

Evolution of Taxation System in India

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ABSTRACT

Taxation is an essential component of economic development and public finance in India. The Indian taxation system has evolved significantly from ancient times to the modern GST regime. This article discusses the historical evolution of taxation in India, including ancient, medieval, colonial, and post-independence tax systems. It also highlights the structure, objectives, principles, and major reforms in Indian taxation. The implementation of Goods and Services Tax (GST) and the proposed GST 2.0 reforms are important milestones aimed at simplifying taxation, improving transparency, and promoting economic growth. The study concludes that taxation plays a vital role in revenue generation, economic stability, and sustainable national development.

INTRODUCTION

Taxation is one of the most important instruments used by governments to raise revenue and manage economic development. The system of taxation in India has evolved over centuries, from ancient civilizations to modern digital tax administration. India possesses a structured

and comprehensive taxation system divided among the Central Government, State Governments, and Local Bodies. Tax revenues help governments provide essential services such as infrastructure development, education, healthcare, defence, and social welfare programs. Over time, taxation in India has also

been used as a tool to promote economic stability, reduce income inequality, and encourage industrial growth.

What is tax?

The word “tax” is derived from the Latin words *taxare* or *taxo*, which mean *to assess the worth of something*. Taxes are compulsory payments imposed by the government for public purposes. In simple terms, taxes are the price we pay to live in a civilized and functioning society. Various international economists have defined taxes in different ways:

According to David Ricardo “Taxes are a part of the land resources and labour of the country which comes at the disposal of the government, and which is ultimately paid out of capital or the income of the country.” (Nematulla, 2021)

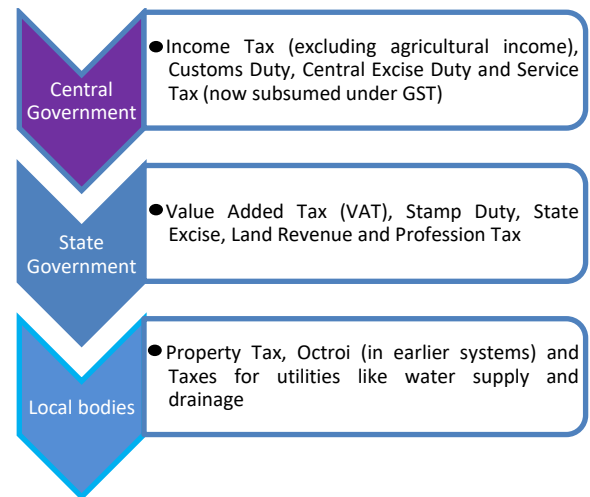
According to Prof. D.G. Chernik taxes are Mandatory fees levied by the state on businesses and citizens at rates legally established. (Chernik, 2001)

Taxes are the backbone of any nation’s development, as they enable governments to finance public goods and services. For example, in India, targeted tax incentives encouraged the rapid growth of sectors such as information technology, automobile manufacturing, and biopharmaceutical industries, contributing to economic prosperity (Gray, 2018). Thus, the Indian taxation system aims not only to raise revenue but also to promote economic growth, equity, and national development.

Taxation structure in India:

Taxation is a fundamental aspect of human civilization and serves as the primary mechanism through which governments provide public goods and services. India has a

well-developed tax structure with clearly defined powers between them:



Features of Tax: Taxes have certain essential characteristics that distinguish them from other forms of payments.

- 1. Legal Collection:** Taxation has statutory sanction and must follow legal procedures. Taxes cannot be imposed arbitrarily.
- 2. Personal Obligation:** Payment of taxes creates a personal responsibility for the taxpayer.
- 3. Compulsory Contribution:** Taxes are mandatory. Individuals cannot refuse to pay taxes even if they do not receive direct benefits.
- 4. Element of Sacrifice:** Paying taxes involves giving up a part of income or wealth.
- 5. Imposed by Government:** Only the government has the authority to impose and collect taxes.
- 6. Revenue Collection:** The primary purpose of taxation is to generate revenue for government activities.
- 7. Socio-Economic Objectives:** Taxes are used to achieve economic and social goals such as reducing inequality and promoting development.

8. **Common Benefit:** Taxes are collected for the welfare of society as a whole.
9. **No Direct Benefit Condition:** Taxpayers are not guaranteed a specific benefit in return.
10. **Not a Payment for Services:** Taxes are not charged as a direct price for government services.
11. **Paid Out of Income:** Taxes may be assessed on income or capital but are generally paid from income.
12. **Ultimately Paid by Individuals:** Even if taxes are levied on goods, property, or companies, the burden ultimately falls on individuals.

