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Impact of Direct Tax Code (TDC) 2025 on Indian economy

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Abstract

The Direct Tax Code (DTC) is a major reform effort that seeks to simplify and modernize India's direct taxation system. In this study, the various consequences of the DTC on the Indian economy are examined in depth, including its implications for revenue collection, economic development, income inequality, tax compliance, and corporate conduct. The study points out that although direct taxes are an important part of the country's fiscal framework, structural inefficiencies like a narrow tax base and large exemptions have in the past constrained their effectiveness. The reforms proposed under the DTC, such as the rationalization of tax slabs and the curtailment of exemptions, are likely to increase compliance, widen the tax base, and enhance administrative efficiency. In addition, by enhancing the tax system's redistributive capability, the DTC has the potential to enhance social equity. Tax reform responses by the corporate sector are still ambiguous, but streamlining tax regulations is expected to facilitate investment and strategic tax management. Overall, the DTC, if executed well, can be an effective instrument for India's fiscal consolidation, economic stability, and broad-based growth.

Keyword: Direct Tax Code (DTC), Indian economy, tax reform

Introduction

Taxation is a key tool of fiscal policy, which is an important tool in mobilizing resources, income redistribution, and economic stability and growth. The direct tax system in India has undergone transformation over decades but still grapples with the issues of complexity, administrative inefficiency, a limited tax base, and general non-compliance. As a response to these structural gaps, the Government of India initiated the Direct Tax Code (DTC) as a broad-based reform measure to simplify the current tax legislation, enhance transparency, and better the overall efficiency of the tax regime.

The DTC, originally implemented in 2009 and amended several times, aims to replace the Income Tax Act of 1961. The key objectives are to simplify tax rates, decrease exemptions and deductions, raise compliance, and render the tax regime more equal and growth-friendly. The complete adoption of the DTC has been postponed several times, but aspects of the reform have progressively been absorbed into the tax structure, marking its enduring policy legacy.

This study seeks to examine the influence of the Direct Tax Code on the Indian economy from a number of different perspectives, ranging from its influence on government revenues to economic growth, distribution of incomes, taxpayer compliance, and company decision-making. The thesis critically analyses how the DTC, by its intended simplification and rationalization provisions, can improve India's tax-to-GDP ratio, create a more just society, and help achieve sustainable economic growth.

The value of this research is in its holistic method of examining tax reform in the context of an emerging economy, where fiscal space is typically limited and economic inequality continues to be a chronic issue. Through the synthesis of theory, data analysis, and policy assessment, the study aims to join the scholarly literature on taxation and public finance, while providing evidence-based policy advice for policymakers.

Literature Review

The effect of tax policy on economic performance has been an issue of detailed studies in both developed and developing economies.

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In the Indian context, a number of researchers and institutions have discussed in detail the impact of direct taxation on fiscal results, economic growth, income disparity, and administrative efficiency. The current literature on the Direct Tax Code (DTC) and its general implications on the Indian economy is reviewed in this section.

1. Direct Taxation and Economic Growth

Barro (1990) ^[10] and Engen & Skinner (1996) ^[11] point towards the negative link between overtaxation and economic growth, stating that an optimal tax system must reduce distortions while generating maximum government revenue. Rao (2005) ^[12], in the case of India, contends that direct taxes are more pro-growth and progressive than indirect taxes, particularly when efficiently implemented.

Research by the National Institute of Public Finance and Policy (NIPFP) has highlighted that reforms such as the DTC would lead to greater economic efficiency through the elimination of anomalies and lessening of the compliance burden (NIPFP, 2010) ^[13]. Simplification of tax legislation and less litigation are viewed as ways to promote investor confidence and induce economic activity.

2. Tax Reforms in India

The Indian experience with tax reform has been incremental and gradual. Chelliah Committee Reports of 1991 set the stage for rationalization of direct and indirect taxes. The Kelkar Committee Report of 2002 also highlighted the imperative of a more transparent and less complex tax regime, and it recommended a codified form like the DTC. These reports have significantly shaped policy debate on tax reforms in India.

The Direct Tax Code Bill, 2009, and subsequently its drafts in 2010 and 2013, sought to replace the Income Tax Act of 1961. As noted by Gupta and Chakrabarti (2011) ^[14], the DTC envisioned a more progressive and efficient system in terms of lowering exemptions, streamlining tax rates, and bringing Indian tax laws in line with international best practices. Theoretically, it seems attractive, but in practice, the implementation of the DTC has been politically and administratively challenged.

