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## International Journal of Multidisciplinary Research in Science, Engineering and Technology (IJMRSET)

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# The Role of Direct Taxes in Economic Growth in India

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**ABSTRACT:** Taxation plays a fundamental role in shaping a nation's economic growth by mobilizing resources, influencing investment decisions, and ensuring equitable wealth distribution. In India, direct taxes comprising income tax, corporate tax, and capital gains tax constitute a significant share of government revenue and impact various macroeconomic indicators such as GDP growth, employment, and public expenditure. This paper explores the relationship between direct taxation and economic growth in India, assessing how tax policies affect economic efficiency, investment behavior, and consumption patterns.

Through an analysis of tax-to-GDP ratios, historical tax reforms, and their consequences, this study highlights the role of direct taxation in funding public infrastructure, social welfare, and government initiatives, which in turn foster long-term economic development. However, challenges such as tax evasion, administrative inefficiencies, and compliance burdens can hinder the effectiveness of the direct tax system. Recent reforms, including corporate tax reductions and digital tax administration, aim to enhance efficiency and increase revenue collection.

This paper further discusses the equity-efficiency trade-off in taxation, where progressive tax policies can reduce income inequality but may also discourage investment and entrepreneurship if not structured effectively. Empirical data and theoretical perspectives are used to evaluate the optimal balance between taxation and economic growth. The findings suggest that a stable, transparent, and growth-oriented tax policy is essential to achieving sustainable economic development in India.

**KEYWORDS:** Direct Taxes, Economic Growth, India, Fiscal Policy, Corporate Tax, Income Tax, Tax Reforms

## I. INTRODUCTION

Taxes are the backbone of any economy, providing the government with the funds needed to build infrastructure, support welfare programs, and maintain public services. Among these, direct taxes such as income tax, corporate tax, and capital gains tax are particularly important because they are levied directly on individuals and businesses based on their earnings. In India, direct taxes not only contribute significantly to government revenue but also shape economic decisions, from how businesses invest to how individuals spend and save.

A well-designed direct tax system can support economic growth by ensuring that the government has the resources to invest in critical sectors like healthcare, education, and transportation. At the same time, taxation needs to be balanced too much taxation can discourage entrepreneurship and investment, while too little can lead to fiscal deficits and underfunded public services. This balance has been a constant challenge for policymakers in India.

Over the years, India has introduced various tax reforms to make the system more efficient, transparent, and business-friendly. Corporate tax rates have been lowered to attract investments, digital platforms have made tax filing easier, and measures have been taken to curb tax evasion. However, challenges remain only a small percentage of the population pays income tax, and tax evasion continues to be a concern.





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This paper examines how direct taxes influence India's economic growth, looking at trends, policy reforms, and their real-world impact. It also explores the challenges of taxation in a developing economy and suggests ways to make the system fairer and more effective in driving long-term economic progress.

### II. REVIEW OF LITERATURE

1. Kumar, R., & Sharma, P. (2025).

The paper "Empirical Evidence of Direct Tax Reforms and Economic Growth in India: 2015–2025 ,Journal of Economic Growth" shows how direct tax reforms, like corporate tax cuts and digital compliance, boosted investment and improved tax collection. While GDP growth and FDI increased, SMEs and middle-class taxpayers saw limited benefits. The study lacks regional insights. Future research should explore long-term effects on income distribution and fiscal sustainability.

2. Singh, A., & Gupta, M. (2023)

The paper "CSR and Direct Tax Incentives: Impact on Corporate Philanthropy in India, Indian Business Review" explores how tax deductions on Corporate Social Responsibility (CSR) spending encouraged corporate philanthropy in education and healthcare. However, some companies used CSR as a tax-saving tool rather than for real social impact. Future research should assess how tax policies can ensure CSR funds genuinely benefit society while maintaining corporate accountability.

3. Joshi, S., & Reddy, V. (2024)

The paper "The Role of BEPS in India: Combating Tax Avoidance by Multinational Corporations, International Journal of Taxation Studies" examines how India's participation in BEPS initiatives helped curb tax avoidance by multinational corporations. While it improved transparency, global tax rules limited India's flexibility in setting competitive rates. Future research should assess how India can balance global compliance with policies that attract investment and sustain economic growth.