Why Tax is imposed?

Taxation plays a crucial role in shaping a country's economy. In India economy, taxation serves several objectives beyond revenue generation.

Promoting Economic Development: Economic development is a primary objective of taxation.

- ✓ Developing countries often face a shortage of capital.
- ✓ Taxes help mobilize resources for public investment in sectors such as infrastructure, transportation, and education.
- ✓ Strategic taxation increases the savings-to-income ratio, enabling investment in productive sectors.

Maintaining Price Stability: Taxation helps to control inflation and deflation.

- ✓ During inflation: Higher taxes reduce disposable income and decrease demand. Example, higher taxes imposed on luxury goods during inflation can reduce excessive consumption.

- ✓ During deflation: Lower taxes increase disposable income and encourage spending.

Achieving Full Employment: Tax policies influence employment levels.

- ✓ Lower tax rates increase disposable income and consumption.
- ✓ Higher demand encourages businesses to expand production and hire workers.

Tax incentives provided to industries often stimulate employment growth.

Regulating Trade and Improving Balance of Payments:

Taxation helps regulate international trade.

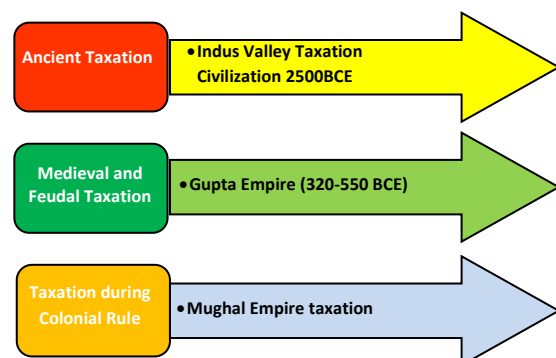
- ✓ Import duties discourage excessive imports.
- ✓ Tariffs promote domestic production.

This approach strengthens domestic industries and improves the balance of payments.

Reducing Wealth Inequality: Taxation system helps in reducing the gap between rich and poor people of the country.

- ✓ Progressive taxation ensures that higher-income groups pay more taxes.
- ✓ Government uses tax revenue to provide education, healthcare, and welfare programs.

Historical Evolution of Taxation in India



A. Indus Valley Civilization: The Indus Valley Civilization (around 2500 BCE) is one of the earliest urban societies. Although direct evidence of taxation is limited, archaeological findings suggest that agricultural produce, crafts, and trade goods were collected to support administrative and public activities (Possehl, 1996).

B. Vedic Period: During the Vedic period (1500–500 BCE), society was organized along tribal lines.

- Taxes were mainly collected in agricultural produce and cattle.
- The “Bali” system required people to contribute a share of their produce to rulers and priests (Chatterjee, 2009).

C. Mauryan Empire: The Mauryan Empire (322–185 BCE) developed one of the earliest organized tax systems in India.

- Land revenue became the main source of government income.
- Taxes were collected in both cash and kind.
- The famous treatise Arthashastra, written by Kautilya (Chanakya), provided detailed guidelines on taxation, administration, and governance (Thapar, 2012).

2 Medieval and Feudal Taxation

A. Gupta Empire: During the Gupta Empire (320–550 CE), taxation systems became more structured. Agricultural taxes formed the main source of revenue.

Later, during the Mughal period, Emperor Akbar introduced the “Zabt” system, which involved measuring land and assessing agricultural output to determine tax liability (Sarkar, 1960).

B. Feudal Period: During the medieval period, India experienced political fragmentation and the rise of feudalism.

- Local rulers and landlords collected taxes from peasants.
- Taxes were often collected in agricultural produce or labour services.
- These revenues supported local governance and military activities (Habib, 1963).

3 Taxation during Colonial Rule

A. Mughal Empire: The Mughal Empire introduced systematic revenue administration. Akbar’s Zabt system aimed to create a fair and predictable tax collection mechanism. However, as Mughal power declined, tax collection became decentralized and often exploitative (Habib, 1982).

B. British Colonial Rule: British colonial rule introduced major changes to India’s taxation system. The British implemented several land revenue systems:

1. Permanent Settlement
2. Ryotwari System
3. Mahalwari System

These systems aimed to create a stable source of revenue for the British government but often imposed heavy burdens on farmers, contributing to poverty and famines (Chakrabarti, 1985).

