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DIRECT TAX REGIMES IN COMPARATIVE PERSPECTIVE: STRUCTURAL INEQUITY, BASE EROSION, AND THE MIDDLE-CLASS BURDEN - A STUDY OF INDIA, THE USA, AND THE UAE -

AUTHORED BY - HARSH BHALOTIA

ABSTRACT

This paper presents a comparative analysis of direct tax systems across three jurisdictions that together span the full spectrum of contemporary fiscal philosophy: India, a developing-economy democracy anchoring its national revenue on a narrow formal workforce; the United States of America, a mature federal democracy whose highly progressive statutory code conceals profound structural inequities at the effective rate level; and the United Arab Emirates, a high-income Gulf federation that until recently eschewed direct personal taxation entirely, and has now introduced a low-rate corporate tax framework driven by international OECD commitments rather than domestic welfare imperatives. Drawing on primary legislation, administrative statistics, judicial precedent, and empirical survey data, this paper argues that all three systems - despite their radical architectural differences - share a common structural pathology: the effective tax burden falls disproportionately on the middle-income formal workforce, while passive capital accumulation and informal economic activity enjoy structurally embedded preference. The paper identifies the mechanisms through which this inequity operates in each jurisdiction, quantifies the resulting distributional outcomes, and derives a set of cross-jurisdictional policy lessons applicable to India's ongoing tax reform agenda.

Keywords: *Direct taxation; comparative tax law; income tax; middle-class burden; capital gains; effective tax rate; India; United States; UAE; tax reform; fiscal equity; BEPS; GAAR.*

1. Introduction

The architecture of a nation's direct tax system is among the most consequential expressions of its political economy. It answers, with legal precision, three normative questions that every modern state must confront: who bears the cost of public goods, in what proportion, and through what mechanisms. The answers that India, the United States, and the United Arab

Emirates have arrived at are strikingly different - yet, this paper contends, they share a common structural outcome that is rarely acknowledged in the comparative tax literature: each system, in its own institutional idiom, systematically privileges the accumulation of passive capital over the earnings of formal labour.

This convergence is not ideologically self-evident. India is a constitutional democracy with socialist Directive Principles that explicitly mandate redistribution and the prevention of wealth concentration. The United States deploys a nominally steep progressive rate schedule that, on its face, imposes marginal rates of up to 37% on the highest earners. The UAE, conversely, imposes no personal income tax at all - a design choice rooted in the rentier state model and the competitive imperative of attracting mobile human capital. Three radically different fiscal philosophies - and yet the salaried middle class in each jurisdiction ends up bearing an effective tax burden that, as a proportion of their ability to accumulate wealth, is structurally heavier than that borne by the wealthiest individuals or by those operating in the informal economy.

The analytical contribution of this paper is to map the specific institutional mechanisms through which this convergent inequity is produced in each jurisdiction, to situate these findings in the context of current legislative developments - including India's Income-Tax Bill 2025, the post-TCJA American fiscal landscape, and the UAE's first full cycle of Corporate Tax implementation - and to derive a set of actionable policy propositions for Indian tax reform.

2. Theoretical Framework: The Equity-Efficiency Trade-off in Comparative Perspective

The normative evaluation of any tax system proceeds from two foundational principles that are in perpetual tension: equity and efficiency. Equity is conventionally subdivided into vertical equity - the requirement that taxpayers with different levels of income bear proportionately different burdens - and horizontal equity - the requirement that taxpayers with similar economic circumstances bear equivalent burdens. Efficiency, in the fiscal context, requires that the tax system distort private economic decisions as little as possible, preserving the allocative signals of market prices while raising the revenue the state requires.

