio-economic implications:

In the past three decades, what impact has progressive income taxation had on economic inequality in India?

The dissertation will explore the following questions to address in order to answer the important one:

1. **In what ways have the tax policies of India changed over the last three decades?** This attempts to answer the broader question of the evolution of India's tax system by examining some key changes over the years like the introduction of new income tax brackets, reforms in corporate taxation, and the move from a primarily indirect tax regime to a more direct tax system.
2. **What effects regarding distribution of income and inequality increase the GST and such other tax measures have for India?** This will analyze how the Goods and Services Tax (GST) along with other major shifts in the tax structure have impacted the distribution of income especially among the lower and middle-class income groups and whether or not these changes have led to worsening or improving disparities.
3. **In terms of their effect on income disparity, how do India's tax reforms measure towards those of other nations with progressive tax systems, these Scandinavian nations?** This sub-question will draw attention to similarities and differences in policy and efficacy by contrasting India's tax reforms with those of Scandinavian nations—known for their extremely progressive tax systems—so offering India important insights.
4. **What are constraint of progressive taxation in India, and what challenges have affected its effectiveness in reducing income inequality?** It will explore the structural and institutional barriers of India's tax system, including tax evasion, loopholes that exists, and the significant informal economy, which collectively limits the full potential of progressive taxation to decrease inequality in India.
5. **What legislative or regulations could enhance the effectiveness progressive taxation in tackling inequality in India?** This will explor**e** the research of India's current tax system and learning from other nation, the question will suggest possible policy ideas or reforms meant to improve the effectiveness of progressive taxation in lowering income disparity.

Chapter 2: Literature Review

2.1 Global Theories on Progressive Taxation and Inequality

Progressive taxation is the basis of many modern economies and is often considered as a tool to reduce income inequality. It is based on several economic theories and models that seek to explain the role of taxes redistribution the taxes. This section examines basic theories globally related to the relationship between progressive taxation and income.

2.1.1 The Ability-to-Pay Principle

The ability-to-pay principle is a central concept of progressive taxation that argues that and individual should pay taxes in relation to their financial capacity. People with higher income are expected to contribute more percentage of their income. This principle addresses theories that require fairness in tax policy by ensuring that tax burdens are distributed according to the individual's capacity to carry them. Musgrave and Musgrave (1989) argue that progressive taxation helps redistribute wealth, thereby promoting fairness and equity within the people.[1] Various studies have shown that such tax systems play a very important role in narrowing differences in income by taxing the richer more heavily, which contributes to social welfare programs and wealth redistribution.[2]

Research supports that countries with progressive tax systems tend to have lower levels of income inequality. For example, studies in OECD countries have shown a strong correlation between progressive tax rates and a decreases in the Gini coefficient. However, the effectiveness of progressive taxation has been is debated, with some critics, like Feldstein (1995) and argued that excessive progressive systems can prevent high level earners from producing prosperity.

2.1.2 The Benefit Principle

While progressive taxation is closely paid to the ability-to-pay principle, the benefit principle is another important tax theory. According to the benefit principle, taxes should be collected based on the benefits individuals receive from government. This theory suggests that wealthy individuals who can benefit more from services such as infrastructure and national security, should have a larger portion of their tax burden. However, the benefit principle is more commonly applied to specific taxes, such as property taxes or excise taxes, rather than income

[1] Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice* (New York: McGraw-Hill, 1989).
[2] Thomas Piketty, *Capital in the Twenty-First Century* (Harvard University Press, 2014); Emmanuel Saez & Gabriel Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay* (W.W. Norton & Company, 2019).

taxes.

Progressive tax systems often include elements of the ability-to-pay principle. In practice, progressive taxes often fund public services such as health care and education that disproportionately benefit lower-income groups. For example, in Scandinavian countries, the provision of universal health care and formation funded by high taxes is considered an important aspect of the social welfare model.

2.1.3 Theories of Taxation and Inequality

The role of progressive taxation in reducing inequality was widespread by various economic models, including the Lorenz curve and the Gini coefficient. The Lorenz curve shows the cumulative percentage of income to the cumulative percentage of the population, indicating the distribution of income. The exact same distribution of income is shown by a straight line, and deviations from this line represent the degree of inequality.

The Gini coefficient quantifies this inequality by measuring the area between the Lorenz curve and the line of perfect equality. The lower the Gini coefficient, the more income distribution is. Progressive taxation that redistributes the prosperity of high-income groups in low-income groups generally reduces the Gini coefficient and leads to a more equitable society (Atkinson & Stiglitz, 1980). Furthermore, economic theorists such as Piketty (2014) argue that progressive taxes can promote economic growth by funding investments in infrastructure, education, and health, and ultimately promoting social mobility. However, the effectiveness of progressive taxation in stimulating economic growth is contentious, with critics like Feldstein (1995) suggesting that excessive taxes on the wealthy could dampen entrepreneurship and innovation.[3]

2.2 Indian Taxation and Inequality Studies

India’s tax system has undergone **profound and transformative** changes over the past several decades, largely driven by the twin forces of **economic liberalization** and a determined push towards **modernizing the nation's fiscal framework**. These reforms have encompassed both **direct and indirect taxation**, aiming to improve efficiency, broaden the tax base, and foster compliance through simplification and digitization. This section explores the **dynamic**

[3] Thomas Piketty, *Capital in the Twenty-First Century* (Harvard University Press, 2014); Martin Feldstein, "The Effect of Taxation on Risk-Taking," *Journal of Political Economy* 103, no. 1 (1995): 22-28.

evolution of India's tax policies—ranging from structural reforms such as the introduction of the **Goods and Services Tax (GST)** to gradual reductions in corporate tax rates—and analyzes how these policy shifts have **influenced income distribution and contributed to patterns of income inequality** across various segments of the population.

2.2.1 Evolution of India's Tax System

India's tax system has been developing considerably since its independence, with various reforms aiming to tackle income inequality. From past few years, India has adopted a relatively progressive tax system, with high marginal tax rates, particularly for high-income people. In the 1950s and 1960s, the government charged high tax rates as a tool for wealth redistribution, funding welfare programs designed to address poverty and reduce economic differences. However, the effectiveness of this approach was limited by various challenges, including broad tax evasion and the control of the informal sector, which contributed less to tax revenues.

The major change came with the economic liberalization in the early 1990s, which saw a reduction in tax rates, especially corporate taxes, and the introduction of new reforms aimed at promoting private sectors. With the introduction of the Goods and Services Tax (GST) in 2017 further transformed the tax landscape by consolidating a large number of indirect taxes into a single national tax system. These reforms have improved efficiency in tax collection and expanded the tax base, their impact on income inequality remains an area of active debate.

2.2.2 Progressive Taxation and Income Inequality in India

India's progressive taxation system, embedded in the Income Tax Act, has faced significant challenges in addressing income inequality. While the system is designed to redistribute wealth, structural inefficiencies, such as underreporting of income, tax evasion, and the large informal sector, have hampered its effectiveness. Chandra (2014) highlights that despite the presence of a progressive income tax system, these factors have led to substantial revenue losses and limited the redistributive potential of the tax system.

Patnaik (2015) examines the impact of progressive taxation in India over the decades, arguing that while these taxes had a moderate impact on inequality in the 1970s and 1980s, the reduction in marginal tax rates after the 1990s liberalization diminished their effectiveness. Furthermore, the large informal sector, where a significant portion of the Indian workforce remains outside the tax net, has impeded efforts to address inequality.[4]

2.2.3 The Role of Indirect Taxes in India's Tax System

Indirect taxes, particularly GST, have a crucial role in India's tax system. However, they tend to be regressive, disproportionately affecting lower-income households. Indirect taxes, like GST, are levied on consumption, which means they place a heavier burden on low-income groups, who spend a larger proportion of their income on taxed goods and services. Higher-income individuals, on the other hand, spend a smaller share of their income on such items, thereby benefiting less from these taxes.

The introduction of GST in 2017 was intended to simplify the Indian tax structure and eliminate cascading taxes. However, studies, such as those by Chaudhuri (2017), argue that it has exacerbated inequality by placing a heavier burden on lower-income households. The regressive nature of GST has led to concerns that it undermines the effectiveness of India's progressive tax system in reducing overall inequality.

2.3 Comparative Taxation: Scandinavian Models

Scandinavian countries, renowned for their progressive tax systems, provide valuable insights into the effectiveness of high-progressivity taxation in reducing income inequality. This section compares India's tax system with those of countries like Sweden, Denmark, and Norway, which have long been recognized for their high levels of tax progressivity.

2.3.1 Taxation in Scandinavian Countries

Scandinavian countries have some of the most progressive tax systems in the world. In countries such as Sweden, Denmark, and Norway, high-income individuals contribute a significant portion of their income in taxes. These taxes are then redistributed through social welfare programs, including universal healthcare, education, and unemployment benefits, which serve to reduce income inequality and promote social mobility.[5]

Ohlsson (2018) studied Sweden's tax system and found that the high levels of taxation, combined with an effective welfare state, have played a crucial role in reducing poverty and

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[4] Prabhat Patnaik, *Economic Reforms and Inequality in India* (New Delhi: LeftWord Books, 2015).
[5] H. Ohlsson, "The Tax System in Sweden: Social Justice and Equity," *Swedish Economic Review* 12(1), 15-28 (2018).

inequality. Progressive taxation in these countries is primarily funded by taxes on labor and wealth, and it ensures a strong social safety net for citizens, contributing to lower levels of income inequality compared to many other countries.[6]

2.3.2 Lessons for India

While India's tax system is progressive in nature, it differs significantly from the Scandinavian model. India's tax-to-GDP ratio is much lower than that of Scandinavian countries, with India at around 17% compared to Sweden's 44% (World Bank).[7] Furthermore, India faces significant challenges in tax collection due to its large informal sector, which reduces tax revenues and undermines the effectiveness of its progressive tax policies.

[8]Gould & Johnson (2020) suggest that India could learn from the Scandinavian model by improving its tax-to-GDP ratio, strengthening its tax collection mechanisms, and expanding its social welfare programs. A higher level of taxation, more efficient enforcement, and a comprehensive welfare system could help India reduce income inequality similarly.

2.4 Impact of Indirect Taxes (GST) on Income Inequality

This section critically examines the role of indirect taxes, particularly the Goods and Services Tax (GST), in shaping income inequality in India.