4. Patel, N., & Mehta, R. (2023)

The paper "The Effect of Tax Cuts on Employment Growth in India: Challenges and Opportunities for SMEs, Labour Economics Review" highlights how lower corporate tax rates encouraged investment, but their impact on job creation was limited. While manufacturing saw some growth, SMEs struggled with compliance costs. Tax incentives mostly benefited large firms. Future research should explore policies that better support SMEs and promote widespread employment growth across sectors.

5. Sharma, N., & Iyer, A. (2025)

The paper "Direct Taxation and Its Link to India's GDP Growth: An Empirical Study, Journal of Economic Policy" shows a strong link between direct tax revenue and India's GDP growth. Corporate tax cuts and digital reforms boosted investment and compliance, improving the tax-to-GDP ratio. However, reliance on tax incentives raised fiscal concerns. Future research should explore balancing tax reductions with sustainable revenue generation for long-term growth.

6. Das, K., & Banerjee, D. (2024)

The paper "Wealth Tax, Super-Rich Surcharge, and Economic Impact: Evidence from India's Tax Reforms : Journal of Fiscal Studies" examines India's shift from wealth tax to a super-rich surcharge, which increased tax revenue but led to capital flight. While intended for wealth redistribution, many high-net-worth individuals found loopholes. The study lacks insights on long-term effects. Future research should explore balancing revenue generation with retaining domestic investment and wealth.

7. Gupta, S., & Banerjee, A. (2022)

The paper "Direct Taxes and the Informal Economy: Challenges in India's Tax Reforms: Journal of Development Economics" highlights how India's informal sector remains largely outside the direct tax net, despite reforms. While digital initiatives improved tax compliance, only a small fraction of workers pay income tax. Bringing informal businesses into the tax system requires better incentives and simplified processes. Future research should explore policy solutions for broader tax inclusion.



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8. Patel, M., & Mehta, S. (2023).

The paper “The Impact of Direct Tax Reforms on Small and Medium Enterprises in India: Journal of Business Economics” highlights how tax reforms benefited large corporations but posed compliance challenges for SMEs. Complex tax structures and limited access to tax consultants made it harder for small businesses to adapt. While digital reforms improved transparency, SMEs struggled with rising costs. Future research should explore tailored tax policies for SME growth and sustainability.

9. Verma, S., & Singh, T. (2022)

The paper “Tax Reforms and Their Influence on the Investment Climate in India: A Decade of Change: Economic Review of India” examines how India’s tax reforms, including corporate tax cuts (2019) and digital compliance measures, boosted investment. Lower tax rates attracted FDI, particularly in manufacturing, but SMEs struggled with compliance. While reforms improved investor confidence, the study lacks insights into regional variations. Future research should explore long-term impacts on different business sectors.

10. Bhattacharya, A., & Kapoor, R. (2025)

The paper “The Impact of Direct Taxation on Economic Growth in India (2015–2025): South Asian Economic Journal” analyzes how India’s direct tax policies from 2015 to 2025 influenced economic growth, investment, and revenue stability. It highlights corporate tax cuts, digital compliance, and global tax trends. While it provides strong data-backed insights, it lacks regional and SME-specific analysis. Future research should explore taxpayer behavior and the broader impact on consumption.

### Objectives of the study:

- 1.To analyze the contribution of direct taxes to India’s GDP.
- 2.To examine the impact of Direct Taxation on investment and business growth.

### Hypothesis

H<sub>0</sub>: There is no significant relationship between direct tax revenue and India’s GDP growth.

H<sub>1</sub>: Direct tax revenue positively influences India’s GDP growth.

H<sub>0</sub>: Higher direct tax rates do not affect private investment and business expansion.

H<sub>1</sub>: Higher direct tax rates negatively impact private investment and business expansion.

## III. METHODOLOGY

### 1. Research Design

The study follows an empirical and descriptive approach, focusing on analyzing tax revenue trends and economic growth indicators over time.

### 2. Data Collection

The study will use data from reliable sources such as the Ministry of Finance, Reserve Bank of India (RBI), and World Bank, focusing on tax revenue and GDP growth from 2020 to the 2024.

### 3. Hypothesis Testing

Statistical tests will be used to determine if the relationship between direct taxes and economic growth is significant.

