

# Impact of Direct Tax and Indirect Tax on Economic Growth in India

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**Abstract:** Tax is one of the most important sources of revenue to the Government and at the same time one of the deciding parameters for economic growth. Whereas direct tax impacts directly the disposable income, the indirect tax impacts the prices of goods and services in the market. The basic objective of this article is to evaluate the impact of both direct and indirect taxes on economic growth of India. A country's standard of living is illustrated by per capita income. The country with higher per capita income is known for its economic progress. E-Filing of returns, GST file, rectifications, processing status and refunds for returns are the examples of emergence of technology in collection of taxes.

**Keywords:** Direct tax, Indirect tax, Revenue, Economy, GDP.

## 1. Introduction

Most of the governments in the world are trying to attain long term growth and economic development with taxation as one of the major tools. The study found that in the long run and short run among the heads of direct taxes, individual income tax had impact on economic growth as well as corporate income tax had a positive statistically significant impact on economic growth. Further on the indirect taxes the study found that in the long run, whiles excise duty had no statistically significant impact on economic growth but more specifically customs duty and GST had a positive statistically significant impact. The study therefore concluded that policy makers must be aware in targeting which tax components to be used as tools in influencing long term economic growth and economic development.

As per the Constitution, "India has a well-developed taxation structure." The tax system in India is mainly a three-tier system which is based between the Central, State Governments and the local government organizations. Article 246 (Seventh Schedule) of the Indian Constitution, distributes legislative powers including taxation, between the Parliament and the State Legislature.

## 2. Literature Review

The present study is both analytical and empirical in nature. This part also highlights the recent developments, progression and prosperity in the field of direct tax and indirect tax.

Bholane P. K. (2020) in his research paper "Analytical Study of Tax Revenue Collection in India" focuses on how the

taxation structure of India plays an important role in our country's development. He also explained that India has a well-developed tax structure.

Jha A., (2013) in his research paper on "Tax structure in India & its effect on corporate and individual in India" suggests that high dependence on indirect taxes should be reduced and direct taxes should be increased on super-rich to compensate the losses. He also states that corporate tax evasion techniques like transfer pricing should be checked.

Kumat H., (2014) in his research paper, "Taxation Laws of India- An Overview and Fiscal Analysis" focused on the overview of Indian tax system and challenges ahead. He thinks that there should be a coordinated consumption tax system. He also states that improving the productivity of Indian tax system continues to be a major challenge in India.

Rao G.M., (2005) opined that "Tax system reforms in India: achievement and challenges ahead" focuses on the union and state level reforms. He states that the reforms are just the beginning and considerable distance in reforming the tax system is yet to be covered.

William G. Gale, Benjamin H. Harris (2011) focused on the challenges and opportunities that the fiscal problem creates for raising revenues and reforming taxation it is concluded that Revenue increases will be an important component of any resolution to the fiscal problem facing by any country.

## 3. Importance of the Study

One of the essential characteristics of our tax rising policy is 'the ability to pay'. Indirect taxes are to be borne by the consumers of goods and services irrespective of their financial ability. On the other hand, the direct taxes are lesser burden than the indirect taxes to the common people as they are payable on income or profits rather than on goods or services. The indirect tax is also called regressive tax as the demand for products and services decreases proportionately as the amount of taxes increases. Excessive reliance on indirect taxes increases the rich and poor disparity. Direct taxes facilitate in more equitable distribution of income and wealth. Sometimes indirect taxes can facilitate equitable distribution by levying them on luxuries and exempting them on necessities. Both direct and indirect taxes are alternative methods of achieving any particular redistribution of income and wealth. The other main aspect of

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taxation is 'proper administration'. The administrative cost of collecting direct taxes is more than that of indirect taxes. Indirect taxes are simple and its cost of collection is stable over a period. From point of view of efficiency and productivity, indirect taxes are better. "Indirect taxes are wrapped up in prices and hence they cannot be easily elude". They are more productive as their cost of collection is the least. However, illegitimate administration of direct taxes leads to tax avoidance and tax evasion which is a loss to the treasury and extend the gap between rich and poor.