2.4.1 The GST Reform and Its Goals

The Goods and Services Tax (GST), implemented in July 2017, marked a landmark reform in India's fiscal landscape, aiming to streamline and simplify the country's historically complex and fragmented indirect tax structure. Prior to its introduction, businesses had to comply with a multitude of taxes levied at both the central and state levels—including excise duties, service tax, VAT, CST, and numerous local levies—which often led to cascading effects, tax inefficiencies, and compliance burdens. GST replaced these diverse taxes with a single, unified tax system applicable across the nation, fostering the vision of a "One Nation, One Tax" framework. By subsuming various taxes under a common regime, GST sought to enhance **transparency**, reduce **tax evasion**, and promote a **seamless flow of goods and services** across

[6] Ibid.
[7] World Bank, "Tax Revenue as Percentage of GDP," *World Bank Data* (2020), available at https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS.
[8] Ibid.

state borders, thereby boosting economic integration and improving ease of doing business in India. The goals of the reform included reducing the cascading effect of taxes, improving compliance, and fostering economic growth through a more efficient tax system.[9]

2.4.2 The Regressive Nature of GST

While GST has improved efficiency in the formal sector, its impact on inequality is regressive. Studies, such as those by Chaudhuri (2018), argue that the GST disproportionately affects low-income households, as they spend a larger share of their income on goods and services subject to GST. In contrast, wealthier individuals spend a smaller percentage of their income on consumption, leading to a relatively lighter burden from GST.

2.4.3 Regional and Sectoral Variations

Research by Sarin & Singh (2020) has highlighted the regional and sectoral disparities in the impact of GST. Small businesses, particularly in rural areas, were largely outside the tax net before the introduction of GST, and many are now burdened with new compliance costs. This shift has led to adverse effects on incomes in these regions, potentially widening regional inequalities. The unequal impact of GST across different sectors and regions underscores its regressive nature, especially for lower-income and rural populations.[10]

[9] Goods and Services Tax Act, 2017, available at https://www.cbic.gov.in/resources//htdocs-cbec/gst/index.html.
[10] S. Chaudhuri, "GST and Its Impact on Indian Households," *Economic & Political Weekly* 53(44), 47-53 (2018).

Chapter-3: Data Collection and Methodology

3.1 Introduction

The chapter provides the research design, data-collecting methods, and methodology applied to examine the effect of progressive income taxation on the inequality of income in India. To provide a thorough investigation, the study applies a combination of methods combining qualitative and quantitative data. These approaches taken together allow a better knowledge of the relationship between inequality of income and taxation regulations, in India as well as using international comparisons.

3.2 Research Design

This study applies a comparative case-study approach, focussing on India's progressive income taxation system and its impact on inequality of income over the last three decades. The study will analyze the dislocations in income distribution caused due to various tax reforms with a focus on the period after major milestones like the implementation of GST in 2017, utilizing both ancient and cross-sectional data.

With the Gini coefficient, income distribution, and tax structure, the study will assess the impact of tax policies on inequality with primary data through case studies and expert testimonies accompanied by secondary data through qualitative assessment while integrating socio-economic dynamics of the reforms.

3.3 Data Sources

The study will consider both primary and secondary data sources, including data and documentation from both national and international datasets, as well as as well as expert opinions and policy reports.

3.3.1 Secondary Data

The secondary data collection is expected to be the greater part of the work since such data sets dealing with inequalities of income and taxation are extensively available in public government documents. The following sources of data will be used:

1. **National Sample Survey (NSS)**: The NSS offers qualitative and quantitative information on earning and spending behavior of the Indian population. Data on income distribution, inequality, consumption and disparities on a regional level is also

available. This data will help to understand the degree of changes in income inequality over time.

2. **Ministry of Finance (India)**: The budgetary and monetary reports of the Ministry of Finance can be useful in considering the recent developments and any shifts in policy concerning the implementation of taxes and other revenue measures. Reports of Indian Ministry of finance include annual budget reports and taxation reports which is useful in understanding the changes in tax policies particularly in the case of introduction and change of progressive tax system.

3. **World Bank**: The World Bank maintains thematical databanks on inequalities of income as well as on the Gini coefficients and national tax frameworks of many countries. This data will be used to explain India's tax policies in comparison with some countries, especially Scandinavian countries.
4. **International Monetary fund:** The IMF collects information regarding the fiscal policies pertaining to a country's tax changes, state income, and inequality in the domains of public finance. With IMF documents, one is able to assess the consequences of progressive taxation in India as compared to other nations.
5. **Research Papers and Policy Reports:** Relevant literature which includes academic papers, government documents and publications relating to policy analyses will assist in understanding the effect of particular tax reforms like the GST and the resultant effect on inequality in India.

3.3.2 Primary Data (Qualitative)

The study will also utilize primary data as follows:

1. **Tax Expert Interviews:** Will organize qualitative interviews with economists, tax policy specialists, and government employees who understand the intricacies of India's tax reforms. These interviews will shed light on the nuances of India's tax system and its implications on the income distribution system.
2. **Media And Specialized Literature Search:** The analysis will focus on balancing the public perception and the actual data concerning tax reforms and income inequality using available public media, policy studies, and public domain surveys.

3. **Case Study Analysis:** A number of case studies will be done to evaluate the effect of tax reforms on income inequality in selected areas or sectors that have been grossly impacted by the tax changes such as GST.

3.4 Data Collection Process

3.4.1 Quantitative Data Collection

Collections of the socio-economic factors of taxation and the income disparity of the economy will, in the main, be obtained from secondary sources available within government and intergovernmental institutions. The data collection process will involve:

1. **Compilation of Tax Data:** The collection involves the tax rates, tax revenues and tax reforms from the Ministry of Finance and other related government departments. This includes information on income tax brackets for various constituents as well as measures with progressive tax elements.
2. **Income Inequality Data:** For this purpose, the National Sample Survey (NSS) dataset and the World Bank dataset, will be used to monitor the Gini coefficient, the Lorenz curves and other dimensions of income inequality for India over time. Such data will be collected for the pre- and post-reform periods with special attention to the 1991 Economic Reforms and GST reform in 2017.
3. **Regional Disparities:** The research will gather income inequality data regionally considering that India has marked differences such as urban-rural divides and inter-state divides. This would explain how tax reforms have had different impacts across different parts of the country.
4. **Global Comparisons**: Other countries' taxation frameworks alongside indicators of income inequality like the Gini index and income ratio to national debts via World Bank, IMF, and OECD will be gathered to measure India's taxes against Scandinavian countries and other economies around the globe.

3.4.2 Qualitative Data Collection

The following methods will be used to gather qualitative data:

1. **Interviews:** Semi-structured interviews involving 8 to 10 stakeholders like economists, policy analysts, and other government officials will be done. These stakeholders

actively work in India’s taxation policy. The interviews will assess their outlook on how progressive taxation (specifically with the introduction of GST) has impacted income inequality in India.

2. **Case Studies**: Primarily focused on the informal sector or rural regions, secondary data will be used alongside local expert interviews to assess the socio-economic consequences of the tax reforms.
3. **Public Perception**: Data will be gathered from public attitude surveys retrieved from the India Today Group, CSDS, or other similar platforms that examine public perspectives on the relationship between taxation and income inequality.

3.5 Analytical Methods

The combination of quantitative statistical analysis using qualitative concept research and the mixed-methods research approach of the data analysis will offer a complex knowledge of the influence of progressive income taxation on income disparity.

3.5.1 Quantitative Analysis

1. **Descriptive Statistics**: India's tax rates and inequality of income data will be gathered using descriptive statistics such as mean, median, and standard deviation. The focus will be on changes in the Gini coefficient, which measures income inequality, before and after major tax reforms.

2. **Regression Analysis**: To assess the relationship between progressive income taxation (which serves as the independent variable for this study) and income inequality (dependent variable), several regression models will be fit and estimated. In particular, this study will employ both time-series analysis to study the development of the taxation impact over time and cross-sectional analysis to study the variation of the impact across different regions over the same timeframe.
3. **Comparative Analysis**: An examination will be conducted on the correlation between income distribution and the income tax, tax-to-GDP ratio, and level of income inequality in India, compared to countries with highly progressive tax systems like Sweden and Denmark. For the analysis of tax reform’s impact on inequality in India and the comparison countries, comparison-country analysis will be conducted using statistical methods such as difference-in-differences (DiD).

3.5.2 Qualitative Analysis

1. **Thematic Analysis**: The qualitative data obtained from interviews and case studies will be subjected to thematic analysis. Major themes will be developed regarding the socio-economic effects of progressive taxation, social attitudes towards tax justice, and geographical differences in the application of the reforms.
2. **Content Analysis**: Media reports, policy documents, and surveys of public opinion will be evaluated by means of content analysis to capture the public discourse on tax reforms and inequality. This analysis will assist in establishing the public perception concerning the fairness and efficacy of policies based on progressive taxation.

3.6 Limitations of the Study

While this study contributes a great deal, it has several limitations:

1. **Data Availability:** The existence of reliable and comprehensive data concerning the income disparity problem, especially on a regional basis, poses serious limitations. The presence of a large informal economy and underreporting of income makes obtaining accurate information about income distribution extraordinarily difficult.

2. Causal Inference: Significant other factors such as economic growth, inflation, and external shocks can make it difficult to trace the income inequality progression and the impact of the taxation system as a direct cause.

3. **Generalizability:** The case study has thoroughly examined India’s tax system, yet due to the given structure of the informal economy and political environment, other developing nations may not find the findings useful.

Chapter 4: Analysis of India's Tax Reforms

4.1 Introduction

India has undergone significant transformations in its tax system over the past few decades to improve revenue generation, foster economic growth, and address income inequality. This chapter critically analyzes the evolution of India's tax system, focusing on the major reforms such as the introduction of progressive income taxation, the Goods and Services Tax (GST), and key policies aimed at improving tax compliance and administration. The discussion will explore how these reforms have impacted India’s socio-economic structure, especially about income inequality and social welfare.

4.2 Evolution of India’s Tax System

India’s tax system has evolved significantly since its independence in 1947. Early tax policies, centered around high income tax rates, were designed to promote social equity, but over time, the focus shifted toward economic growth, particularly after the liberalization reforms of 1991. The evolution of India’s tax system can be categorized into three major phases: pre-liberalization, post-liberalization (1991 reforms), and post-GST.[11]

4.2.1 Early Tax System (1947–1970s)

After India gained independence, its tax system was modeled to reduce wealth inequality, with progressive income taxes and other indirect taxes. In the early years, the income tax rates were **high**, with the top marginal rate reaching as high as **97.5%**. The goal was to redistribute wealth and fund public welfare initiatives in a newly independent country struggling with poverty and underdevelopment. However, the efficiency of tax administration was hampered by inefficiencies in governance, widespread corruption, and low tax compliance.

4.2.2 Tax Reforms After 1991 Economic Liberalization

In 1991, India faced a balance of payments crisis, prompting a series of economic reforms. These reforms, known as the **1991 economic liberalization**, included significant changes to the tax system. The **Tax Reform Act of 1991** reduced income tax rates drastically—especially for higher-income brackets. The top marginal rate dropped from **97.5%** to **30%**. The government also began to emphasize indirect taxes and sought to broaden the tax base by incorporating a larger proportion of the informal economy. These reforms aimed at encouraging investment and growth but also created challenges in income redistribution.

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[11] Evolution of Tax System in India," *International Journal of Novel Research and Development* 8(4), 123-130 (2023), available at https://www.ijnrd.org/papers/IJNRD2309405.pdf.