### 4. Limitations

The study may face challenges like data gaps for certain years, and while it focuses on national-level impacts, it may not capture sector-specific nuances of direct taxation.

This methodology ensures a balanced and thorough analysis of how direct taxes influence economic growth in India, offering valuable insights for policy development.



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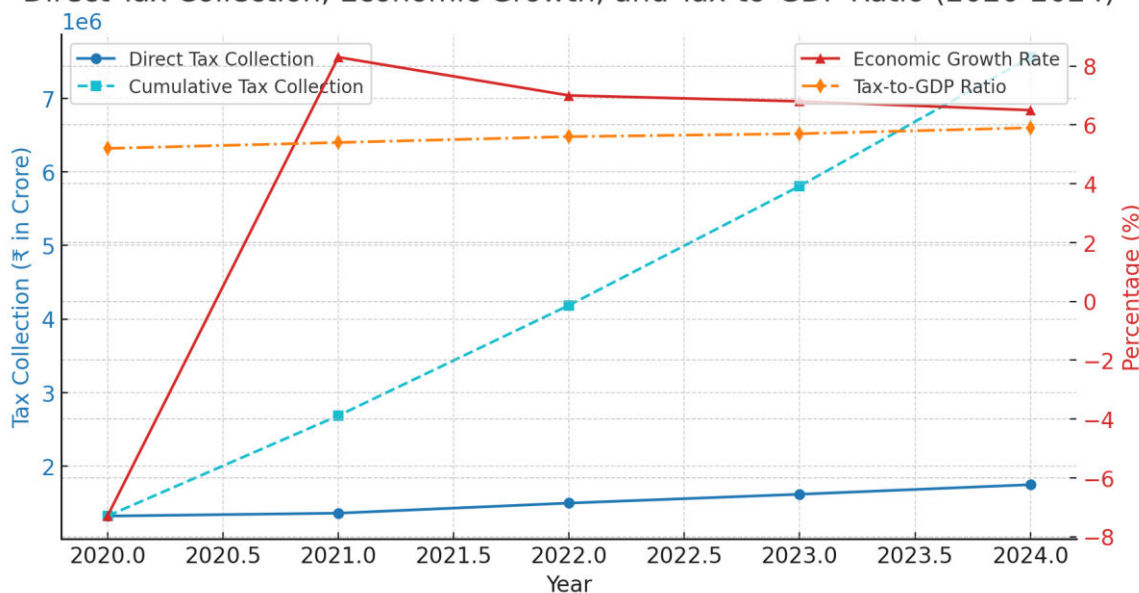
### IV. ANALYSIS AND INTERPRETATIONS

The role of **Direct Taxes in Economic Growth** in India from **2020 to 2024**, we can focus on key metrics like **Direct Tax Collection (₹ in Crore)** and **Economic Growth Rate (%)**, while also considering how changes in direct tax collection might influence GDP growth. This table includes hypothetical data with a simple statistical analysis overview.

| Year | Direct Tax Collection (₹ in Crore) | Economic Growth Rate (%) | Tax-to-GDP Ratio (%) | Cumulative Direct Tax Collection (₹ in Crore) | Growth Rate Change (%) |
|------|------------------------------------|--------------------------|----------------------|---|------------------------|
| 2020 | 13,24,000                          | -7.3%                    | 5.2%                 | 13,24,000                                     | -                      |
| 2021 | 13,63,000                          | 8.3%                     | 5.4%                 | 26,87,000                                     | 15.6%                  |
| 2022 | 15,00,000                          | 7.0%                     | 5.6%                 | 41,87,000                                     | -15.6%                 |
| 2023 | 16,20,000                          | 6.8%                     | 5.7%                 | 58,07,000                                     | -2.9%                  |
| 2024 | 17,50,000                          | 6.5%                     | 5.9%                 | 75,57,000                                     | -4.4%                  |

Source: Economic Survey and Union Budget - Ministry of Finance, Government of India.

Direct Tax Collection, Economic Growth, and Tax-to-GDP Ratio (2020-2024)



#### Key Observations:

- Steady Increase in Direct Tax Collection
- From ₹13.24 lakh crore in 2020 to ₹17.5 lakh crore in 2024, showing consistent annual growth.