#### 4. Objective of the Study

The objectives of present study are,

- 1) To examine the tax structure of India.
- 2) To study the contribution of direct and indirect taxes in total tax revenue collection.
- 3) To examine the tax to GDP ratio.
- 4) To analyse how the total tax collection has been increased from FY.2015-16 to F.Y.2018-19.

#### 5. Research Methodology

The Direct Tax is one of the important sources of government revenue. Further it also impacts directly the disposable income of individuals. If direct tax rate is increased by the Government, people start saving for investment purposes. Due to this behaviour of individual's income generation process of economy is hampered. This decreases the production of luxury commodities in the economy and as a result also adversely

affects the GDP and standards of living. Thus, broadly following are the positive sides of Direct Taxes on the economic growth,

- Better capital formation
- Instinct of saving and investment
- Government's revenue growth
- Decrease in inflation rate due to lesser availability of disposable income to individuals.

On the other hand, the burden of Indirect Taxes directly falls on the consumers, it directly impacts on the cost of goods and services. Thus, indirect tax increases the efficiency of the producers, since to maintain their demand, they will have to put their full efforts towards cost cutting measures. Further, this effort of producers also brings proper utilization of resources in the economy. The consumers are at freedom to select products at their choice, thus healthy competition also grows in the economy. Thus, broadly following are the positive sides of Indirect Taxes on the economic growth,

- Better utilization of resources
- Increase in efficiency of producers
- Growth of healthy competition in the market
- Increase in demand for luxury goods
- Increase in standard of living of people of the society.

Table 1  
Direct tax collected by the Income Tax Department (for the Financial Year 2015-16) [Rs. in Crore]

	Individual	HUF	Firm	AOP/BOI	Companies	Others	Total
Salary Income	11,67,746	-	-	-	-	-	11,67,746
House Property Income	27,221	3,469	2,858	55	11,227	744	45,574
Business Income	6,66,717	16,575	70,242	251	9,94,466	27,948	17,76,199
Capital Gains (Long Term + Short Term)	53,262	2,519	4,111	11,898	77,226	9,178	1,58,194
Other Sources Income	2,34,523	16,486	3,243	1,615	1,10,686	4,016	3,70,568
Total (Addition of above)	21,49,469	39,049	80,454	13,819	11,93,605	41,886	35,18,281
Total Loss Setoff	21,505	432	3,546	3,990	1,21,840	4,953	1,56,266
Gross Total Income	21,27,964	38,617	76,908	9,829	10,71,765	36,932	33,62,015

Table 2  
Direct tax collected by the Income Tax Department (for the Financial Year 2016-17) [Rs. in Crore]

	Individual	HUF	Firm	AOP/BOI	Companies	Others	Total
Salary Income	13,96,194	-	-	-	-	-	13,96,194
House Property Income	30,774	319	3,309	722	12,087	3,908	51,119
Business Income	7,73,146	3,567	77,589	28,412	10,55,171	18,223	19,56,109
Capital Gains (Long Term + Short Term)	59,068	4,316	3,099	4,470	68,208	2,881	1,42,042
Other Sources Income	2,87,963	2,996	3,505	5,506	1,29,614	18,346	4,47,929
Total (Addition of above)	25,47,145	11,198	87,502	39,111	12,65,080	43,359	39,93,393
Total Loss Set off	23,132	1,974	3,988	3,578	1,09,917	410	1,42,999
Gross Total Income	25,24,013	9,224	83,513	35,533	11,55,162	42,949	38,50,394

Table 3  
Direct tax collected by Income Tax Department (for the Financial Year 2017-18) [Rs. in Crore]

