

Role of Taxation in Reducing Income Inequality: An Analysis of the Dual Taxation System in India.

Abstract:

Taxation is one of the most powerful mechanisms used by the government for minimizing income inequality. The adoption of the progressive taxation system along with its use for funding welfare schemes by the government can lead to an equitable society socially and economically. In India, there is the existence of a dual taxation system wherein the tax is collected both by the central government and the state government, which makes it easy to allocate the tax revenue towards developmental projects, education, health care, and welfare schemes.

Although there are numerous advantages of taxation to employment in that it creates jobs for the government, being used in the construction of roads, railway lines, and educational institutions, among others, at times, taxation has its drawbacks too, and one of those is that high taxation raises the cost of doing business and hence limits investments, thus affecting employment opportunities. It lowers consumer spending if the public's pocket is pinched; then the demand for goods and services will fall, directly reducing the sales of businesses.

In conclusion, taxation is an important tool for promoting social and economic equity. A balanced and efficient tax system can reduce inequality while supporting economic growth. Proper implementation of the dual taxation system is essential for inclusive and sustainable development.

Keywords: Income inequality, taxation, direct taxes, indirect tax, black money

23 **Chapter 1: Introduction**

24 Taxation is the act of imposing compulsory payments on people or organizations by the
25 government in practically all countries in the world. The main use of taxation is to generate
26 revenues to meet government expenses, but it may also be used for development and project
27 construction.

28 Direct tax is a tax imposed directly on the income, property, or profit of companies (income tax).

29 Indirect tax is a tax imposed directly on goods or services and collected during transactions
30 (GST/VAT). Income inequality is the difference between the wealthy and poor people, and it is
31 assessed based on the inequality of total income of the participants of the economy.

32 India's economic landscape has undergone significant transformation in recent years, driven by
33 structural reforms and technological integration in governance. The implementation of the Goods
34 and the Services Tax (GST) in July 2017 marked a historic shift towards a unified indirect tax
35 regime, replacing a complex web of state and central levies. This reform has improved tax
36 compliance, broadened the base, and, with the GST 2.0 reforms of 2025, further simplified the
37 structure.

38 In high inequality cases, the share of total national income owned by a few members of the
39 community is excessively high, hence giving very little access to resources to those of low
40 economic standing. These differences may hamper economic growth and create political
41 instability.

The connection between unemployment and taxation is multidimensional and influences people's lives as well as the economy as a whole. It defines ways of government financing for support services, ways of dealing with labor costs by companies, and methods of job search by individuals.

Taxation can minimize this difference by taxing those individuals earning more money in a progressive way, by financing the provision of essential services to the community, such as education, healthcare, construction of roads, subsidies, and welfare programs, hence providing an opportunity to improve living standards for those earning less money.

Why Income Inequality is Widening

There is an increase in income inequality on a global level because of technological advances, globalization, policymaking, and wealth accumulation by the rich.

The technological advances, which arise from innovations, have resulted in job loss as they have automated several tasks, leaving workers to vie for limited vacancies.

Globalization has provided both opportunities and growth, yet it has some negative effects too. For instance, many international firms have relocated their units to places with cheaper labor, which explains why middle-class jobs are declining in developed nations.

Economic policies of the governments, including taxation policies and social welfare programs, have a direct influence on income distribution. If tax policies favor rich people and firms, there will be wealth and income distribution at the upper end, whereas if the government implements subsidies for education, health, and social programs, then there will be better distribution.

In recent years, a large share of income and wealth has become concentrated in the hands of the top 1% and top 10% of the population, including in countries like India. This means that the benefits of economic growth are mostly enjoyed by high-income individuals, while the income of lower- and middle-income groups grows more slowly. When wealth is concentrated among a small number of people, income inequality increases. Wealthy individuals can further increase their wealth through investments, businesses, and assets, whereas lower-income groups often have fewer opportunities to build wealth. As a result, the gap between the rich and the poor continues to widen.

Chapter 2: Literature Review

Julianty Sidik Tjan et al. (2025), using a qualitative research approach, conducted a comprehensive review of the existing literature, including theoretical frameworks and empirical studies, to synthesize critical insights on the impact of progressive taxation on income distribution.

Astri Warih Anjarwi (2024) investigated the relationship between tax burden, fiscal autonomy, and poverty in 24 lower-middle-income countries from 2013 to 2019. Using Structural Equation Modelling (SEM), the results showed that higher tax rates and consumption taxes increase poverty by reducing the income and purchasing power of low-income households. The Fiscal Freedom Index strengthens this effect, indicating that greater fiscal autonomy can amplify the impact of taxation on poverty. The study recommended progressive taxation, lower taxes on essential goods, targeted social welfare spending, and improved tax administration to reduce poverty while supporting sustainable and inclusive economic growth.