Classical tax theory, from Adam Smith's canons of taxation to the optimal tax framework of Mirrlees (1971), recognises that complete vertical equity and economic efficiency are mathematically incompatible at high income levels: a perfectly progressive system that taxes the last dollar of high-income earnings at very high rates will, above some elasticity threshold, generate sufficient behavioural distortion to reduce aggregate output. This foundational tension

has been invoked, with varying degrees of empirical rigour, to justify tax cuts at the upper end of the income distribution in all three jurisdictions studied in this paper.¹

However, the comparative evidence assembled in this paper suggests that the canonical equity-efficiency trade-off has, in practice, been consistently deployed as a rhetorical cover for a different distributional agenda: the structural preference of passive capital income over active labour income. This preference is not an inevitable mathematical consequence of optimising for efficiency; it is a political choice, embedded in the specific design of capital gains rates, stepped-up basis rules, free zone exemptions, and informal sector exclusions that define each system. Recognising this distinction - between genuine efficiency imperatives and politically constructed preference for capital - is the essential first step in developing a comparative framework adequate to the complexity of the three systems analysed here.

3. Constitutional Foundations and Legislative Architecture

The three jurisdictions under study derive the authority to levy direct taxes from constitutionally distinct sources, and these distinctions shape the practical scope and limits of their respective tax systems in ways that are analytically significant.

In India, the sovereign right to tax income is anchored in Article 265 of the Constitution, which prohibits the levy or collection of any tax except by the authority of law - a categorical guarantee of legality against executive arbitrariness. The exclusive power to levy income taxes (other than on agricultural income) is assigned to the Union Government under Entry 82 of List I of the Seventh Schedule. The primary legislative instrument, the Income Tax Act, 1961 (ITA), is currently undergoing a historic overhaul through the Income-Tax Bill, 2025, which proposes to reduce the statute from 819 sections to 536, eliminate over 1,200 provisos, and replace the archaic previous-year/assessment-year duality with a unified Tax Year - a simplification designed to reduce chronic litigation and improve administrative efficiency.²

The American federal income tax rests on the Sixteenth Amendment (ratified 1913), which grants Congress the power to tax incomes from "whatever source derived." The primary instrument, the Internal Revenue Code of 1986 as substantially amended by the Tax Cuts and Jobs Act (TCJA) of 2017 and the Inflation Reduction Act of 2022, is administered by the Internal Revenue Service - an agency under chronic resource pressure whose enforcement workforce shrank by over 30% between 2010 and 2022, producing a structural audit asymmetry that falls most heavily on lower-income filers.³

The UAE's corporate tax framework, built from scratch through Federal Decree-Law No. 47 of 2022 (effective for financial years commencing on or after 1 June 2023), represents the most

architecturally novel of the three systems. Designed in explicit alignment with the OECD's BEPS 2.0 framework and incorporating a statutory General Anti-Avoidance Rule from Day One, it illustrates how a jurisdiction building a tax system in the twenty-first century can leapfrog decades of contested case law by embedding anti-avoidance principles legislatively rather than developing them through judicial evolution.⁴

4. Personal Income Taxation and the Structural Burden on the Middle Class

The most significant comparative finding of this study is the degree to which all three systems, through structurally different mechanisms, concentrate the effective direct tax burden on the formal middle-income salaried class.

In India, this concentration is achieved primarily through the Tax Deducted at Source (TDS) mechanism. For salaried employees, the income tax is intercepted at source by the employer before the salary is credited - making compliance non-negotiable, total, and inescapable. This pre-emptive withholding stands in sharp contrast to the treatment of business income and professional income, which passes through a complex self-assessment process offering significantly greater scope for deduction, deferral, and structural reduction. The practical consequence is striking: despite a population exceeding 1.44 billion, only approximately 84 million income tax returns were filed for Assessment Year 2024-25, of which roughly 60% declared zero net tax liability. The entire PIT burden of the world's fifth-largest economy rests on approximately 23 to 25 million effective taxpayers - barely 1.6% of the population.⁵