	Individual	HUF	Firm	AOP/BOI	Companies	Others	Total
Salary Income	15,94,486	-	-	-	-	-	15,94,486
House Property Income	31,957	4,236	3,549	318	13,413	1,105	54,578
Business Income	8,18,724	19,679	90,866	3,774	11,68,526	36,093	21,37,662
Capital Gains (Long Term + Short Term)	68,722	2,733	4,691	4,607	1,03,309	7,541	1,91,604
Other Sources Income	3,29,386	19,847	4,460	2,751	1,47,090	7,100	5,10,633
Total (Addition of above)	28,43,275	46,494	1,03,566	11,450	14,32,339	51,838	44,88,963
Total Loss Setoff	26,435	586	5,455	2,367	1,50,237	5,617	1,90,697
Gross Total Income	28,16,840	45,908	98,111	9,083	12,82,102	46,221	42,98,265

Table 4  
Direct tax collected by Income Tax Department (for the Financial Year 2018-19) [Rs. in Crore]

	Individual	HUF	Firm	AOP/BOI	Companies	Others	Total
Salary Income	20,04,070	-	-	-	-	-	20,04,070
House Property Income	37,448	4,758	4,923	922	14,693	23	62,765
Business Income	9,30,416	21,061	1,21,269	28,924	13,33,069	2,214	24,36,953
Capital Gains (Long Term +Short Term)	90,210	3,618	7,028	20,983	1,09,029	623	2,31,490
Other Sources Income	3,79,013	21,969	7,586	13,533	1,80,506	700	6,03,307
Total (Addition of above)	34,41,156	51,405	1,40,805	64,362	16,37,297	3,560	53,38,585
Total Loss Set off	26,259	512	6,144	7,870	1,63,826	891	2,05,501
Gross Total Income	34,14,897	50,893	1,34,660	56,492	14,73,472	2,669	51,33,084

Table 5  
Gross Direct Tax Collection as compared to GDP [Rs. in Crore]

Year	Direct Tax	GDP	Direct Tax as % of GDP
FY2015-16	33,62,015	1,25,41,208	26.81%
FY2016-17	38,50,394	1,35,76,086	28.36%
FY2017-18	42,98,265	1,51,83,709	28.31%
FY2018-19	51,33,084	1,67,73,145	30.60%

Table 6  
Revenue Trend of Indirect Tax from the Year of 2015-16 to 2018-19 [Rs.in Crore]

Tax Components	2015-16	2016-17	2017-18	2018-19
Indirect tax receipt (Including other tax)	7,13,879	8,66,167	91,66,445	9,42,747
Grand in aid and contribution	1,881	1,299	3,582	1,063
Miscellaneous Capital receipts	42,132	47,743	1,00,049	94,979
Public debt receipts	43,16,950	61,34,137	65,54,002	67,58,482
Total receipt	50,74,842	70,49,346	1,58,24,078	77,97,271

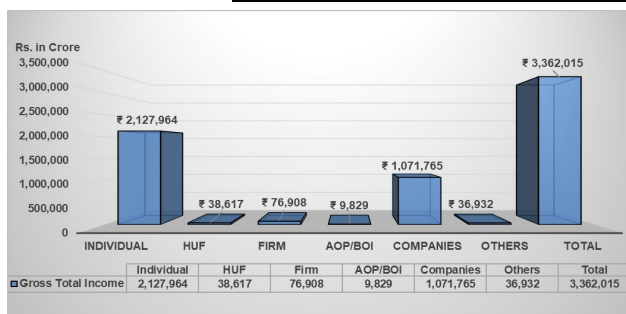


Fig. 1. Gross direct tax collection [FY 2015-16]

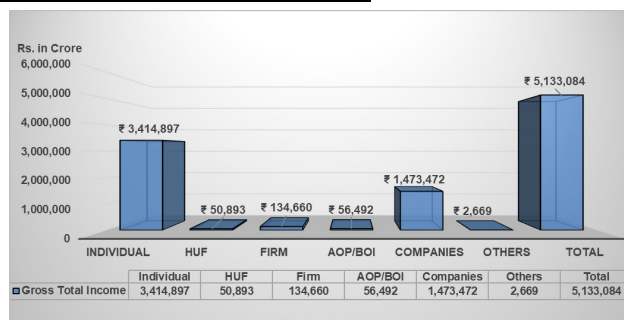


Fig. 4. Gross direct tax collection [FY 2018-19]