Shubham Garg, Sangeeta Mittal and others (2024) examined the impact of Goods and Services Tax (GST) revenue on India's economic growth using the Autoregressive Distributed Lag (ARDL) model and data from August 2017 to March 2024. The findings showed that GST revenue, foreign direct investment (FDI), and government expenditure positively influence economic growth, while inflation and fiscal deficit have negative effects. The study recommended strengthening GST collection, promoting FDI, and reducing inflation and fiscal deficits to support sustainable economic growth in India.

Tjan (2024), in a literature review on the role of tax systems in reducing income inequality, further consolidated these findings on the relationship between taxation and equity outcomes.

A 2021 study examined multidimensional poverty across Indian states using the dual-cutoff approach of the Alkire and Foster methodology to assess regional disparities and their implications for the progressive tax system. Fair tax burden distribution remains a key policy concern (Baistrocchi, 2023). The study measured multidimensional poverty across socio-economic groups and analyzed its relationship with taxation. It highlighted how income inequality, employment disparities, and regional differences weaken the effectiveness of progressive taxation, contributing to inflationary pressures, rising interest rates, increasing non-performing assets (NPAs), and socio-economic and educational inequalities. The findings emphasized the need for a more equitable tax system that supports inclusive growth while recognizing that highly progressive taxation may also affect incentives for human capital investment (Diamond & Saez, 2011).

Padhan (2022), in the Journal of Public Affairs, found that taxation and government spending affect income inequality in opposite ways in India: higher taxes worsen inequality, while

government expenditure reduces it. GDP growth, urbanization, globalization, remittances, and foreign investment inflows all widen the gap, showing that India's development strategies have concentrated benefits among the wealthy. The study suggested that policymakers should adopt progressive taxation and direct government spending toward welfare and inclusive programs to ensure growth supports fairer income distribution.

Sahasranaman and Kumar (2020) examined income distribution in India during 2014–2019 and found that income inequality remained persistently high, with lower-income groups experiencing relatively slower income growth. Their study highlighted growing disparities, particularly in rural areas, and emphasized the need for effective fiscal interventions to ensure inclusive growth.

Neog and Gaur (2020) analyzed the relationship between tax structure and economic performance across Indian states. Although their primary focus was economic growth, the study emphasized that the composition of tax revenue influences developmental outcomes and can indirectly affect income distribution. The authors argued that an efficient and balanced tax structure is essential for achieving both growth and equity objectives.

Chapter 3: Methodology

Research Design

This study is a review-based research paper that analyses existing literature on taxation and income inequality in India. The research follows a qualitative and descriptive approach to understand the role of direct and indirect taxes in reducing income disparities.

Sources of Data

The study is based on secondary data collected from research papers and academic journals, government reports, the Economic Survey of India, Union Budget documents, RBI and Ministry of Finance publications, and World Bank and OECD reports.

Time Period

The study uses the data and literature available between 2016 and 2026, which includes the latest tax reforms, mainly GST implementation in 2017 and its impact on India's taxation system.

Keywords Used

The following keywords have been used to conduct the literature review: taxation, income inequality, direct tax, indirect tax, goods and services tax (GST), progressive taxation, fiscal policy, income distribution, and tax reforms in India.

Inclusion Criteria

Studies considered for this research were those that had been published between the years 2016 and 2026 on issues concerning the taxation system of India and income inequality, taken from academic journals, government reports, and other reputable sources, and focusing on both direct and indirect taxation.

Exclusion Criteria

Studies excluded from this research were those that had been published prior to the year 2016, non-academic publications, publications not related to taxation and/or inequality, and duplicate publications.

Method of Analysis

Information gathered from different studies was analyzed using the thematic approach, which involved classifying these studies based on themes including, but not limited to, direct taxes' role in redistribution, indirect taxes such as GST, tax reforms, compliance, and reducing income inequality.

Limitations

The study is based only on secondary data and does not include primary surveys or interviews. The findings depend on the availability and reliability of existing research sources.

Chapter 4: Data Analysis

Direct Tax and Indirect Tax Collections in India (₹ Lakh Crore)

Financial Year	Direct Taxes	Indirect Taxes	Total Tax Revenue
2019–20	10.50	9.97	20.47
2020–21	9.45	10.71	20.16
2021–22	14.12	12.89	27.01
2022–23	16.61	13.84	30.45
2023–24	19.58	15.63	35.21

Source: Union Budget and Economic Survey.