The structural consequence of this narrowness was made visible in the unprecedented macroeconomic event of FY 2023-24: for the first time in India's fiscal history, Personal Income Tax (PIT) collections formally surpassed Corporate Income Tax (CIT) collections, with PIT constituting over 53% of total direct tax revenue. This crossover is not an administrative anomaly; it is the direct, quantifiable consequence of the deep corporate tax cuts of 2019 (which reduced the standard rate from 30% to 22% and introduced a 15% rate for new manufacturing entities) combined with the expanding formal salaried workforce. The state, having reduced the corporate tax burden to attract mobile capital, has increasingly relied on the captive salaried class to anchor national revenue.⁶

The dual-regime personal tax architecture introduced through Section 115BAC - now the default framework from FY 2025-26 - adds a further dimension of structural complexity. The New Tax Regime (NTR) offers lower statutory rates but mandates the forfeiture of

approximately 70 deductions and exemptions. For the mass of middle-income earners who lack the surplus capital to maximise the investment vehicles that generate these deductions, the NTR simplifies compliance without materially improving effective outcomes. However, for the upper-middle professional class that has historically used Section 80C investments and housing loan deductions as enforced wealth-building mechanisms, the NTR's simplification removes state-supported incentives for long-term asset accumulation - a behavioural consequence that will compound across a generation in ways the statutory rate table does not capture.⁷

The American system produces a structurally analogous outcome through a different mechanism. The US tax code is nominally steep - the highest federal marginal rate is 37%, and in high-tax states like California or New York, the combined marginal rate for top earners can exceed 50%. But the effective rate paid by the ultra-wealthy diverges dramatically from this statutory ceiling through the "Buy, Borrow, Die" strategy: high-net-worth individuals hold appreciating assets without triggering the Realization Doctrine established in *Eisner v. Macomber* (1920), borrow against their value tax-free, and transfer them at death with a stepped-up basis that permanently eliminates accrued capital gains liability.⁸ For a middle-class American earning wage income, every dollar is visible, withheld, and fully taxed. For a billionaire whose wealth is stored in appreciating stock, decades of accumulation can pass untaxed. The IRS's own data confirm that the top 1% of filers paid approximately 40.4% of all federal income taxes collected in 2022 - a figure that sounds progressive until one notes that this same group's income share has grown to approximately 22% of national income, and that their effective rate remains, in most analyses, below the statutory rate for middle-income wage earners once payroll taxes are included in the comparison.⁹

The UAE's position in this analysis is structurally unique. There is no personal income tax - a fact that functions simultaneously as the UAE's most powerful tool of human capital attraction and as a complete exemption of approximately 9.9 million residents (88% of whom are expatriates) from any direct personal fiscal obligation to the state. The distributional consequences of this design are complex. For the high-earning expatriate professional - the primary demographic the zero-tax policy targets - the UAE offers a transformative financial proposition relative to high-tax home jurisdictions. For the large population of low-wage migrant workers in construction and domestic services, the absence of personal income tax provides no benefit - they are too poor to pay tax anywhere - but it is accompanied by an equally complete absence of the social protection infrastructure that a tax-funded welfare state would provide.¹⁰

5. Comparative Structural Overview: Key Parameters

Table 1: Key Structural Parameters of Direct Tax Systems - India, USA, and UAE (as of FY 2025-26)

Indicator	India	USA	UAE
Peak PIT Rate	30%	37% (federal)	0% (no PIT)
Standard CIT Rate	22% / 15% (new mfg.)	21%	9% (0% for SMEs / QFZPs)
LTCG Rate	12.5% (no indexation)	20% (max. preferential)	Folded into CT; nil personally
Direct Tax / GDP	~6.2%	~17.6%	~1.4–3.5% (transitional)
Effective Taxpayer Base	~1.6% of population	~45% of population	Zero (PIT); ~350,000 CT registrants
Social Security Architecture	EPF (12%+12%); limited informal coverage	FICA: 15.3% combined; near-universal	Gratuity only; no state pension for expatriates
Anti-Avoidance Framework	Statutory GAAR (2017); POEM; SEP	Economic Substance Doctrine (codified 2010)	Statutory GAAR (Art. 50, CTL 2022); Economic Substance Rules
Jurisdictional Basis	Residence-based	Citizenship-based (unique)	Incorporation / effective management

Sources: CBDT Annual Report 2023-24; IRS Statistics of Income 2022; Federal Decree-Law No. 47/2022; World Bank WDI 2024; OECD Revenue Statistics 2023.