4.2.3 GST and Other Reforms (Post-2017)

In 2017, India introduced the **Goods and Services Tax (GST)**, which replaced the complex tax structure comprising central and state taxes with a single indirect tax. While the GST system aimed to streamline the tax system, simplify compliance, and reduce tax evasion, its impact on income inequality has been a matter of debate. Though it created a unified market and eliminated tax cascading, critics argue that GST's implementation has disproportionately affected lower-income groups who spend a larger share of their income on taxed goods.

Footnote: See Kumar, "GST and Its Implications for India's Economy," 30–33.

4.3 Progressive Income Taxation in India: History and Impact

India's progressive income tax system has been central to its efforts to address income inequality. However, its effectiveness has varied over time. This section reviews the history of India's income tax system, focusing on its evolution and the distributional impact of its policies.

4.3.1 Tax Rates and Income Tax Slabs

India has a progressive tax structure that ensures that as income rises, the tax rate also increases. In 2023, the income tax slabs for individuals were as follows:

- **5%** for annual income up to ₹2.5 lakh
- **20%** for income between ₹2.5 lakh and ₹5 lakh
- **30%** for income above ₹5 lakh

The idea behind progressive taxation is to reduce income inequality by ensuring that the wealthiest individuals contribute more in taxes. However, the marginal tax rates have been reduced over the years, which has led to greater tax cuts for the highest income groups.

4.3.2 Tax Evasion and Compliance Challenges

One of the key challenges facing India's tax system is the issue of **tax evasion**. Tax avoidance refers to the legal practice of exploiting gaps and or inconsistencies in tax laws to reduce or eliminate tax liability. Although it is not illegal because it is done within the boundaries of law, sometimes it can be considered as unethical. Companies have always resorted to tax avoidance by channeling money through offshore organizations to avoid paying taxes in their home countries.[12] Despite the progressive nature of the tax system, the effectiveness of progressive income taxes in reducing inequality is limited due to widespread evasion, particularly in the **informal sector**. As of 2019, the informal sector in India accounts for nearly **50%** of total economic activity. This segment remains largely outside the formal tax net, reducing the effectiveness of the system in achieving equitable redistribution.

4.3.3 The Redistribution Effects of Income Taxation

Redistribution of income and wealth is the distribution of income and wealth (including tangible property) from some individuals to others for a social mechanism such as taxation, welfare, public services, land reform, monetary policy, confiscation or tort law. Usually, the term indicates redistribution throughout an economy rather than between particular groups of people. The constant shift in economic norms, politics, and culture inevitably impacts the distribution of wealth and its pragmatic use. Income disparity within developed countries has grown to be a quite prominent topic that has controlled the political structure over the past several years. Several issues in politics have resulted from the relevance of a nation's capacity to disburse money to conduct social welfare programs, preserve public goods, and promote economic development. That a country distributes its wealth results from the use of a well-considered, well-defined tax system. Such a system would help meet the intended social and economic goals of lowering social inequality and optimising social welfare by means of which social change is facilitated. Many democratic and socialist governments use a progressive system of taxation to achieve economic redistribution. However, there are various methods to implement tax systems that can lead to more effective resource allocation. Apart from the development and execution of these tax systems, "globalisation of the world economy provided incentives for reforming the tax system" all around. Apart from applying a tax system to accomplish the redistribution of wealth, the same socio-economic advantage can be obtained if suitable laws are passed under the present political framework to address these problems. The modern perspective on the issue of wealth redistribution emphasises the idea that economic growth raises the general standard of living in a whole society.

[12] Indrajeet Sharma, *Tax Evasion: Challenges and Solutions*, TaxBuddy Blog (Apr. 24, 2024), available at https://www.taxbuddy.com/blog/tax-evasion-challenges-and-solutions (last visited Apr. 15, 2025).

By spreading wealth from higher-income groups to lower-income people, progressive income tax laws seek to lessen income disparity. Although income tax changes have helped lower poverty, their effect on more general income disparity has been negligible. A 2018 report by the Indian Statistical Institute indicates that the Gini coefficient, which gauges inequality, has stayed somewhat high, indicating that growth has disproportionately helped the rich.

4.4 The Goods and Services Tax (GST): A Double-Edged Sword

The **Goods and Services Tax (GST)** was implemented in India in 2017 to overhaul the indirect tax system, replacing a patchwork of state and central taxes with a single tax on goods and services. While the GST was designed to improve the efficiency of tax collection and foster economic growth, its impact on income inequality has been contentious.

4.4.1 The Structure of GST

The Goods and Services Tax (GST) system in India, with its multi-tiered tax slabs ranging from 0% to 28%, was designed to simplify the indirect tax regime, streamline the taxation process, and ensure uniformity across the country. However, the structure of the GST, particularly the differentiation in tax rates for various goods and services, has raised significant concerns about its regressive nature.

Regressive Impact on Lower-Income Households

One of the primary criticisms of GST’s tax slabs is that the system can disproportionately burden lower-income households. While essential goods and services, such as food and medicine, are taxed at lower rates (usually 5% or even 0%), the tax burden on other goods like household appliances, cars, and electronics, which are typically associated with wealthier households, is significantly higher, at 28%. This creates a scenario where lower-income households may end up spending a larger proportion of their income on goods that are subject to tax, thus feeling a heavier financial strain than wealthier households who consume more expensive, higher-taxed goods.

The **regressive nature** of the tax structure is evident because GST does not differentiate between the necessities of life and luxury items in a way that reflects the varying purchasing power of different income groups.[13] For instance, while lower-income families may struggle

13 Tax Foundation, *Regressive Tax*, TaxEDU Glossary (last visited Apr. 15, 2025), available at https://taxfoundation.org/taxedu/glossary/regressive-tax/

to afford basic necessities, the higher tax on luxury items like cars or expensive gadgets doesn't directly affect them since they are less likely to purchase these items in large quantities. However, the increased tax on items such as foodstuffs, healthcare products, and personal care items directly affects the poorest, who rely on such goods for daily survival.

Food and Medicine Taxation

Medicines are covered under Chapter 30 and, when delivered by a pharmaceutical business, are responsible for excise duty at 6% on 65% of MRP. A few drugs were free from excise taxes. There also were certain area-based excise duty exemptions options. The manufacturing inputs needed drew 12.5% excise duty. This inverted duty structure led to CENVAT credit building up. Furthermore imposed VAT of 4% on pharmaceutical sales by manufacturers and stores. [14]

Though food and medicine are taxed at a lower rate of 5%, for the poorest households, even this relatively low rate can still make a significant difference in their overall spending. A larger share of their income is dedicated to meeting their basic needs, so any additional tax burden, no matter how small, can exacerbate their financial challenges. Food, especially staple items like vegetables, grains, and pulses, forms a significant part of their consumption. If these goods are taxed, it places an additional strain on household budgets. Even a small increase in the cost of essential goods could push them further into poverty, particularly in areas where income levels are already low.

Luxury Goods and Higher-Income Consumers

Luxury items have great income elasticity of demand: people will buy proportionately more luxury goods as they get wealthy. This also indicates that demand will drop more than proportionately should income drop. The income elasticity of demand is not constant with respect to income and may change signs at different income levels. That is to say, a luxury good may become a necessity good or even an inferior good at different income levels. On the other hand, luxury goods like cars, electronics, and high-end fashion are taxed at the highest rate of 28%. While this rate aligns with the principle of taxing luxury goods at a higher rate, it is worth noting that such goods are primarily purchased by wealthier segments of society. The tax burden on these goods does not have a significant impact on low-income households since

14 ClearTax, *GST Rate on Medicines and Other Pharmaceuticals*, (Jan. 22, 2025), available at https://cleartax.in/s/impact-of-gst-rate-on-pharmaceutical-industry (last visited Apr. 15, 2025).

they are unlikely to be regular consumers of high-cost products. However, the issue lies in the broader economic implications, where the increasing prices of both essentials and non-essentials lead to inflationary pressures, pushing the cost of living higher for all segments of society, including the poor.

Overall Cost of Living

As GST is applied across various sectors, even seemingly small increases in tax on basic goods and services can add up, affecting household expenses. Goods like personal care products, medicines, and even services such as healthcare, education, and transportation are often taxed at varying rates. For lower-income groups, these incremental costs can quickly accumulate and represent a substantial portion of their disposable income.

This taxation structure, where basic goods and services necessary for daily life are taxed while luxury goods are taxed at a higher rate, exacerbates the already-existing inequalities. Low-income households, already grappling with rising living costs, find that the taxes on everyday goods eat into a large part of their income. For example, even though essential food items are taxed at a lower rate, the regressive impact is still significant because the tax disproportionately affects those who are dependent on these goods as a larger share of their expenditure.

4.4.2 The Informal Sector and GST Compliance

Through the implementation of GST, the government sought to simplify the earlier tax system and thereby unify the country as a single market. Previously, the tax system was largely regarded as having a significant cost associated with compliance which explained the lack of registration in various sectors. This was largely a consequence of the informal nature of the construction industry and, under the previous tax regime, developers charged VAT and Service Tax on the consideration received from the customer, which meant compliance for two different statutes. Developers often asserted that factors such as ambiguous computation of land value, diverse methodologies of calculating taxation at the state level through VAT, and inability to claim input tax credit (ITC), central sales tax (CST), and entry tax made these taxation policies difficult to adhere to and increased their cost. The need for compliance resulted in enormous cost and still Solving the numerous issues associated with taxes in these regions enabled these players to comply. The reduction in the number of unregistered businesses in this industry was made possible because of the uniform tax rate for all states and the sole tax—GST—levied on building contracts.

The challenges faced by the informal sector in adjusting to the Goods and Services Tax (GST) in India can be attributed to a combination of factors, including limited access to information, inadequate digital literacy, and insufficient support systems. Small traders, unregistered businesses, and micro-enterprises, which form the backbone of the informal economy, often struggle with the complexity of the tax system, making it difficult for them to comply with GST regulations.

1. Lack of Awareness and Understanding:
Many small business owners in the informal sector are not fully aware of the benefits and obligations that come with GST compliance. The intricacies of GST, such as input tax credits, filing returns, and maintaining proper documentation, can be overwhelming for those who have limited knowledge of tax laws or lack the resources to hire professional accountants or consultants. This lack of awareness leads to non-compliance or delayed compliance, which results in penalties and fines, further increasing the financial burden on these businesses.

2. Digital Barriers:
With GST being a digital-first tax system, businesses are required to maintain electronic records, file online returns, and access the GST portal for various processes. However, many small traders in the informal sector do not have the necessary technological infrastructure, including reliable internet access or digital literacy, to navigate the GST system. This digital divide limits their ability to comply with the tax regulations and, in turn, excludes them from the formal economy, reinforcing their informal status.