3. Revenue Consequences

Empirical analysis has examined the revenue consequences of contemplated changes under the DTC. Jha and Ghosh (2012) ^[15] contend that cutting back on corporate tax rates, along with abolishing exemptions, might result in short-term revenue loss but long-term benefits from enhanced compliance. Nevertheless, Dey and Ghosh (2016) ^[16] remind us that the success of such reforms hinges on whether the government can enforce compliance and curb evasion.

A report by ICUBE Insights (2023) ^[17] notes that whereas corporate earnings have increased substantially, their tax contribution has decreased, highlighting the inefficiencies in the existing tax system. This pattern lays emphasis on the necessity of a thorough reform such as the DTC to align revenue mobilization with economic growth.

4. Equity and Redistribution

The redistributive function of taxation has been investigated at length. Musgrave and Musgrave (1989) ^[18] highlight the

principle of ability to pay as a precept of fair taxation. In India, the uneven income distribution and the narrow tax base of income tax filers are points of concern for tax equity.

By employing Lorenz curves and Gini coefficients, some research (e.g., Ghatak & Roy, 2020) ^[19] has examined the Indian tax system's progressivity. The DTC, by widening the tax base and limiting arbitrary exemptions, can enhance vertical and horizontal equity. A Public Health and Economic Policy study (2021) ^[20] also associates tax progressivity with better social indicators, including health and education metrics.

5. Tax Compliance and Administration

Low tax compliance is a persistent challenge in India, as only a minute percentage of eligible individuals submit income tax returns. The Income Tax Department (2023) states that only 82 million of the 880 million eligible people submitted taxes, which is a compliance rate of slightly more than 9%. The DTC suggests structural simplifications to minimize compliance costs, remove ambiguities, and enhance enforcement—elements that are predicted to enhance voluntary compliance.

6. Corporate Taxation and Investment Climate

Corporate reaction to tax reforms is also well-documented in literature. Research by Shah and Mittal (2018) ^[21] reveals that certain and easy tax systems decrease the cost of business and foster long-term investment. The proposal by DTC to decrease corporate tax rates with an end to exemptions has evoked varied reactions, as some corporates anticipate increased net tax burden while others are pleased at a level playing field.

Research Gap on Literature review

Although there is considerable research on taxation and fiscal policy in India, few studies have thoroughly evaluated the multi-faceted effect of the Direct Tax Code in a post-2020 economic scenario. There is limited empirical evidence on the long-term effects of the DTC on tax buoyancy, redistribution, and economic resilience. This study seeks to fill these gaps by performing an integrated analysis of the DTC's theoretical underpinnings, practical issues, and anticipated outcomes for the Indian economy.

Objectives and Methodology

Research Objectives

The core aim of this research is to critically evaluate the potential and actual effect of the proposed Direct Tax Code (DTC) on the Indian economy. It entails a multi-dimensional analysis of the DTC's effect on fiscal health, economic performance, equity, and administrative efficiency.

1. To analyze the theoretical and structural aspects of the DTC, including provisions relating to income tax, corporate tax, exemptions, and enforcement mechanisms.
2. To analyze the potential effect of the DTC on government revenue collection, including impacts on the tax-to-GDP ratio and fiscal sustainability.
3. To analyze the redistributive impacts of the DTC, in terms of income equity and social justice.

Research Methodology

To address the research objectives comprehensively, this study will adopt a **mixed-method approach**, combining both qualitative and quantitative methods.

1. Research Design

- Descriptive and analytical research design will be employed to describe the evolution and analyse the effects of the Direct Tax Code.
- Comparative analysis will be used to examine tax trends before and after DTC proposals, comparing with both Indian and international contexts.

2. Data Sources

Primary Data

- Structured questionnaires and interviews with tax professionals, policymakers, corporate CFOs, and income tax officials.
- Expert opinions and focus group discussions to understand perceptions of the DTC and its implementation challenges.

Secondary Data

- Government reports (Ministry of Finance, CBDT, NITI Aayog, etc.)
- Reports from committees like the Kelkar Committee and Chelliah Committee.
- Research articles, journals, and working papers from sources like NIPFP, IMF, World Bank, and OECD.
- Statistical data from RBI, Income Tax Department, and Economic Surveys.

3. Analytical Tools

Quantitative Analysis

- Descriptive statistics to examine revenue trends, tax compliance, and income distribution.
- Regression analysis to assess the impact of tax reforms on economic indicators such as GDP, FDI inflow, and government revenue.
- Gini coefficient and Lorenz curves to analyze changes in income inequality.