6. Capital Gains, Wealth Accumulation, and Structural Asymmetry

The taxation of capital gains - income derived from the appreciation and realisation of assets - is the terrain on which the preference of all three systems for passive capital over active labour income is most transparently visible. Despite different statutory designs, each system produces a substantially lower effective rate on capital gains than on equivalent amounts of active labour

income, generating horizontal inequity between taxpayers of similar economic capacity who differ only in the composition of their income.

In India, the 2024 Budget's rationalisation of the capital gains regime imposed a uniform 12.5% Long-Term Capital Gains (LTCG) rate across virtually all asset classes, simultaneously abolishing the indexation benefit for real estate. The abolition of indexation is the most distributionally regressive feature of this reform. For the Indian middle class - for whom residential property remains the primary generational wealth-building vehicle - the removal of inflation adjustment means taxation of nominal, inflation-driven gains rather than genuine economic profit. A family that purchased a suburban property in 2010 for ₹30 lakh and sold it in 2025 for ₹90 lakh may have generated a real economic gain of ₹25 to ₹30 lakh after adjusting for inflation - but is taxed on the full ₹60 lakh nominal gain at 12.5%. The upper class, whose wealth is disproportionately concentrated in listed equities, pays the same 12.5% LTCG rate on gains that represent genuine, inflation-adjusted economic profit - a structurally comparable rate applied to economically incomparable situations.¹¹

The American capital gains preference is, if anything, more institutionally entrenched. Long-term capital gains - on assets held for more than one year - are taxed at preferential rates of 0%, 15%, or 20%, compared to the 37% top marginal rate on ordinary income. The combination of the preferential rate and the stepped-up basis rule under Section 1014 of the Internal Revenue Code means that the lifetime appreciation of any asset permanently escapes income taxation if the asset is held until death and passed to heirs. Saez and Zucman (2019) estimated that the stepped-up basis rule alone represents an annual tax expenditure exceeding \$40 billion - a structural subsidy for inherited wealth that has no counterpart in the tax treatment of wage income.¹²

In the UAE, capital gains are not subject to personal income tax - a position consistent with the overall architecture of zero personal taxation. For corporate entities, gains on the disposal of "qualifying" assets - including participations meeting the Participation Exemption criteria - are similarly exempt from corporate tax, provided the holding meets the ownership and holding period conditions in the CTL. The result is a jurisdiction in which the accumulation and realisation of capital wealth proceeds largely free of direct tax at every level, a design choice that maximises the UAE's attractiveness as a wealth-holding jurisdiction for global HNIs while simultaneously foreclosing the possibility of using the tax system as a redistributive instrument.

7. Corporate Taxation, Supply-Side Economics, and the Labour-Capital Divide

The divergence in the tax treatment of corporate income relative to personal labour income across all three jurisdictions has a common ideological origin: the supply-side proposition that reductions in corporate tax rates stimulate investment, capital formation, and ultimately employment and wage growth. This proposition has driven a secular decline in effective corporate tax rates across the developed world since the 1980s, and India's 2019 corporate tax cuts - from 30% to 22% for existing companies and 15% for new manufacturing entities - were explicitly framed within this framework.¹³

The empirical evidence for the strong version of this proposition - that corporate tax cuts pay for themselves through induced growth - is, at best, contested. The TCJA's reduction of the US corporate rate from 35% to 21% was followed by a period of above-trend business investment in 2018-19, but separating this effect from concurrent factors (accelerated depreciation, favourable monetary conditions) is methodologically challenging. The Congressional Budget Office (CBO) projects that the extension of expiring TCJA provisions adds approximately \$4.6 trillion to the federal debt over the next decade - a fiscal sustainability concern that the supply-side narrative does not adequately address.¹⁴