3. Increased Costs and Complexity:
The compliance costs for small businesses in the informal sector can be prohibitively high. These businesses often operate on thin profit margins and lack the financial capacity to invest in technology or professional services to meet GST requirements. The need to hire tax consultants, invest in accounting software, and train employees in GST procedures adds to the financial strain. As a result, many businesses opt to remain outside the formal system, which deprives them of the benefits that come with formalization, such as access to credit, government schemes, and a broader market reach.

4. Impact on Cash Flow and Business Operations:
GST compliance can affect the cash flow of small businesses, particularly those that deal with customers in the unorganized sector. Since businesses need to collect GST on their sales and

pay tax on their purchases, the working capital of small businesses is tied up in the tax system. In cases where businesses have a large customer base that is unable or unwilling to pay GST, they may struggle to manage their cash flow, further threatening their sustainability. The delay in receiving input tax credits or refunds also exacerbates liquidity problems.

5. Exclusion from Government Schemes and Formalization Benefits: The informal sector often misses out on government schemes designed to promote business growth and provide financial assistance. GST non-compliance leads to a lack of access to formal financial systems, such as loans or subsidies, which are available to GST-registered businesses. Consequently, small enterprises remain trapped in the informal economy, where they continue to face challenges in accessing markets, obtaining credit, and receiving social security benefits.

6. Impact on Income Inequality and Poverty: The difficulties in complying with GST regulations exacerbate income inequality within the informal sector. The added financial burden from GST compliance often leads to lower earnings for small business owners and workers, pushing them further into poverty. Workers in the informal sector, such as those involved in casual labor, street vending, and small-scale manufacturing, may face job insecurity and declining wages as businesses scale down operations or shut down due to the strain of complying with tax laws.

7. Government Support and Solutions: Recognizing the challenges faced by the informal sector, the government has introduced several measures to ease GST compliance. Initiatives such as the *GST Composition Scheme* offer simplified tax filing options for small businesses with a turnover below a certain threshold, reducing the compliance burden. Additionally, the government has implemented programs aimed at improving digital literacy, such as providing online training and resources for small business owners. However, more needs to be done to ensure that these measures reach all informal sector workers and business owners, particularly in rural and underserved areas.

Furthermore, there is a need for greater flexibility in GST regulations to accommodate the realities of small and informal businesses. Simplifying return filing processes, extending deadlines for compliance, and offering financial assistance for technological upgrades could help ease the burden on these businesses. Providing localized support through government outreach programs and creating awareness campaigns would also help bridge the gap between policy and practical implementation, encouraging more informal sector players to embrace GST compliance.

4.5 Comparative Analysis: India vs. Scandinavian Tax Systems

India's tax system, with its focus on **progressive income taxation** and the introduction of **GST**, can be compared to those in **Scandinavian countries**, where taxation systems are characterized by high tax rates and comprehensive welfare programs.[15] In Scandinavian countries, taxes are primarily structured around high income tax rates, including both progressive income taxes and substantial wealth taxes. For example, in Sweden, the top marginal income tax rate is around 56%, and Norway applies a top rate of about 38% for individuals. The tax systems in these countries are designed not only to generate revenue but also to redistribute wealth, thus narrowing income disparities. Additionally, Scandinavian tax systems include extensive consumption taxes such as VAT, which contribute further to the revenue base. These countries have a high tax-to-GDP ratio, often exceeding 40%, which supports a range of public services and welfare programs aimed at reducing poverty and inequality. This large tax base funds universal healthcare, free education, comprehensive unemployment benefits, and other social services, ensuring that the wealthiest individuals contribute disproportionately to the funding of these welfare programs.

India's Progressive Income Taxation

In contrast, India's tax system, while progressive in nature, operates with a much lower tax-to-GDP ratio. India's top marginal tax rate for individuals is set at 30%, much lower than that in Scandinavian countries, and the country's overall tax-to-GDP ratio hovers around 17%. India's income tax system, though progressive, has limitations due to challenges such as widespread tax evasion, particularly in the informal sector, where a significant portion of the population remains outside the tax net. This issue has severely hindered the effectiveness of the progressive tax system in addressing income inequality.

Moreover, the implementation of GST in 2017, which replaced a complex tax structure of multiple state and central taxes, has introduced new challenges for income redistribution. While GST aimed to simplify India's tax system and improve efficiency, its regressive nature has raised concerns. The tax disproportionately affects lower-income households, as they tend to

[15] *Comparative Tax Systems* (slides, Institute of International Tax Law, 2018), available at https://www.international-tax-law.at/fileadmin/Bibliothek/StudyMaterials_1819/Evans_18_slides1.pdf.

spend a larger proportion of their income on taxed goods and services. For example, essential goods like food, which are consumed by poorer segments of the population, are taxed at a lower rate (5%), while luxury items are taxed at much higher rates (28%), exacerbating the tax burden on the poor.[16]

Welfare Programs and Redistribution

One of the key factors distinguishing Scandinavian tax systems from India's is the scope and efficiency of social welfare programs. Scandinavian countries invest heavily in social welfare, including universal health care, extensive public pension systems, and generous unemployment benefits. These programs are critical in reducing income inequality by redistributing wealth from higher-income individuals to those in need. For example, Sweden's universal healthcare system ensures that all citizens, regardless of income, have access to essential medical services. Similarly, Norway's pension system guarantees financial security for the elderly, further reducing income disparities.[17]

In contrast, India's social welfare programs, such as the Pradhan Mantri Jan Dhan Yojana (PMJDY) and the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), have made notable progress in alleviating poverty, but their scope remains limited in comparison to the comprehensive welfare systems in Scandinavia. India's welfare programs are often plagued by inefficiencies, leakage, and corruption, which limit their ability to reach the most vulnerable populations. Moreover, these programs are underfunded, as reflected in the country's low tax-to-GDP ratio, and often do not cover the entire population.

4.5.1 Tax Rates and Tax-to-GDP Ratio

Scandinavian countries are renowned for their high tax rates and efficient tax-to-GDP ratios, which play a central role in their ability to fund expansive social welfare programs. The top marginal tax rates in these countries range from 50% to 60%, significantly higher than India's highest rate of 30%. This steep tax structure reflects the countries' commitment to redistributive policies and social equity. Such high rates are not limited to income taxes but extend across a broad array of taxes, including corporate taxes, value-added taxes (VAT), and wealth taxes. In Sweden, for example, the top individual income tax rate is approximately 56%, and the VAT

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16 Embassy of India, Paris, *A Key Pillar of Nation Building* (last visited Apr. 15, 2025), available at https://www.eoiparis.gov.in/content/A-Key-Pillar-of-Nation-Building.pdf.

17Daniel Bunn, Sean Bray & Joost Haddinga, *Scandinavian Social Programs and Taxes*, Tax Foundation (Oct. 12, 2023), available at https://taxfoundation.org/blog/scandinavian-social-programs-taxes-2023/

rate is 25%, contributing significantly to public revenues.

The substantial tax-to-GDP ratio in Scandinavian countries, averaging around 40%, is a testament to the high levels of taxation that fund a wide array of social benefits. This is in stark contrast to India, where the tax-to-GDP ratio is much lower, hovering around 17%. The difference in tax-to-GDP ratios illustrates the varying fiscal capabilities of the two regions. A higher tax-to-GDP ratio enables Scandinavian countries to provide universal healthcare, free education, generous unemployment benefits, and extensive pension systems. These services, often funded by high taxes, help reduce income inequality by redistributing wealth from higher-income individuals to those who are less well-off.

The high levels of taxation in Scandinavian countries support an effective welfare state that provides a robust social safety net for its citizens. For instance, in Norway, the state funds a variety of programs such as subsidized child care, elderly care, and disability support. These services reduce the financial burden on individuals and families, promoting social mobility and reducing disparities in income distribution.

In contrast, India’s relatively lower tax-to-GDP ratio limits the government's ability to fund comparable welfare programs. Despite India’s efforts to provide social services like the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) and Pradhan Mantri Jan Dhan Yojana (PMJDY), these programs have limited scope and coverage compared to the comprehensive systems in place in Scandinavian nations. Consequently, India's capacity to address income inequality is constrained, and the country continues to face significant challenges in reducing disparities across its diverse population.

India’s lower tax-to-GDP ratio also reflects challenges in tax collection and compliance, with a large portion of the economy operating in the informal sector, where taxation is difficult to enforce. Moreover, India's progressive tax system, while beneficial, is undermined by factors such as tax evasion, underreporting of income, and poor enforcement mechanisms. As a result, the country’s welfare programs often do not reach the most vulnerable sections of the population at the scale needed to achieve significant reductions in inequality.

4.5.2 Welfare and Redistribution Programs

Scandinavian countries are renowned for their extensive and effective social welfare systems, which are central to their efforts in reducing income inequality and promoting social mobility.

These programs are funded by high tax rates and provide a broad safety net to all citizens. In countries like Sweden, Denmark, and Norway, universal healthcare, free education, paid parental leave, and generous unemployment benefits are just a few examples of the services available to the population. These programs play a critical role in reducing the wealth gap by ensuring that wealth is redistributed from higher-income individuals to those in need.

1. Universal Healthcare: In Scandinavian countries, healthcare is universally accessible and funded through taxes, ensuring that all citizens, regardless of income, receive the same level of care. Sweden, for instance, spends around 10% of its GDP on healthcare, ensuring equitable access for all. This reduces income inequality by preventing medical expenses from becoming a barrier to basic healthcare for lower-income individuals.

2. Free Education: Education in Scandinavian countries is free, from primary school all the way through university. This system reduces inequality by providing equal opportunities for individuals, regardless of their socio-economic background. By investing in education, Scandinavian countries ensure that future generations have the tools they need to succeed, contributing to greater social mobility.

3. Unemployment Benefits: Scandinavian countries provide substantial unemployment benefits, which are designed to replace a significant portion of an individual's lost income if they lose their job. These benefits are aimed at reducing poverty and providing financial security during periods of unemployment. The generosity of these benefits helps to maintain a basic standard of living for unemployed citizens, thus reducing the negative impacts of unemployment on inequality.

In addition to these universal programs, Scandinavian countries also offer a wide range of other welfare benefits, including child allowances, pensions for the elderly, disability benefits, and housing subsidies. The comprehensive nature of these welfare programs ensures that even the most vulnerable members of society are supported, reducing poverty and narrowing the wealth gap.

India's Social Welfare Programs

India’s social welfare system, while expansive in some areas, is far more limited in scope and effectiveness when compared to its Scandinavian counterparts. Although India has introduced several welfare programs aimed at poverty alleviation and income redistribution, these programs face significant challenges in implementation and funding.

1. Pradhan Mantri Jan Dhan Yojana (PMJDY): Launched in 2014, PMJDY is a financial inclusion initiative aimed at providing access to banking services for low-income individuals. While the program has successfully opened millions of bank accounts, the overall impact on income redistribution is limited by the fact that many individuals in the informal sector, which accounts for a large portion of India's economy, remain outside the formal banking system. The program’s effectiveness is also hindered by issues related to financial literacy and access to banking infrastructure in rural areas.

2. Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA): MGNREGA, introduced in 2005, guarantees 100 days of wage employment per year to rural households. While MGNREGA has been successful in reducing poverty and providing employment in rural areas, its effectiveness is constrained by underfunding, poor implementation, and corruption. The program also faces challenges in terms of the quality of jobs created and the adequacy of wages offered to beneficiaries.

3. Other Welfare Programs: India also has a variety of other welfare schemes, such as the Public Distribution System (PDS) and the National Food Security Act (NFSA), aimed at providing food security and subsidies to low-income households. While these programs have had some success in addressing food insecurity, inefficiencies in distribution, corruption, and the leakages in the system often reduce their effectiveness in reaching the most needy.

Key Differences Between India and Scandinavian Welfare Systems

While both India and Scandinavian countries recognize the importance of welfare programs in addressing income inequality, there are key differences in their approaches:

- **Universal Coverage vs. Targeted Programs:** Scandinavian countries provide universal coverage for healthcare, education, and unemployment benefits, ensuring that every citizen benefits equally. In contrast, India’s welfare programs tend to be more targeted, often aimed at specific income groups or rural areas. This approach can lead to exclusion or inequities in access, as some individuals may not qualify for benefits due to stringent eligibility criteria or bureaucratic inefficiencies.

- **Funding and Efficiency:** The success of Scandinavian welfare programs is supported by high levels of taxation, which create a substantial fiscal capacity to fund these programs. India’s lower tax-to-GDP ratio limits its ability to finance comprehensive welfare programs on the same scale. Additionally, issues like tax evasion, inefficiencies in public spending, and corruption reduce the impact of India’s social welfare system.

- **Comprehensiveness and Coverage:** Scandinavian countries' welfare systems are designed to provide a comprehensive safety net, addressing multiple dimensions of poverty and inequality simultaneously. In comparison, India’s welfare programs often focus on specific issues, such as food security or rural employment, rather than providing a holistic approach to welfare.

Chapter 5: Comparative Analysis of Progressive Tax Systems

5.1 Tax Systems in Scandinavian Countries

The Scandinavian countries—**Denmark**, **Norway**, and **Sweden**—are renowned for their robust and highly progressive tax systems, which play a crucial role in maintaining their social welfare systems and reducing income inequality. These countries have among the highest tax rates in the world, with a strong emphasis on **redistributive fiscal policies** and **welfare programs** designed to provide a safety net for all citizens.

5.1.1 Structure of Taxation in Scandinavian Countries

The tax systems in Scandinavian nations are based on the principle of **progressivity**, which means that individuals with higher incomes are taxed at higher rates. Scandinavian countries generally have **progressive income taxes**, **capital gains taxes**, **inheritance taxes**, and **wealth taxes**, which ensure that the wealthiest individuals and corporations contribute a fair share of the country's revenue. These taxes are then used to fund a wide array of social services, including **universal healthcare**, **education**, **unemployment benefits**, **pension systems**, and **public housing**.[18]

In **Sweden**, the **personal income tax** is progressive, with the highest marginal rate reaching **57%** for individuals earning over a certain threshold. Similarly, **Denmark** and **Norway** also feature high personal income tax rates, which range from **55% to 60%** at the upper income brackets. These high tax rates are not limited to income tax but also extend to **social security taxes**, **value-added taxes (VAT)**, and **corporate taxes**, all of which contribute to the extensive welfare systems in these countries.

Moreover, Scandinavian countries have made **substantial investments in tax administration** through digital infrastructure and the enforcement of tax compliance. The Swedish Tax Agency, for example, uses highly efficient systems to collect taxes and manage public revenue, which results in high compliance rates and minimal tax evasion. This robust administrative structure is crucial to maintaining the financial sustainability of these high-tax systems.[19]

5.1.2 Tax-to-GDP Ratios and Public Expenditure

Based on the tax to GDP ratio, it can be determined whether a country's government has sufficient funds to sustain itself. The lower the ratio, the worse the government's financial situation is in regards to spending fed resources. This ratio needs to be maintained in order to provide the government with suffcient funding for its costs and control over the economy. The ratio also helps evaluate the overall economic situation of a country: advanced, emerging, or lagging. A higher ratio indicates that the country is developed whereas a lower ratio signals that the country is in developing stage.

One of the defining features of Scandinavian countries' tax systems is their **high tax-to-GDP ratios**. These countries collect a significant portion of their GDP in taxes, enabling them to fund **comprehensive welfare programs**. For instance, **Sweden** has a tax-to-GDP ratio of

[18] Swank, D. (2002). *Global Capital, Political Institutions, and Policy Change in Developed Welfare States*. Cambridge University Press

[19] Krogstad, J. M., & Garcia, M. D. (2017). *Tax Compliance and the Role of Effective Administration in Scandinavia*. *Journal of Public Policy*, 35(2), 162-179.

approximately **44%**, **Denmark** stands at **46%**, and **Norway** is close to **42%**. These high ratios reflect the significant role that taxation plays in funding public services and maintaining a high standard of living for their populations.

In contrast, India's tax-to-GDP ratio is much lower at **17%**, underscoring a significant gap in revenue generation. The high tax-to-GDP ratios in Scandinavian countries enable governments to allocate substantial portions of their revenue to social welfare programs, which is a critical tool in reducing **income inequality** and **poverty**.

5.1.3 Social Welfare Systems Funded by Taxes

The taxes collected in Scandinavian countries are primarily directed towards funding expansive welfare programs. These programs provide a range of services, including **universal healthcare**, **subsidized education**, and comprehensive **unemployment benefits**, which collectively aim to ensure that all citizens have access to basic services and a high standard of living. For example, Sweden's universal healthcare system ensures that all citizens receive medical treatment at little to no cost. Similarly, higher education is free in these countries, reducing the financial burden on students and their families.

These comprehensive welfare systems not only reduce **income inequality** but also promote **social mobility**. In countries like Sweden and Denmark, these systems help ensure that an individual's socio-economic status is less likely to be determined by their family background, leading to a more **equitable society**.

5.1.4 Wealth and Capital Taxation in Scandinavia

In addition to income taxes, Scandinavian countries also utilize **wealth taxes**, **inheritance taxes**, and **capital gains taxes** to redistribute wealth more equitably. In Sweden, for instance, capital gains are taxed at rates up to **30%**, and **inheritance taxes** are levied on estates above certain thresholds. This progressive tax structure ensures that wealth is more evenly distributed across society.

Scandinavian countries have also enacted various policies to curb **tax avoidance** and **tax evasion**, often employing digital systems that make it difficult for individuals and businesses to conceal income or assets. This has led to **higher tax compliance** and a more equitable redistribution of wealth.

5.2 Key Policy Implications for India

India, while making strides in reforming its tax system, can draw important lessons from the Scandinavian tax systems in terms of addressing income inequality, improving tax compliance, and expanding social welfare. By examining the strengths of Scandinavian countries' tax structures and their broader social policies, several key recommendations emerge for India's tax reforms.

5.2.1 Increasing the Tax-to-GDP Ratio

One of the most immediate policy changes India could consider is **raising the tax-to-GDP ratio**. This could be achieved by broadening the tax base, improving tax compliance, and targeting sectors that are currently under-taxed, such as the **informal economy**. While raising taxes, especially for high-income earners, can be politically challenging, the Scandinavian model demonstrates that higher taxes can be acceptable to the public if they are clearly linked to high-quality public services.

India's tax-to-GDP ratio is currently **17%**, which is well below the **40-45%** seen in Scandinavian countries. To achieve a more equitable society and fund expansive social welfare programs, India could increase its tax revenue by enforcing higher taxes on high-income earners, expanding the **GST base**, and ensuring that the **informal economy** contributes to tax revenue.

5.2.2 Expanding Social Welfare Programs

India's current welfare programs, such as **MGNREGA** and **PMJDY**, have been successful in reducing poverty and providing support to the poorest sections of society. However, they remain insufficient in scope compared to the comprehensive welfare systems in Scandinavian countries. Expanding welfare programs to include **universal healthcare**, **free education**, and **more generous unemployment benefits** could significantly reduce income inequality in India.

By following the Scandinavian model, India could invest more in public services to reduce reliance on the private sector, which often exacerbates inequalities. For instance, expanding access to healthcare could alleviate the financial burden on low-income households and improve overall public health.

5.2.3 Strengthening Tax Administration and Compliance

India's tax administration faces significant challenges, particularly in terms of compliance and enforcement. The **informal economy**, which accounts for nearly **50% of India's GDP**, is largely outside the scope of formal taxation. To address this, India must invest in modernizing its **tax collection infrastructure** and improving its **tax compliance culture**.

Digital tax reporting systems, like those used in Sweden, could be introduced to improve transparency and reduce opportunities for tax evasion. Additionally, India could enhance tax audits and use data analytics to identify tax evaders. By improving compliance, India could increase its tax revenues without raising tax rates.[20]

5.2.4 Addressing Wealth Inequality Through Capital and Inheritance Taxes

Another important area where India can improve is the taxation of wealth. While India currently levies taxes on capital gains and has provisions for inheritance tax, the rates are relatively low compared to those in Scandinavian countries. Expanding **capital gains taxes**, **inheritance taxes**, and introducing a **wealth tax** could help in redistributing wealth more equitably.

The Scandinavian countries' wealth tax systems, which focus on taxing **high-net-worth individuals**, could be a model for India. India could implement a **progressive wealth tax** system to address growing wealth inequality, ensuring that the wealthiest individuals contribute a fair share of taxes.

20 https://www.oecd.org/en/topics/policy-issues/tax-administration.html

Chapter 6: Theoretical Framework

6.1 Economic Theories Supporting Progressive Taxation

Progressive taxation—the principle that individuals with higher incomes should pay a greater proportion of their earnings in taxes—has long been a cornerstone of modern tax policy in many developed nations. While the debate over the fairness and effectiveness of such a system continues, progressive taxation finds strong support in various economic theories. These theories span utilitarian ethics, modern public finance, and macroeconomic stability models. This essay explores the major theoretical justifications for progressive taxation, demonstrating that such a system is not only morally compelling but also economically rational. Recent fiscal policy, which seeks to guarantee a more fair distribution of resources in a society and thereby solve inequality, depends critically on progressive taxation. The progressive tax system is supported by several economic theories, which underline its function in reducing wealth and income inequality as well as in providing the government's funds for maintaining public goods and services.

6.1.1 The Theory of Fiscal Redistribution

Fiscal responsibility distribution theory maintains that the tax structure should be established to minimise disparities in income. The key to this concept are progressive taxes, in which individuals with greater wealth pay more rates. This theory stems from the larger utilitarian idea in economics, which supports the maximum of overall welfare. Governments can increase the welfare of the less rich by taxing the wealthier sections of society at greater rates and then distributing the income, therefore raising general social welfare.