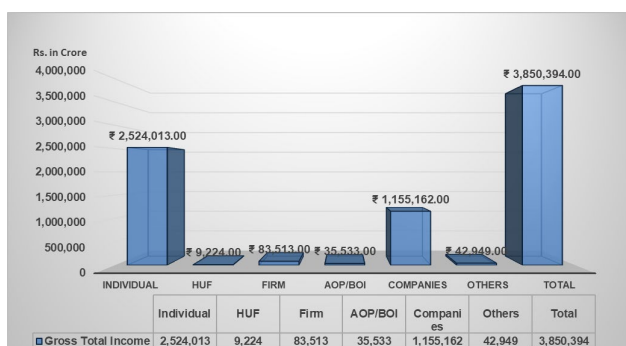


Fig. 2. Gross direct tax collection [FY 2016-17]

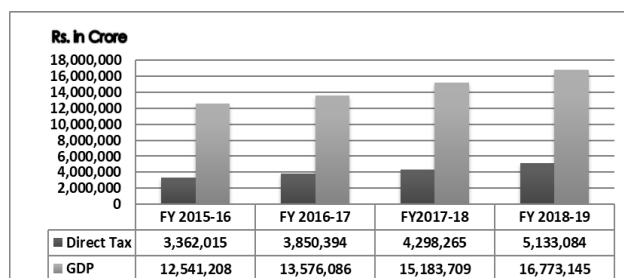


Fig. 5. Gross direct tax collection as compared to GDP for different financial year

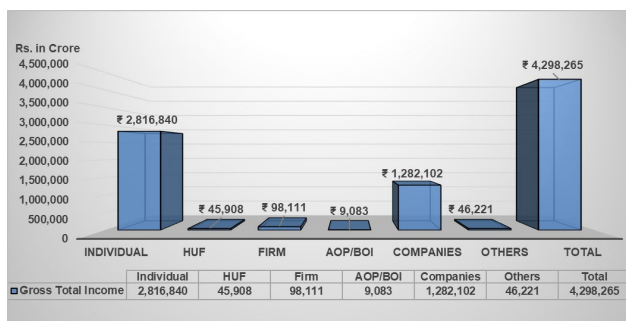


Fig. 3. Gross direct tax collection [FY 2017-18]

A. Indirect Taxes Revenue Trend

Tax revenue of the Union Government consists of revenue receipts from Direct and Indirect Taxes. In the pre-GST regime, Indirect Taxes comprised of Central Excise, Service Tax and Customs duties. After the implementation of GST, Service Tax and duties of Central Excise other than Petroleum products have been subsumed in GST. Central Excise continues to be levied on petroleum products, and tobacco has been subjected to both GST as well as Central Excise. The overall resources of Government of India and details of tax revenue of the Union Government from 2015-16 to 2018-19 have been given in table 6.

As for FY18 and FY19, Ministry did not acknowledge any specific reasons for the decline in growth of indirect taxes. However, ministry mentioned that indirect tax collections and tax resilience in a particular year depends on various external factors such as GDP growth, level of domestic consumption of goods and services, change in tax policy, crude oil prices, change in tax rates etc.