Principles of Taxation:

Adam Smith (1776) proposed four fundamental principles of taxation, known as the Canons of Taxation.

1. Equity – Taxes should be based on the taxpayer’s ability to pay.

2. Certainty – The amount, time, and method of tax payment should be clear.
3. Convenience – Taxes should be collected in a convenient manner.
4. Economy – The cost of tax collection should be minimal.

Smith supported proportional taxation but warned that excessive taxation could discourage production and savings.

Post-Independence Tax Reforms in India:

Major tax reforms in modern India include:

- **1991:** Economic liberalization introduced tax reforms and reduced income tax rates (Bhattacharyya, 1998).
- **1997:** Voluntary Disclosure of Income Scheme (VDIS) encouraged declaration of undisclosed income (Gupta, 1998).
- **2000:** Introduction of Fringe Benefit Tax (FBT) on employee benefits (Subramanian, 2000).
- **2005:** Introduction of Value Added Tax (VAT) replacing sales tax (Sen, 2007).
- **2007:** Introduction of Securities Transaction Tax (STT) (Mishra & Sharma, 2009).
- **2012:** Proposal of the Direct Taxes Code (DTC) to simplify the tax system (Choudhury, 2015).
- **2017:** Implementation of Goods and Services Tax (GST), creating a unified indirect tax system (Mukherjee, 2018).
- **2020:** Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act provided tax relief during COVID-19 (Ministry of Finance, 2020).
- **2025:** Implementation of GST 2.0.

Committee/task force and Tax reform recommendations

A. Direct Tax Reform Committees	
Committee / Task Force	Recommendations:
Kelkar Committee (2002)	Key Recommendations: <ul style="list-style-type: none"> • Rationalize tax slabs • Reduce exemptions • Encourage voluntary compliance • Gradually reduce corporate tax rates
Parthasarathi Shome Committee (2012)	Recommendations: <ul style="list-style-type: none"> • Clear criteria for tax avoidance • Safeguards against misuse • Expert panel review of GAAR cases • Alignment with international standards
Direct Tax Code Committee (2009):	Recommendations: <ul style="list-style-type: none"> • Simplified tax structure • Fewer exemptions and deductions • Lower corporate tax rates • Improved tax administration through technology
B. Indirect Tax Reform Committees	
Raja J. Chelliah Committee (1991)	Recommendations: <ul style="list-style-type: none"> • Introduction of VAT • Harmonization of central and state taxes • Input tax credit system • Uniform tax rate structure • Taxpayer education programs
T.R. Rustagi Committee (2011)	Recommendations: <ul style="list-style-type: none"> • Simplified service tax structure • Input tax credit • Electronic compliance systems • Regular audits and reviews
Arvind Subramanian Committee (2015)	Recommendations: <ul style="list-style-type: none"> • GST rate range • Lower tax rate for precious metals • Compensation mechanism for states • Regular review of GST rates

Goods and Services Tax in India

The Goods and Services Tax (GST) was introduced in 1 July 2017 to create a unified indirect tax system.

Key features include:

- One Nation, One Tax, One Market
- Elimination of cascading taxes
- Input Tax Credit system
- Simplified tax administration
- GST significantly improved transparency, compliance, and tax revenue generation.

Future of Taxation in India (GST 2.0)

- A major reform in India's taxation system took place in September 2025 with the introduction of GST 2.0, an upgraded version of the Goods and Services Tax. The reform was approved by the GST Council on 3 September 2025 and implemented from 22 September 2025 to simplify the tax structure and boost economic activity.
- Under the earlier GST system (2017), multiple tax slabs existed such as 0%, 5%, 12%, 18%, and 28%, along with cess on luxury goods. The 2025 reform rationalized the structure by removing the 12% and 28% slabs, creating mainly 5% and 18% rates, while keeping 0% for essential goods and 40% for luxury or "sin" goods like tobacco and high-end automobiles.
- GST 2.0 aimed to simplify taxation, reduce compliance burdens for businesses, lower

prices for consumers, and improve ease of doing business. Key changes included lower taxes on essential goods, reduced GST on some consumer products such as small cars and electronics, relief on certain healthcare items, and higher taxes on luxury and harmful goods.

- Overall, GST 2.0 represents one of the most significant reforms in India's indirect tax system since the introduction of GST in 2017, aiming to create a more transparent, efficient, and growth-oriented tax framework.
- Taxation remains a cornerstone of India's fiscal strategy, ensuring equitable revenue mobilization and sustainable economic development (Yoganandham & Kalaivani, 2025).

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