In India, the macroeconomic consequence of the 2019 corporate tax cuts is now statistically visible: the shift of the total direct tax burden from CIT to PIT documented in the preceding section is the precise, quantifiable fiscal cost of the supply-side experiment. Whether the induced investment and employment growth justifies this redistributive consequence is an empirical question that the Indian tax policy debate has, to date, not systematically answered. The UAE's 9% corporate rate - deliberately calibrated below the rates of all major competitor jurisdictions - represents the logical endpoint of this supply-side competition, a rate so low that it functions as a signal of fiscal hospitality rather than a genuine revenue mechanism. Post-CT implementation data will, over the next decade, provide the first empirical test of whether a 9% rate generates sufficient non-hydrocarbon fiscal revenue to support the UAE's ambitious public expenditure commitments under Vision 2071.

8. Anti-Avoidance Architecture: Judicial Evolution vs. Legislative Pre-emption

The design of anti-avoidance mechanisms - the legal frameworks through which states prevent the exploitation of technically legal but economically artificial structures to shelter taxable

income - is a domain of remarkable institutional divergence across the three jurisdictions, with significant implications for investment predictability and compliance culture.

India's anti-avoidance architecture has been forged primarily through judicial conflict. The foundational tension between the Westminster principle - the taxpayer's right to arrange affairs to minimise tax, affirmed in *IRC v. Duke of Westminster* [1936] - and the state's sovereign revenue claim was contested in a series of landmark Supreme Court cases: *McDowell & Co. v. CTO* (1985), which condemned "colourable devices" in favour of revenue maximisation; *Union of India v. Azadi Bachao Andolan* (2004), which reversed this stance to uphold treaty shopping and attract FDI; and the definitive confrontation in *Vodafone International Holdings v. Union of India* (2012), in which the Supreme Court's ruling in favour of Vodafone was followed by the Parliament's unprecedented retrospective amendment of the ITA to 1962 - a legislative override that triggered international arbitration defeats at The Hague and ultimately necessitated the Taxation Laws (Amendment) Act, 2021's humiliating withdrawal of the retrospective demands.¹⁵ Against this background of judicial volatility, the Statutory GAAR (codified in Chapter X-A of the ITA with effect from April 2017) represents a belated legislative attempt to stabilise the anti-avoidance framework.

The United States developed its anti-avoidance doctrine through a more incremental, but equally contested, judicial process. The foundational case, *Gregory v. Helvering* (1935), established the Business Purpose and Economic Substance Doctrines - the principles that a transaction must have a genuine non-tax business purpose and a meaningful economic reality to be respected for tax purposes.¹⁶ The subsequent codification of the Economic Substance Doctrine in Section 7701(o) of the IRC in 2010 brought statutory certainty to what had previously been a judicially managed regime, imposing a 20% penalty (rising to 40% for undisclosed transactions) on underpayments attributable to transactions lacking economic substance.

The UAE's approach is institutionally the most modern of the three. By embedding Article 50's statutory GAAR in the CTL at inception - before any significant volume of avoidance schemes had emerged - the UAE has adopted a prospective anti-avoidance architecture based explicitly on OECD best practices. This legislative pre-emption avoids the cycles of judicial conflict and legislative overreach that characterise the Indian and American histories, but transfers the institutional burden of sound anti-avoidance governance to the FTA - an authority whose decision-making quality has not yet been stress-tested by complex, large-scale avoidance disputes.¹⁷

9. Policy Implications for India: Cross-Jurisdictional Lessons

The comparative analysis developed in this paper generates a set of specific, actionable policy propositions for Indian tax reform that go beyond the generic prescriptions of "broaden the base" and "simplify compliance."

First, the UAE's institutional design philosophy - building for transparency, taxpayer service, and predictability from inception - is directly applicable to India's administrative modernisation agenda. The contrast between the EmaraTax portal's stable launch and the ITR portal's widely criticised technical failures of 2021 illustrates that administrative quality is an institutional investment whose returns - measured in voluntary compliance, reduced litigation, and investor confidence - are as significant as the choice of statutory rate. The Income-Tax Bill, 2025 is an opportunity to embed this design philosophy in the legislative text itself, creating a code that constrains future administrative arbitrariness as well as simplifying the current compliance burden.