It holds that progressive taxes help close the disparity between the rich and the poor, therefore promoting a more inclusive society. It contends that taxing higher incomes at progressively higher rates and distributing this money will help to finance social services including welfare, healthcare, and education that assist the lower-income sections of society. The progressive tax system is also supported by the marginal utility hypothesis, which holds that as a person's income increases their marginal value of income. Thus, higher taxes on the wealthy have less negative impact on their well-being than higher taxes on the poor.

6.1.2 The Social Contract Theory

The **social contract theory**, notably developed by philosophers such as **Jean-Jacques Rousseau** and **John Locke**, also provides a strong argument for progressive taxation. According to this theory, individuals consent to be governed in exchange for protection of their rights and provision of public goods. In the case of taxation, the social contract can be seen as a mutual agreement where wealthier individuals contribute a larger share of their income to ensure the functioning of society, including the provision of public services.[21]

Progressive taxation is a reflection of this contract, where individuals who benefit most from a society's resources, such as infrastructure, security, and economic stability, contribute proportionally more in taxes. This ensures that the state has sufficient resources to protect and promote the well-being of all citizens, especially the disadvantaged. The theory suggests that the wealthier class, due to their larger share of societal benefits, has an ethical obligation to

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21 Daniel Bunn, Sean Bray & Joost Haddinga, *Scandinavian Social Programs and Taxes*, Tax Foundation (Oct. 12, 2023), available at https://taxfoundation.org/blog/scandinavian-social-programs-taxes-2023/

contribute more.

6.1.3 The Capability Approach

The capability approach of Amartya Sen offers a convincing theoretical foundation for progressive taxation. According to Sen, real economic development goes beyond only raising income levels to include empowering people to operate in society. Capabilities refer to the real opportunities people have to fulfil their life values. Progressive and redistributive tax systems help to encourage this by allowing those from lower-income backgrounds to make use of the chances that wealthy individuals take for granted.

The ability method holds that taxing the rich and sharing resources lets the government offer those in need necessary services like healthcare and education, which enhances their abilities. By doing this, it improves social justice—that is, guarantees each person's capacity for productive functioning in life. Progressive taxation thereby helps to achieve the objectives for enhancing human capacities and promoting a more fair society.

6.2 Emerging Economies and Progressive Taxation

In the framework of developing nations, the implementation of progressive taxes presents distinct interest and issues. Although many of these nations have embraced progressive tax systems in theory, structural economic problems, informality in employment opportunities, and administrative capacity concerns greatly affect the implementation and efficiency of these types of structures.

6.2.1 Taxation in Emerging Economies: Challenges and Opportunities

Developing countries such as such as South Africa, Brazil, and India find it difficult to use progressive taxes efficiently. Some of these problems are:

- **Large Informal Economies**: Many developing countries have a large economy that is informal, in which the income is not adequately documented or taxed. Progressive tax systems' effectiveness is hindered by this since the tax system cannot sufficiently represent a great amount of economic activity.
- **Weak Tax Compliance**: In many developing nations, tax compliance is still a major problem. Low-income people and companies may escape taxes through inadequate

enforcement systems or distrust of government departments.

- **Limited Administrative Capacity**: Many developing nations have weak tax systems and little capacity to enforce tax rules, therefore reflecting their poor administrative competence. High tax evasion rates and a lack of enough income for public services can follow from this.

Developing countries attempting to become fully integrated in the world economy will probably need a higher tax level if they are to pursue a government role closer to that of industrial countries, which, on average, enjoy twice the tax revenue. Developing nations must drastically cut back on their reliance on foreign trade taxes without establishing economic barriers, particularly when it comes to increasing personal income tax receipts. Policymakers in these nations will need to establish clear policy goals and possess the political will to carry out the required reforms in order to tackle these difficulties. The necessary policy changes must be accompanied by strengthened tax administrations.

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The development of sound tax policies presents major challenges for emerging nations when trade barriers are removed and wealth becomes more mobile. The necessity of substituting domestic taxes for foreign trade taxes will be accompanied by an increase in worries about foreign investors diverting profits, which is currently unabated by the tax laws' lax prohibitions against tax evasion and the insufficient technical training of tax auditors in many developing nations. Therefore, it is imperative that a concentrated effort be made to remedy these inadequacies. In a world where capital movement has been liberalised, tax competition presents another policy difficulty. In the absence of other essential components, the efficacy of tax incentives is seriously in doubt. Rent-seeking activities will unavoidably flourish in a tax structure that is rife with such incentives. It would be wise for developing nations to avoid depending solely on poorly targeted tax incentives to encourage investment in order to give their nascent markets the time they need to establish themselves.[22]

Lastly, in many developing countries, individual income taxes have been contributing only a very small portion of total tax collection. The outcome is largely due to the ease with which individuals can invest their money overseas, in addition to structural, legislative, and administrative factors. For underdeveloped nations, taxing this money is therefore something that is challenging.

Notwithstanding these difficulties, developing nations have chances to make good use of progressive taxes. Strengthening revenue collecting systems, enhancing tax administration via digital transformation, and growing the official sector will help to solve the primary problems. Furthermore, by changing their systems based on specific circumstances, developing countries that have effectively adopted progressive tax policies may help rising economies.

6.2.2 Impact of Progressive Taxation on Economic Growth

By means of encouraging a more equitable development model, progressive taxation in developing nations can help to boost economic growth. Studies point to long-term economic growth being inversely connected to income disparity. A significant amount of inequality could compromise social cohesiveness, cause political unrest, and restrict the possibility of constant economic progress. Emerging nations may create more fair development, improve access to education and healthcare, and encourage social mobility by implementing a progressive tax structure that distributes riches.

By raising the ability to purchase of the middle and lower-income classes—who are more likely to use goods and services than more wealthy people who might save more—progressive tax schemes can also assist boost domestic demand. Increased economic activity resulting from this can help to drive development.

6.2.3 Case Studies of Progressive Taxation in Emerging Economies

Despite the fact that with various levels of success, several newly developed countries have made notable progress in applying progressive taxation:

22 International Monetary Fund, *Economic Issues No. 27 – Tax Policy for Developing Countries* (1993), available at https://www.imf.org/external/pubs/ft/issues/issues27/

- In Brazil: While Brazil offers a slightly high degree of economic disparity, its progressive tax system has helped lower poverty and advance social welfare. The Income Tax of the entire country is quite progressive, and taxes on inheritance and wealth help to distribute riches. These taxes have paid for the creation of social initiatives such as Bolsa Família, therefore lowering poverty rates.
- **South Africa**: South Africa offers a well-established progressive tax system in which income taxes rise progressively for increasing income. Additionally supported from taxes, the country has instituted other welfare initiatives like child grants and pensions. However, difficulties such as tax evasion and too much unemployment reduce the tax system's ability to fully lower inequality.
- **India**: India has a growing economy with a significant informal sector. Although India's tax system is progressive in theory, informal markets and tax evasion may hinder its efficacy. Although other changes like digital tax filing and GST have helped, tax collecting from unorganised sectors continues to create challenges.

Chapter 7: Challenges and Criticisms of Progressive Taxation

7.1 Challenges in High-Income Economies

Although most people agree that progressive taxes help to lower economic disparity, even in countries with high incomes it provides some challenges. These challenges result from several political, economic, and social factors restricting the fairness and efficiency of the system.

7.1.1 Tax Evasion and Avoidance

The frequent utilisation of tax evasion and tax avoidance techniques by high-income people and businesses is one of the main issues of progressive tax systems in wealthy countries. Tax evasion has become the illegal practice of not paying taxes due; tax avoidance is the legal manipulation of tax regulations to reduce liabilities. With their great resources, high-income earners typically have access to complex methods to evade or avoid taxes, including offshore tax havens, complex business structures, and legal gaps.

These methods may significantly reduce the efficiency of progressive taxation even if wealthy people pay higher tax rates. In reality, these policies could cause the wealthiest individuals to pay a smaller effective tax rate than the middle class. The Panama Papers leak in 2016 revealed the extensive use of offshore tax havens by the wealthy and powerful, therefore stressing the difficulties in tackling these problems in high-income countries.

The Panama Papers scandal in India

The Panama Papers revealed suspected illegal properties valued at around Rs 20,078 crore of 500 Indians, named in the disclosures.After the papers were published in 2016, the authorities discovered the accused individual and their alleged illegal entities' tax avoiding activity.Advocate for the Supreme Court Manohar Lal Sharma's request that under the authority of the highest court in India an inquiry of Indian offshore account holders as well as stock market authorities be undertaken.Justice Dipak Misra was assigned to oversee a bench that would provide the CBI directions on filing first information reports (FIRs) and investigating claims of violations of the Prevention of Corruption Act and the Prevention of Money Laundering Act.At present under control by a multi-probe agency headed by Atulesh Jindal, the chairman of the Central Board of Direct Taxes (CBDT), attended by officials from the CBDT inquiry unit as well as the Financial Intelligence Unit (FIU), and the Reserve Bank of India (RBI).

7.1.2 Political Resistance to High Taxes

Political resistance to progressive tax policy has grown to be a major challenge in many high-income nations. Rich people typically have great political power, which they can utilise to change tax laws in their benefit. Tax cuts for the wealthy, reduced rates on capital gains, and the adoption of policies disproportionately favouring higher income groups follow from this political campaigning.

Such opposition prevents tax rates from rising sufficiently on the rich, therefore compromising the objectives of progressive taxation. Not only does this phenomena exist in the United States but also in other high-income nations where tax changes may benefit the rich by means of exclusions and loopholes.

7.1.3 The "Laffer Curve" and Economic Growth Concerns

The Laffer Curve shows how tax rates affect the amount of tax revenue collected. That means there is a specific tax rate that can generate the maximum revenue. According to the Laffer Curve theory, the ideal tax rate maximises income without depressing economic activity. Proponents of this view contend that too high taxes—especially progressive taxes on the wealthy—may hinder economic advancement. High taxes, they contend, weaken the incentives for investment and entrepreneurship, which slows down economic growth eventually.

Key Elements of the Laffer Curve

- The government finds itself without income at both ends of the tax rate range, 0% and 100%. At a 100% tax rate, individuals lose motivation to earn money as the government would receive all their profits; conversely, at a 0% tax rate, virtually no taxes are collected. Reduced economic activity resulting from these situations causes zero income.
- The ideal tax rate maximises overall income by crossing these two extremes. Many elements, including the state of the economy, taxpayer behaviour, and particular market conditions, might affect T's precise position. Finding this perfect point is challenging since it will differ greatly from one country to another.
- In light of tax sensitivity, the Laffer Curve—the way sensitive taxable income reflects changes in tax rates— shapes the curve. Should taxpayers respond aggressively to tax changes and modify their behaviours or investment decisions, the curve will show more obvious rises or declines in income when tax rates vary.

Although the Laffer Curve is still a divisive issue, in high-income countries officials' fear of compromising economic growth often causes them to exercise caution when deciding on increased progressive tax rates. Critics contend that this focus on expansion has led to less progressive tax systems with an unequal share of the tax pressure placed on workers in the middle class.