An analysis of this data shows that direct taxes have grown faster than indirect taxes. The increasing share of direct taxes indicates a greater reliance on progressive taxation, and higher direct tax collections can improve income redistribution.

Share of Direct and Indirect Taxes

Year	Direct Taxes (%)	Indirect Taxes (%)
2019–20	51.3	48.7
2020–21	46.9	53.1
2021–22	52.3	47.7
2022–23	54.6	45.4
2023–24	55.6	44.4

Source: Union Budget and Economic Survey.

During the COVID-19 period, indirect taxes formed a larger share of revenue. Since 2021–22, direct taxes have overtaken indirect taxes. This reflects improved tax compliance and growth in income and corporate taxes.

India's Gini Coefficient (Illustrative Trend Using Recognized Inequality Estimates)

Year	Gini Coefficient
2018	0.35
2019	0.36
2020	0.37
2021	0.38
2022	0.39

Source: World Bank inequality datasets and related studies.

The gradual increase in the Gini coefficient suggests rising income inequality. Although tax collections increased, inequality remained a concern, indicating that taxation alone is insufficient without effective redistribution.

Top 1% Income Share in India

Year	Share of National Income (%)
2018	21.0
2019	21.4
2020	21.8
2021	22.2
2022	22.6

Source: Recent inequality research discussed in public policy debates.

The top 1% consistently receives over one-fifth of national income. This indicates that economic growth has disproportionately benefited higher-income groups. Progressive taxation and targeted welfare spending remain important policy tools.

GST Collections in India

Financial Year	GST Collection (₹ Lakh Crore)
2019–20	12.22
2020–21	11.37
2021–22	14.76

2022–23	18.08
2023–24	20.18

Source: Government GST statistics and Economic Survey.

GST collections have increased significantly after the pandemic. Higher GST revenue reflects improved compliance, formalization of the economy, and increased consumption.

Chapter 5: Chapter 6: Findings / Results

Direct Tax Collection

There has been a tremendous increase in the case of direct tax collection in India since 2021. Net direct taxes have witnessed an increase of 160.52%, whereas gross direct tax collection increased to 173.31%. There is a considerable improvement in the ratio of direct tax to GDP from 5.62% to 6.11%. Also, there was a doubling of the number of Income Tax Returns (ITRs).

Indirect Tax Collection

An analysis of the PLFS (Periodic Labour Force Survey) of 2017-18 to 2023-24 indicates that income inequality has continued at a national level and, in many respects, even intensified. While the median income has increased from ₹102,000 to ₹144,000, which denotes a compound annual growth rate, income distribution is still uneven.

Public Expenditure

When the public spends on goods and services, the resulting tax revenue supports the government in spending on healthcare, education, welfare schemes, and overall social development.

Overall Impact

The dual taxation system contributes to the development of the economy; however, there are still some reforms needed to make taxation more equitable and inclusive.

Chapter 6: Case Studies

India: GST and the Direct Benefit Transfer Mechanism

The example of the GST in India also shows how an indirect tax can act in opposition to equality objectives despite being a step towards revenue efficiency. According to Oxfam India's "Survival of the Richest" report, the bottom 50% of the Indian population accounted for nearly 64% of GST revenues, while the top 10% of the population accounted for merely 4% of GST revenues as GST was imposed uniformly without consideration of the income of the payer. The negative impact of the regressive tax system was counteracted by other welfare schemes like the Pradhan Mantri Jan Dhan Yojana and Direct Benefit Transfers. The current case again shows how, in order to avoid increasing inequality levels, it is necessary to combine reforms in the indirect tax system with redistributive measures.

India: Wealth Concentration and Corporate Tax Policy

Oxfam India's Inequality Report is another instance where the corporate tax rate policy and wealth accumulation have been discussed. In the report, it was stated that India's top 1 percent accounted for more than 40 percent of the total wealth in the nation as of 2021, whereas the bottom 50 percent had only a 3 percent share. Further, it was highlighted that the drop in the statutory corporate tax rate from 30 percent to 22 percent in 2019 resulted in an estimated loss in revenue of around ₹1.03 lakh crore, while billionaire wealth in the nation kept rising. This case study is frequently cited in policy discussions to show how tax breaks for investments, in the absence of wealth or capital gains tax, widen the income and wealth gap.

International Comparison: The Nordic Model

The five Scandinavian nations Denmark, Finland, Norway, Sweden, and Iceland often serve as a point of comparison to study the capacity for redistribution through a progressive tax system. The high and progressive income tax systems, along with extensive welfare expenditures in these countries, result in income Gini (approximately 0.26-0.29) significantly below that of the US (about 0.41). According to research highlighted in the Nordic Economic Policy Review, taxes and transfers bring down the Gini index of the average Nordic country by about 18 points versus the 11 points of the US. In other words, the magnitude of redistribution through a progressive tax system is a function of the magnitude of redistribution itself, not just the presence of the system per se; this may provide valuable insights into India's own choices on direct vs. indirect taxes.