Second, the American experience with the sunset provisions of the TCJA and the Indian experience with the retrospective tax saga both demonstrate the profound macroeconomic cost of legislative unpredictability in the tax domain. Tax certainty - the assurance that the rules governing a transaction will not be changed retroactively, and that structural incentives will remain in force for the duration of the investment horizon - is, for mobile capital, as valuable as the rate itself. India's APA programme, its growing treaty network, and the proposed dispute resolution reforms in the Income-Tax Bill, 2025 are steps in the right direction; their effectiveness will be judged by the volume of litigation they prevent, not by their statutory elegance.

Third, the UAE's QFZP model - conditions-based investment incentives tied to the demonstration of genuine economic substance, with no sunset date - offers a more durable template for India's Special Economic Zone policy than the current time-limited, expiring exemption framework under Section 10AA. Investment decisions are made on long time horizons; incentives that expire, or that are subject to the political risk of annual Finance Act revision, do not generate the same investment response as durable, principle-based commitments.

Fourth, and most fundamentally, the evidence assembled in this paper supports a renewed policy commitment to broadening the Indian personal income tax base rather than merely increasing rates on the existing narrow base. Every structural reform that draws another cohort of informal sector income into the formal compliance net - whether through GST-linked income disclosure, mandatory PAN seeding for high-value transactions, or the expanded AIS regime -

reduces the concentration of the PIT burden on the captive salaried class and improves the long-run fiscal sustainability of the system. This is the reform that no politically palatable Finance Act has yet seriously pursued: not higher rates on existing taxpayers, but a genuine expansion of the pool of persons who bear any tax obligation at all.

10. Conclusion

This paper has undertaken a systematic comparative analysis of the direct tax systems of India, the United States, and the United Arab Emirates, examining their constitutional foundations, personal and corporate tax architectures, capital gains regimes, anti-avoidance frameworks, and administrative systems. Its central finding is that each system, through structurally distinct mechanisms, produces a convergent distributional outcome: the effective tax burden falls disproportionately on the formally employed middle-income population, while passive capital accumulation and informal economic activity enjoy institutionally embedded structural preference.

In India, this preference is produced through the TDS mechanism's total capture of salaried income, the preferential LTCG rate applied to capital gains without inflation adjustment, the deep corporate tax cuts of 2019, and the constitutional exclusion of agricultural income. In the United States, it is produced through the realization doctrine, the stepped-up basis at death, the preferential capital gains rate schedule, and the structural decline of IRS enforcement capacity against high-income complex returns. In the UAE, it is produced through the deliberate absence of any personal income tax - a feature that benefits high-earning professionals enormously and provides no redistributive mechanism for the majority low-wage expatriate workforce.

The convergence of these structurally different systems around a common distributional outcome suggests that the problem is not one of technical tax design alone - it is one of political economy. In all three jurisdictions, the mobile and the wealthy have the structural capacity to avoid or minimise direct tax obligations in ways that the formally employed middle class fundamentally cannot. Addressing this asymmetry requires not merely rate adjustments at the margins but structural reforms that target the institutional mechanisms through which avoidance is generated: the realization doctrine, the preferential capital gains rate, the exclusion of agricultural income from the tax base, and the enforcement asymmetry that falls most heavily on the most compliant.

India's tax reform agenda - articulated through the Income-Tax Bill, 2025 and the ongoing rationalisation of direct tax administration - is at a historic inflection point. The comparative evidence assembled in this paper suggests that the most durable reforms will not be those that

simplify the existing system for existing taxpayers, but those that address the structural mechanisms of base erosion, broaden the formal compliance population, and establish the institutional credibility that turns voluntary compliance from a slogan into a lived experience for the Indian taxpayer.

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