7.2 Challenges in Developing Economies

In developing countries, progressive taxes create a different kind of problems than in high-income nations. These difficulties result from the inherent constraints of these economies as well as from outside elements influencing their capacity to implement sensible tax policies.

7.2.1 Informal Economies

The predominance of informal industries presents a major obstacle for progressive taxes in emerging nations. Many developing nations have a lot of individuals working in informal industries, where revenue is not publicly recorded and people are not usually bound to pay taxes. This causes significant tax base erosion and a situation whereby just a small portion of the population helps contribute to government income.

Effective progressive taxation can be difficult in countries like India where informal industry makes more than half of the overall economic activity possible. Efforts to automate and register informal workers into the tax system can run against major obstacles like bureaucratic inefficiency, mistrust of government institutions, and fear of penalising.

7.2.2 Weak Tax Administration and Compliance

Problems in taxation and compliance provide yet another obstacle for developing countries. Many developing countries lack the necessary infrastructure to effectively enforce compliance and collect taxes. Further affecting the effectiveness of the tax system is corruption within government departments.

Sometimes without faith in the system, taxpayers in developing countries cause great violation. Progressive taxes become ineffective without strong administrative processes to identify and prevent evasion when wealthy individuals and companies use legal gaps or simply refuse to pay taxes entirely.

7.2.3 Political Instability and Resistance to Reform

Many developing countries have instability in politics that can seriously hinder tax reform. Established interests—including large businesses, wealthy elites, and even foreign enterprises trying to evade taxes—may object strongly to governments. Particularly those meant to transfer wealth through progressive taxes, such opposition sometimes results in the preventing of tax reform.

Furthermore, the lack of political determination to implement progressive taxation policies results from governments in developing nations being unable to engage in long-term planning because of short-term political cycles. Therefore, even if progressive tax reforms could be theoretically good, they are sometimes neglected in favour of more immediate policy moves with faster results.

7.3 Global Tax Avoidance Strategies

The global rise in tax evading techniques that compromises government's ability to gather the income essential for social initiatives is one of the most important concerns of progressive taxation. Also taking advantage of taxation differences between nations, large businesses, wealthy individuals, and investors utilise various strategies to reduce their tax liabilities across countries.

7.3.1 Offshore Tax Havens

Changing income to offshore tax havens, where corporation tax rates are either significantly lower or even none, is one of the most common tax evasion methods. Countries like the Cayman Islands, Germany, Luxembourg, and Switzerland have become famous for providing tax havens for businesses and high-net-worth individuals. Often lacking transparency or administration, these tax havens let companies and people protect revenue from taxes in higher-tax countries.

Utilising offshore tax havens has resulted in a situation whereby multinational companies pay little or no taxes in the nations where they conduct business while yet reporting great profits. Reports from groups like Oxfam indicate that hundreds of billions of dollars are wasted yearly from tax avoidance using these devices.

7.3.2 Corporate Tax Avoidance and Transfer Pricing

Apart from offshore tax havens, transfer pricing is another tool used by multinational corporations to distribute earnings across different countries, therefore lowering their total tax obligations. Transfer pricing is the practice of varying the prices corporations trade products and services between their subsidiaries across several nations. Through inflation or deflation of prices for internal operations, businesses can distribute earnings to countries with reduced tax rates.

This approach is especially troublesome since it takes advantage of legal gaps in international tax rules, therefore costing governments large amounts of income. Working on projects like the Base Erosion and Profit Shifting (BEPS) project to offset such techniques, the Organisation for Economic Co-operation and Development (OECD) nevertheless has difficulties with enforcement.

7.3.3 Tax Competition Between Nations

Another worldwide problem undermining the efficacy of progressive taxation is tax competitiveness in the marketplace. Countries can reduce their tax rates in order to attract foreign capital or investment, therefore fostering a race to the bottom in tax rates. Progressive tax systems thus become more difficult as nations are compelled to lower their tax rates on corporate profits, capital gains, and even individual income.

Globalization's growth has aggravated this problem since capital and labour can travel across boundaries more freely than in earlier periods. This causes tax rates to be under downward pressure, therefore impairing governments' capacity to finance social welfare initiatives by progressive taxation.

Chapter 8: Policy Recommendations

Reducing economic inequality and guaranteeing an equitable distribution of wealth in both rich and developing nations depends on progressive taxation as the ideal tool. But as previous chapters highlighted, certain issues must be resolved if the system is to run as it is supposed to. This chapter emphasises on suggestions for policies aimed to improve India's progressive tax system and discusses the need of world cooperation.

8.1 Improving India’s Progressive Tax System

Over the past few years, India has made great progress towards modernising its tax system; nevertheless, its progressive tax system still confronts many difficulties. The massive informal economy is one of the most important obstacles to a truly equitable system, as it is believed to account for a significant portion of national revenue but remains essentially free of taxes. Furthermore, understated income and administrative inefficiencies contribute to generally low tax compliance. Moreover, despite progressive tax rates, the current system misallocates tax income, with wealthy individuals often benefiting unjustly. Several changes and policies are required to make India's progressive tax system better and guarantee it functions as an instrument for lower wealth disparity.

8.1.1 Enhancing Tax Compliance through Digitalization

India's tax base is heavily hindered by a significant informal economy, where a large portion of income is not captured in official statistics or taxed. The digitisation of the tax system will help to solve this by increasing compliance and transparency. By using technology for tax collecting, the Goods and Services Tax (GST) achieved efficacy in this regard and offers an example for subsequent modifications to taxes. The government should fund the introduction of e-filing systems, digital invoicing, and automated reconciliation tools to guarantee more companies and people engage in the official economy and so extend this digitalisation. Furthermore, using instruments that enable real-time transaction monitoring and enhancing online platforms can help to lower chances for tax fraud.

Furthermore, India's Aadhaar system—which gives its people a digital identity—may be even more important in increasing tax transparency. Linking Aadhaar to tax filing would enable the government to more precisely monitor income and expenses, therefore guaranteeing more easily identified taxpayers. Mobile-based tax solutions could be used for both people and companies in remote areas or those without banks to help lower the entry obstacles. This move would also promote more involvement from the unofficial sector, therefore ensuring that once those excluded find their place on the official tax file.

8.1.2 Strengthening Tax Enforcement and Monitoring

Improving India's progressive tax system depends critically on bettering tax law enforcement. Particularly for high-net-worth people and businesses, the weakening of tax laws now significantly creates evasion. While some advancement has been done, further has to be done to guarantee compliance. The government has to invest in the capability of tax authorities by means of more efficient technology monitoring of non-compliant taxpayers and resource improvement for audits and investigations.

A possible strategy could involve expanding data exchange across various government departments, financial institutions, and tax authorities. Tax authorities may find differences between detailed income and actual wealth by cross-referencing instruments and real-time data collection. In addition, it should be a top priority to concentrate on wealthy individuals as well as multinational companies that utilize profit shifting and transfer pricing as means of tax evasionEliminating gaps that disproportionately benefit the rich depends on specialised task teams as well as worldwide cooperation in observing business practices.

8.1.3 Expanding the Tax Base

Another crucial step in strengthening India's tax system is expanding the tax base. Currently, India's tax system is overly reliant on direct taxes, such as income and corporate taxes, which means it is vulnerable to revenue shortfalls when compliance drops. To diversify the tax base and make the system more progressive, India should consider expanding the scope of indirect taxes like the GST. However, care must be taken to ensure that the impact on lower-income groups is minimized, as indirect taxes are often regressive. One potential solution is to fine-tune the GST to ensure that essential goods and services remain tax-free or heavily subsidized for low-income households, while increasing taxes on luxury goods and services.

Another way to expand the tax base is by increasing property taxes, particularly on higher-value properties. This could include revising the tax rates to ensure they are progressive, targeting those with substantial real estate holdings. This would create a more equitable system and prevent the wealthy from avoiding taxes through under-reporting or evasion of asset wealth. Furthermore, India should explore the implementation of capital gains and inheritance taxes, which are relatively underdeveloped in comparison to other countries. The introduction of wealth taxes for high-net-worth individuals would help target those who benefit the most from the economy's growth and ensure they contribute fairly to funding public services.

8.1.4 Progressive Tax Rate Adjustments

India's current tax rates for higher-income earners are relatively low compared to international standards, especially in comparison with other high-income countries that employ more progressive systems. The highest personal income tax rate in India stands at 30%, with some additional surcharges for ultra-high-income earners. This rate is far lower than in countries like Sweden or Denmark, where the top marginal tax rates approach 50-60%. To make India's tax system more progressive, higher tax brackets should be introduced for individuals with very high incomes, with the highest tax rate potentially reaching 40% or more for those in the wealthiest decile.

Additionally, corporate tax rates should also be scrutinized. While India has made efforts to reduce corporate tax rates to attract investment, there is still room to adjust corporate taxation to ensure that large, profitable multinational companies pay their fair share of taxes. Special attention should be given to adjusting tax rates for companies that report high profits but engage in aggressive tax planning to shift profits to low-tax jurisdictions. A progressive corporate tax system, including closing loopholes on international taxation, is crucial to ensure that multinational corporations contribute to the country's tax revenue.

8.1.5 Ensuring Better Redistribution of Tax Revenue

Even with improved tax collection, the real benefit of a progressive tax system lies in how tax revenue is redistributed. If the revenue generated through progressive taxation is not allocated effectively, it could fail to address the needs of society's most vulnerable populations. Therefore, the government must ensure that a larger portion of the tax revenue is directed toward social welfare programs such as public health, education, and employment schemes. These sectors are crucial for reducing inequality and ensuring that the benefits of economic growth are more evenly distributed.

India must also focus on strengthening targeted cash transfers and subsidies for low-income households. Programs like the Direct Benefit Transfer (DBT), which sends subsidies directly to individuals' bank accounts, can be expanded to include more citizens. These transfers should be adjusted to address inflation and the rising cost of living, especially in rural areas where access to essential services may be more limited.

8.2 International Cooperation on Tax Issues

Although domestic reforms are important, especially for multinational companies, worldwide taxation collaboration is very vital to solve world tax evasion and avoidance. India cannot solve the tax avoidance problem by itself since many of the most wealthy people and biggest companies exploit international gaps and tax havens. Curbing these behaviours and guaranteeing fair worldwide tax collection depend on international collaboration.

8.2.1 Strengthening Global Tax Transparency

Globally, tax evasion offers a major obstacle especially via offshore tax havens. India should encourage more tax transparency by means of international organisations like the OECD and the United Nations, so addressing this issue. This includes promoting both the automatic global tax data interchange between nations and required disclosure of the beneficial ownership of corporations and trusts. Countries may ensure that their rich citizens pay their fair share of taxes by disclosing financial information and preventing illegal financial flows, therefore preventing the rich from hiding assets in low-tax nations.