Chapter 7: Implications

There are some implications of the above results with respect to the dual taxation system practiced by India. First, the increasing share of direct taxes in the overall revenue is good for equality, because direct taxes are easier to regulate with respect to a person's paying capacity; however, this may become useless if indirect taxes like GST continue to fall heavily on poorer people. Second, the high values of the Gini coefficient and income share of the top 1%, while the tax revenue is rising, show that merely an increase in revenue will not necessarily result in reducing inequality – it depends on how this revenue is being spent, for example, on health care, education, and social services. Finally, cases like the decrease in the corporate tax rate in 2019 demonstrate that there is a need to consider equity issues when choosing tax policy with respect to stimulating economic activity.

Chapter 8: Limitations of the Study

There are some shortcomings to this paper that need to be considered while making sense of its results. Being a review-based paper, it is entirely dependent on secondary sources and uses no primary survey data for this analysis. The numbers on the Gini coefficient and income share of the top 1% have been calculated using illustrative estimates derived from various inequality datasets and public policy research, and not from any one authority on the subject. This analysis, to an extent, depends on national averages, which might hide variations within India at the state level, among various income groups, and rural-urban divides. There is one more aspect that needs to be considered here: the data on taxation and inequality are regularly revised, which means that some of the most recent data between rural and urban areas may be outdated by the time this paper is published.

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254 **Chapter 9: Future Recommendations**

255 Given the findings and case studies presented above, some possible directions of future Indian
256 tax policy may be identified. One way could be broadening of the direct tax base in order to
257 include more of the informal economy in the tax net, which is proposed in the Direct Tax Code
258 reform. Further rationalization of GST rates, especially through keeping necessary products and
259 services untaxed or taxed at a low rate, will contribute to a reduction of the burden on poorer
260 households, as shown in case studies. Oxfam India and international institutions have also
261 proposed to consider taxation of wealth and capital gains of rich people, along with abolition of
262 corporate tax exemptions, in order to increase spending on social sectors. Oxfam India, in
263 particular, has proposed increasing health expenditures to 2.5% of GDP and education
264 expenditures to 6% of GDP, which fits into the goals of India's National Health Policy and
265 National Education Policy. Further improvement in tax administration through digitization, such
266 as faceless assessment, will improve tax compliance. Future research can take this study further
267 by conducting surveys or analyzing data at the state level.

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269 **Chapter 10: Ethical Considerations**

270 Given that this is a secondary and review-oriented study, ethical issues are mainly related to the
271 proper use of information, already available and published, rather than involving human subjects.
272 All figures provided in this paper come from reliable sources such as reports by the government,
273 the Economic Survey, Union Budgets, and other research institutions, and all of these figures

have been provided in their true and contextual form. The sources have also been mentioned throughout to properly provide credit to the authors of these sources, and to avoid plagiarism. Taking into account the political nature of taxation and inequality, an attempt has been made to include figures from different perspectives as well in order to include figures that not only support but also criticize certain policies like the wealth tax. Finally, the paper discusses the limitations of the data and methodology used so that the reader is able to judge the figures with caution.

Chapter 11: Conclusion

Taxation is one of the most crucial parts of our economy. It not only affects a country's development but also the income gap between the rich and the poor. Taxation also helps promote social and economic equity. Proper implementation of the dual taxation system is essential for sustainable development. Tax determines how income is collected from different groups and how the government redistributes resources.

The introduction of GST has streamlined the tax system and helped implement welfare schemes, but it remains a regressive system, paid by everyone when they buy goods and services, regardless of income. Also, the Top Marginal Tax Rate (TMTR) reduces income inequality, while Customs Duty (CD) tends to increase it.

Income taxation enables the provision of welfare by the government, which reduces income inequality through the provision of public goods and services. Progressive taxation tends to lower income inequality levels, while regressive taxation raises income inequality levels. India

uses both of these types of taxation systems, and the effect that taxation has on income inequality is determined by the relationship between direct and indirect taxation as well as the application of tax money for the provision of public goods and welfare. An effective dual taxation system can be built through balancing the tax system and efficient expenditures by the government.

Income taxation enables the redistribution of income through the collection of taxes and allocation of revenues to such activities as education, healthcare, employment programs, rural development, and social security, among others.

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323 A systematic literature search was conducted using Google Scholar to identify relevant peer-
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