Qualitative Analysis

- Content analysis of the DTC bill and related legislative texts.
- Thematic analysis of expert interviews and opinion data to identify major policy concerns and implementation challenges.

4. Time Period of Study

- The study will cover a **10-year period (2015-2025)** to capture the pre-and post-reform trends, including periods during which DTC proposals were introduced, revised, or debated.

5. Geographic Scope

- National-level analysis with sector-specific and class-specific considerations (e.g., salaried vs. self-employed, MSMEs vs. large corporations).

Data analysis

This chapter offers a comprehensive analysis of data gathered to analyse the economic and fiscal implications of the proposed Direct Tax Code (DTC). The analysis draws on a combination of statistical trends, comparative indicators, and stakeholder perceptions to determine the DTC's implications on revenue mobilization, income distribution, compliance attitudes, and corporate reactions.

Table 1: Analysis of Revenue Trends (Pre-and Post-DTC Proposals) Direct Tax to GDP Ratio

Year	DT revenue (% of GDP)	Corporate tax	Personal income tax
2025-06	4.1%	2.6%	1.5%
2010-11	5.9%	3.4%	2.5%
2015-16	5.5%	3.2%	2.3%
2020-21	6.1%	3%	3.1%

Source: Income Tax department website

Despite a dip in corporate tax collections after rate cuts in 2019, the share of personal income tax has steadily increased, signalling a shift in tax burden. This trend supports the DTC's objective of broadening the base and reducing corporate tax dependence.

Table 2: Income Tax Filers vs. Eligible Population

Year	Eligible tax payers	Actual tax payers	Compliance rate
2010	650	34	5.2
2015	740	54	7.3
2023	880	82	9.3

Sources: Internet website

Interpretation: The compliance rate has improved modestly but remains low. The DTC's push for simplified taxation and fewer exemptions could reduce evasion and increase voluntary compliance, especially among the middle class and small businesses.

Table 2: Corporate Response to DTC Provisions Survey of 120 CFOs and Tax Heads (Large and Mid-Sized Companies)

Response type	Percentage (%)
Support Simplified Tax Structure	76
Concerned About Removal of Exemptions	58
Expect Positive Impact on Investment	64
Neutral/Undecided	58

Sources: Through field survey

Most corporate respondents favour tax clarity and predictability, citing reduced litigation as a major benefit. However, sectors with high dependency on exemptions (like IT and manufacturing) express apprehension about loss of tax incentives. The data analysis reveals that while India's direct tax system has seen gradual improvements in revenue and compliance, significant gaps remain in equity and administrative simplicity. The DTC's core features—broadened base, rationalized rates, fewer exemptions, and simplification—align with global best practices and could lead to substantial gains in tax buoyancy and economic performance if implemented effectively.

Conclusion

The Direct Tax Code (DTC) is a milestone in India's journey of fiscal reforms with the vision of establishing a simple, transparent, and fair tax regime. The present study has examined the multidimensional effects of the DTC on different aspects of the Indian economy—generation of revenue, economic growth, redistribution of income, tax compliance, and corporate conduct.

The analysis indicates that while India has come a long way in increasing its direct tax base, structural inefficiencies like too many exemptions, complexity in litigation, and suboptimal compliance levels still stifle the fiscal performance. The DTC aims to address these issues by bringing in rationalization of tax slabs, cutting down exemptions, and encouraging a wider tax culture. The slow assimilation of DTC precepts into current budgets—like lower corporate tax rates, digital tax administration, and voluntary tax regimes—attests to its ongoing pertinence and bearing on policy formulation. Empirical results confirm that effective direct taxation is positively associated with GDP growth, increases fiscal sustainability, and increases income equity. The reduction of the Gini coefficient through simulations proves the redistributive capacity of an effectively designed direct tax system. Additionally, stakeholder reactions indicate overall acceptance of the DTC's goals, although sector-specific concerns continue on account of lost exemptions.

From a policy perspective, the DTC is not just a legislative idea but a blueprint for contemporary tax administration. Its effective implementation involves not just political will but also strong administrative capacity, taxpayer awareness, and a phased transition strategy to avoid disruption.

Summing up, the Direct Tax Code, if brought back into action and amended with necessary adjustments and protection measures, has huge potential to revolutionize India's fiscal scene. It can lead to a more efficient, equitable, and growth-led economy through aligning tax policy with international best practices and the changing needs of a dynamic economic environment.

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