### B. Growth of Indirect Tax

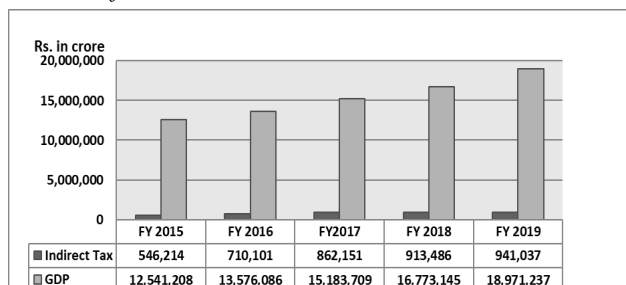


Fig. 6. GDP & Gross indirect tax revenue

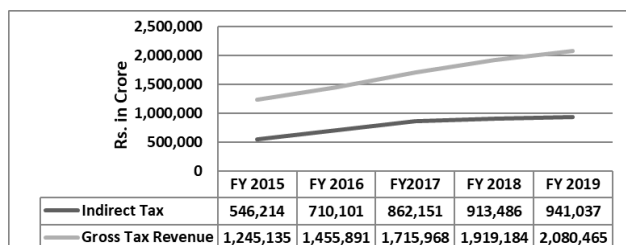


Fig. 7. Indirect tax as compare to gross tax revenue

(\*) Indirect Taxes includes, Revenue from CX, ST, GST, Customs and other taxes on commodity and services. Indirect Taxes as a percentage of GDP continued to decline every year since FY 17. Indirect taxes to GDP ratio declined from 5.68 per

cent in FY17 to 4.96 per cent in FY 19. Indirect Taxes as a percentage of gross tax revenue showed declining trend from FY17 to FY19.

### C. Comparative Growth of Various Components of Indirect Tax

As evident from the table above, Central GST tax revenue grew by 2.97 per cent during FY20 over FY19. Central GST tax revenue as percentage of GDP, however, declined from 3.08 per cent in FY 19 to 2.95 per in FY20. The share of GST remained constant at 62 per cent of the total indirect tax collections during the last two years (FY19 and FY 20). There was a marginal increase of Rs.8,459 crore in the collection of Central Excise duty during FY 20 compared to FY 19.

When pointed out the Ministry attributed GST rate rationalizations as one of the main reasons for decline in Central GST taxes to GDP ratio. Ministry stated that the GST rates were initially fixed on the basis of pre-GST tax incidence and revenue neutrality of the rates. As a result of rate rationalisations by GST Council, GST rates have been reduced notably resulting in relief of about Rs.92,000 crore per year till July 2019.

It is affined to mention that the Report on the Revenue Neutral Rate and Structure of Rates for the Goods and Services Tax (GST)<sup>16</sup> recommended the range of 15 per cent- 15.5 per cent as the revenue neutral rate, in December 2015. However, the effective weighted average GST Rate as on July 2019 was 11.6 per cent to 17 per cent. In addition, GST Council revised the threshold turnover limits upwards for registration of taxpayers and composition levy scheme to Rs.40 lakh and Rs.1.5 crore, respectively, which affected GST collections.

Table 7

During FY15 to FY19, with respect to GDP and Gross Tax Revenue Collection [Rs. in Crore]

Year	Indirect Tax (*)	GDP	Indirect Tax as % of GDP	Gross Tax Revenue	Indirect Tax as % of Gross Tax Revenue
FY 2015	5,46,214	1,25,41,208	4.36	12,45,135	43.87
FY 2016	7,10,101	1,35,76,086	5.23	14,55,891	48.77
FY 2017	8,62,151	1,51,83,709	5.68	17,15,968	50.24
FY 2018	9,13,486	1,67,73,145	5.45	19,19,184	47.59
FY 2019	9,41,037	1,89,71,237	4.96	20,80,465	45.23

Table 8

Growth of Various Components of Indirect Tax [Rs. in Crore]

Tax Components	2018-19	2019-20 (*)
Central GST Taxes (note 1)	5,84,387	6,01,784
Customs	1,17,813	1,09,283
Central Excise	2,30,993	2,39,452
Service tax	6,904	6,029
Other taxes and duties	990	1,162
Total Indirect tax	9,41,037	9,57,710

Table 9

Sectoral development of government expenditure due to increased revenue & its impact on GDP (Disbursements) [Rs. in Crore]