8.2.2 Reforming Global Tax Rules for Multinational Corporations

India ought to promote changes to international tax laws that will handle the broad tax evading practices used by multinational companies. Many of these businesses use profit shifting, transfer pricing, and tax exemption exploiting to evade paying taxes in nations where they bring about notable revenue. Although the OECD's Base Erosion and Profit Shifting (BEPS) initiative is a positive start, India should advocate the creation of a worldwide minimum tax rate to stop the "race to the bottom" whereby nations repeatedly cut their tax rates in order to attract investment.

8.2.3 Cooperation on Taxing Digital Platforms

While growing worldwide digital platforms and e-commerce businesses indicate for international agreements ensuring equitable taxation of these businesses in the nations of operation. Although their complex worldwide structures lead to companies like Google, Amazon, and Facebook to pay less taxes, they often create significant income in nations like India. India should join the worldwide campaign for a single digital services tax, suggested by the OECD, to guarantee that digital giants support national tax systems in a way commensurate with their income in every country.

8.2.4 Expanding Developing Countries' Tax Capacity

India should at last support developing nations to improve their tax capability by working with international organisations. Many nations, including India, struggle to create the infrastructure and knowledge required to properly tax collections and fight avoidance. India can help to guarantee that progressive taxation is used more successfully in the global south by enhancing the ability of developing country's tax structures through development of capacity, technical support, and best practices. This will help to increase world tax compliance and justice.

Chapter- 9 Conclusion

9.1 Summary of Findings

The primary goal of this paper was to examine the impact of progressive income tax on income inequality in India over the past thirty years. With a particular focus on assessing whether recent tax reforms have contributed to reducing inequality. Based on the literature reviews, collection of data, and analysis of India's tax reforms, several key findings have emerged:

1. **Progressive Taxation and Income Inequality in India**: Progressive taxation is an important and an essential policy tool for income redistribution, which had a mixed impact on reducing income inequality in India. India's tax system, which has gone significant reforms since 1990s, has seen changes, particularly with the introduction of the Goods and Services Tax (GST) and changes to income tax rates. Despite these changes, the tax system still remain challenging, including a large informal economy, tax evasion, and limited wealth redistribution.

2. **The Role of Direct Taxes**: India has contributed to some extent in relation to direct taxes (personal income tax and corporate tax), but the effectiveness of the system has been compromised to some extent by compliance with low control, particularly in the informal sector. Additionally, the effectiveness of progressive taxation was limited by relatively low tax rates for high-income groups and inadequate tax classes for the wealthiest people.

3. **The Impact of GST**: The implementation of GST in 2017 had a major impact on India's indirect tax structure. Although the goal was to lower tax evasion and provide a more simple tax system, GST also had some reverse consequences. Because of the way indirect taxes products and services regardless of income, the whole weight of GST affects lower-income groups. Therefore, even if the GST has simplified the tax system, its regressive aspects have contributed to income disparity for the most disadvantaged groups of society.
4. **Comparative Analysis with Scandinavian Tax Systems**: Significant implications for India originate from a study of the tax systems of Scandinavian nations, well-known for their great degrees of advancement and wealth redistribution. To lower income disparity, Scandinavian countries utilise strong welfare systems, higher tax rates for the wealthiest citizens, and very effective tax collecting. India has a lot to accomplish ahead of it, especially in terms of raising tax rates for the wealthy and streamlining public expenditure's efficiency even if it has achieved improvement in other areas.
5. **Global Tax Issues and International Cooperation:** The results also underline the need of international cooperation to handle the problems of tax avoidance, particularly by multinational companies and high-net-worth people. India has to cooperate with foreign agencies like the OECD to carry out worldwide tax changes including the Base Erosion and Profit Shifting (BEPS) framework and advocate worldwide tax transparency and anti-avoidance policies. Global tax evasion tactics will compromise India's home tax reforms without such cooperation.
6. **Challenges in Implementing Progressive Taxation**: While progressive taxation has certain theoretical advantages, there are considerable practical difficulties in using and storing such systems in India. These include the complexity of income and wealth taxes, numerous system errors, and the challenges involved in enforcing tax compliance in the informal sector. Given the powerful interest groups that benefit from the current situation, it remains questionable that political will apply high tax rates to the rich.

9.2 Implications for Future Tax Policy

The results of this study provide valuable insights into how India's existing tax framework can be strategically reformed to foster a more inclusive and financially sustainable economic system. By analyzing trends in tax collection, compliance, and redistribution, the study underlines key areas where targeted reforms can lead to more equitable financial outcomes.

The following proposals aim to reshape India's tax policy in a manner that aligns with the principles of fairness, growth, and long-term national development.

1. **Strengthening the Progressive Tax System:** One of the core recommendations is to restructure the income tax brackets to impose higher marginal tax rates on ultra-high-income individuals. This would help to create a more equitable tax regime and reduce the wealth gap between the richest and the poorest. Additionally, reforms are needed in capital gains tax, especially on long-term holdings, and the reintroduction or strengthening of inheritance or estate taxes could ensure that wealth accumulation across generations is fairly taxed. Moreover, corporate tax policies should be revised to ensure multinational corporations pay a fair share of taxes based on their real economic activities in India. This includes enforcing stricter rules around profit shifting and base erosion to prevent revenue losses that disproportionately hurt public investment.
2. **Enhancing Tax Compliance and Efficiency:** A major challenge in India's tax system lies in the persistently low compliance rates, especially among wealthy individuals and businesses operating within the informal sector. To tackle this, the government must invest in the digitization of tax administration, including expanding the use of biometric identification through Aadhaar, and linking PAN and GST registrations with real-time tracking tools. Automation and AI-driven reconciliation can reduce manual errors, enhance transparency, and speed up processing. Moreover, capacity-building for tax officers through modern training modules, upgraded technological tools, and data-sharing mechanisms among various agencies will be essential to identify tax evaders and promote voluntary compliance. Establishing a taxpayer-friendly ecosystem that offers incentives for timely and honest declarations will also foster a culture of tax responsibility.
3. **Addressing the Regressive Impact of Indirect Taxes:** Although the introduction of the Goods and Services Tax (GST) has been a major structural reform in Indian taxation, its implementation has revealed certain shortcomings, particularly its disproportionate burden on low-income households. The uniform nature of GST does not differentiate between essential and luxury items, which can lead to regressive effects. To counter this, essential goods such as food staples, basic healthcare products, and educational services should be either zero-rated or taxed at the lowest slab. A tiered GST system with higher rates for non-essential or luxury goods can maintain revenue neutrality while achieving progressivity. In parallel, targeted government interventions

like direct benefit transfers (DBTs), food subsidies, or vouchers can be used to offset the consumption taxes paid by the economically weaker sections of society.

4. **Social Welfare and Redistribution:** Effective taxation must translate into meaningful public expenditure. The government should prioritize the allocation of tax revenues to critical areas such as public healthcare, quality education, housing, sanitation, and employment generation. These social investments are fundamental in narrowing the socio-economic divide and improving long-term human capital development. A well-funded education system can uplift future generations, while robust public healthcare can shield vulnerable populations from economic shocks. Social security schemes including pensions, disability benefits, and maternity allowances should be expanded to cover unorganized sector workers. Ensuring transparency in government spending and involving communities in participatory budgeting processes can enhance accountability and optimize the impact of public welfare programs.
5. **International Cooperation and Anti-Tax Avoidance Measures:** With globalization intensifying cross-border financial flows, India must actively collaborate with other nations to address the challenges of tax avoidance and profit shifting by multinational corporations. Participating in global tax initiatives led by the OECD, G20, and UN can help India influence international standards and negotiate fairer treaties. Implementing the global minimum corporate tax rate and adopting country-by-country reporting standards will ensure large corporations pay their fair share regardless of jurisdiction. India should also strengthen its Transfer Pricing regulations and expand the exchange of financial information with tax authorities in other countries. These efforts are critical to safeguarding the domestic tax base and promoting a level playing field in global commerce.
6. **Addressing Political and Social Barriers to Reform:** Implementing a more progressive tax regime in India will inevitably face resistance from powerful interest groups, including affluent individuals and large corporations that benefit from current tax loopholes. These stakeholders often exert considerable political influence, hindering meaningful reform. To counteract this, public outreach campaigns must educate citizens about the importance of fair taxation and the societal benefits of redistribution. Transparency in how tax revenues are utilized—such as publishing citizen-focused expenditure reports—can build trust and generate support for reform. Additionally, creating independent fiscal commissions and involving civil society in tax policy dialogues can depoliticize taxation and align reforms with broader developmental goals.

Conclusion

India has made notable progress in modernizing its tax system over the past few decades. Reforms such as the introduction of the Goods and Services Tax (GST), simplification of customs duties, and improvements in digital infrastructure have been important milestones. However, these advancements have not been sufficient to fully address the growing income and wealth disparities across the country. The current tax framework continues to face major challenges, particularly in dealing with the vast informal sector, widespread tax evasion, and limitations in enforcing progressive taxation. As a result, the system often fails to generate sufficient revenue while also lacking the equity needed to support inclusive economic growth.

To design a more equitable and efficient tax structure, India must refocus its policy priorities. Increasing the tax burden on the wealthiest individuals and large corporations through higher marginal tax rates, reformed capital gains and inheritance taxes, and tighter corporate tax enforcement is crucial for achieving redistribution. Simultaneously, efforts must be made to broaden the tax base by integrating the informal economy into the formal system, leveraging digital platforms, and ensuring that all income-earning entities contribute fairly. Stronger compliance mechanisms, along with simplified and transparent tax procedures, will reduce avoidance and promote greater trust in the system.

Equally important is the effective utilization of tax revenues. Government spending must be strategically directed toward public welfare programs, including poverty alleviation, universal healthcare, quality education, and social protection schemes. Such investments not only reduce short-term inequality but also enhance long-term social mobility and productivity. A fair tax system must not only collect revenue efficiently but must also return value to citizens through improved public services and infrastructure.

India’s ability to reduce income inequality is also linked to its participation in global tax governance. In an era of globalization and mobile capital, international tax cooperation is essential to combat base erosion and profit shifting (BEPS) by multinational companies. India must continue to engage with organizations like the OECD, G20, and the United Nations to advocate for fairer global tax rules, including the implementation of a global minimum tax rate. These initiatives are vital to ensuring that wealthy individuals and corporations pay taxes where economic activity actually occurs, rather than exploiting low-tax jurisdictions to avoid their responsibilities.

As India continues to experience rapid economic growth, it is imperative that its tax system evolves in tandem to reflect the principles of justice, inclusivity, and sustainability. A more progressive and redistributive tax regime, supported by international cooperation and robust domestic policy implementation, can significantly reduce inequality and support the development of a fairer society. In doing so, the benefits of economic progress will not remain concentrated among a few, but will be shared across all sections of the population. This inclusive approach is not only a moral imperative but also a pragmatic strategy to ensure social cohesion, long-term stability, and sustained national development.

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