Sector	F.Y. 2015-16	F.Y. 2016-17	F.Y. 2017-18	F.Y. 2018-19
Administrative service	63,803.28	78,345.85	81,637.72	93,260.52
Defense Service	1,58,391.28	2,22,456.14	2,68,817.18	2,89,284.06
Agriculture & Allied Service	1,88,235.82	1,94,525.87	2,09,768.63	2,43,586.15
Irrigation	1,228.3	2,998.7	3,232.13	4,499.61
Transport	2,89,460.97	2,94,930.38	3,20,970.38	3,40,560.79
Science & Technology & Environment	20,151.81	25,687.97	29,579.48	34,956.95
Total Revenue & Capital Disbursements	7,21,271.46	8,18,944.91	9,14,005.52	10,06,148.08

Note-1: GST revenue included Central Goods and Services Tax, Integrated Goods and Services Tax, UT Goods and Services Tax and GST Compensation Cess.

(\*) Figures for the 2019-20 are provisional (prescribes as CAG Report) (Presumptive figure)

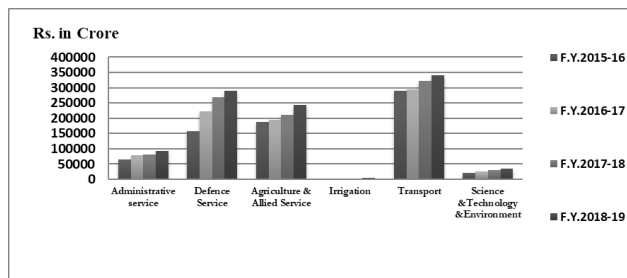


Fig. 8. Pictorial representation of sectoral development of government expenditure due to increased revenue

#### D. Conceptual Framework

Indian tax system is going through evolutionary change owing to spreading the wings of Indian business into global market. Indian Government is paying its full attention to liberalize the taxing system and at the same time closing the loopholes to disable the intruders to evade the taxing system so as to enlarge the revenue to Government exchequer and flourish the overall business scene. Broadly taxing system may be classified into three parts:

- 1) Progressive taxation system
- 2) Regressive taxation system
- 3) Proportional taxation system

##### 1) Progressive taxation system

Progressive taxation implies a taxing system where tax rate increases with increase in income, thus if a person has higher income, he will bear more tax burden due to increased tax rate than person having lesser income.

##### 2) Regressive taxation system

Regressive taxation means a taxing system where tax rate reduces with increase in income and thus a person having lesser income faces lesser tax burden due to facing lesser tax rates.

##### 3) Proportional taxation system

Proportional tax means a taxing system of charging tax on a fixed proportion irrespective of level of amount on which tax is to be levied. Thus, the same tax rate applies to different persons having different taxable amounts.

“Tax may be levied on natural persons like individual, Hindu undivided family artificial entities like Firm, association of persons company, body of individual, society etc. and also on goods and services. Thus, another classification of tax we found into direct tax and indirect tax.”

In a nutshell:

Direct tax means a type of tax which is paid by a person directly to the Government. For example, income tax and wealth tax in India.

Indirect tax means tax on goods and services which are paid by a person to the producer, seller or service provider who is liable to pay the same to the account of Government. For example, GST customs duty, excise duty in India.

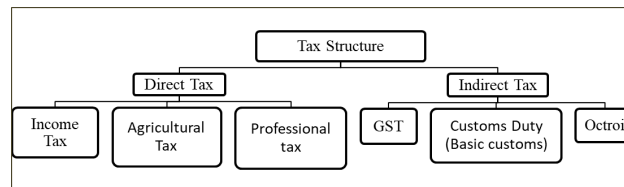


Fig. 9. Tax structure

## 6. Conclusion

In India, the role of indirect taxes in tax collection is more than direct tax. On the other hand, we can see corporation tax is the major contributor in direct tax revenue collection. Goods and Service tax is the major contributor in indirect tax revenue collection. The contribution of indirect tax in GDP is more than that of direct tax.

Government should try to increase the share of direct tax in total tax revenue collection and for that structural reforms should be brought by the government. There is high need to consolidate and simplify the tax laws. Income tax Department should run tax payers' awareness programme so that a common person may understand the tax law and procedures. Taxation system playing important role in the growth of economic and progressive growth are possible due to both type of taxes.

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