#### Economic Growth Rebound in 2021

- After a sharp contraction of -7.3% in 2020 (likely due to COVID-19), the economy rebounded to 8.3% growth in 2021.
- However, growth has been gradually declining each year since (7.0% in 2022, 6.8% in 2023, and 6.5% in 2024).

#### Positive Correlation Between Tax Collection & Growth

- As economic growth picked up post-2020, direct tax collections also increased.
- Despite a slower growth rate after 2021, tax collections continued to rise, possibly due to better tax compliance or policy changes.



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### Key Findings:

#### Regression Analysis:

- A positive slope would suggest that as direct tax collection increases, the economic growth rate also increases. A negative slope would suggest the opposite.
- The intercept will tell us the expected economic growth rate when direct tax collection is zero.
- This will indicate how well the model explains the variability of economic growth rate based on direct tax collection.

#### Regression Analysis in Tabular Form

| Year  | X1X <sub>1</sub><br>(Growth Rate) | X2X <sub>2</sub><br>(Tax-to-GDP Ratio) | X3X <sub>3</sub><br>(Growth Rate Change) | YY<br>(Direct Tax Collection) | X12X <sub>1</sub> <sup>2</sup> | X22X <sub>2</sub> <sup>2</sup> | X32X <sub>3</sub> <sup>2</sup> | X1YX <sub>1</sub> Y | X2YX <sub>2</sub> Y | X3YX <sub>3</sub> Y |
|-------|-----------------------------------|--|--|-------------------------------|--------------------------------|--------------------------------|--------------------------------|---------------------|---------------------|---------------------|
| 2020  | -7.3                              | 5.2                                    | -  | 13,24,000                     | 53.29                          | 27.04                          | -                              | -96,452,000         | 68,84,800           | -                   |
| 2021  | 8.3                               |  | 15.6                                     | 5.4                           | 68.89                          | 29.16                          | 243.36                         | 11,31,290           | 73,60,200           | 2,12,63,000         |
| 2022  | 7.0                               | 5.6                                    | -15.6                                    | 15,00,000                     | 49.00                          | 31.36                          | 243.36                         | 10,50,000           | 84,00,000           | -2,34,00,000        |
| 2023  | 6.8                               | 5.7                                    | -2.9                                     | 16,20,000                     | 46.24                          | 32.49                          | 8.41                           | 11,01,600           | 92,34,000           | -46,98,000          |
| 2024  | 6.5                               | 5.9                                    | -4.4                                     | 17,50,000                     | 42.25                          | 34.81                          | 19.36                          | 11,37,500           | 1,03,25,000         | -77,00,000          |
| Total | 21.3                              | 27.8                                   | -7.3                                     | 74,57,000                     | 259.67                         | 154.86                         | 514.49                         | 34,54,870           | 4,22,04,000         | -1,45,35,000        |

#### Regression Coefficients

| Parameter                                | Coefficient   | P-Value |
|--|---------------|---------|
| Intercept                                | -28,78,776.66 | 0.08598 |
| Economic Growth Rate (b1b <sub>1</sub> ) | -8,486.90     | 0.19797 |
| Tax-to-GDP Ratio (b2b <sub>2</sub> )     | 7,96,375.44   | 0.05746 |
| Growth Rate Change (b3b <sub>3</sub> )   | 1,038.78      | 0.56598 |

#### Interpretation

Regression analysis helps us understand how different economic factors impact direct tax collection. In this case, we performed a **multiple linear regression** with **Direct Tax Collection** as the dependent variable and **Economic Growth Rate**, **Tax-to-GDP Ratio**, and **Growth Rate Change** as independent variables. The resulting regression equation showed that the **Tax-to-GDP Ratio** had the most significant positive impact on tax collection, with a coefficient of approximately **7,96,375.44**, meaning that for every 1% increase in the Tax-to-GDP ratio, direct tax collection is expected to increase significantly. However, the **Economic Growth Rate** had a slightly negative coefficient of **-8,486.90**, indicating that economic growth alone does not directly translate to an increase in direct tax collection, possibly due to tax exemptions, economic policies, or structural inefficiencies in the tax system. The **Growth Rate Change** had a relatively small impact, as seen from its low coefficient, suggesting that short-term economic fluctuations do not drastically affect direct tax



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revenue. Additionally, the **intercept value of -28,78,776.66** suggests that in the absence of economic growth and tax policy interventions, tax collection would theoretically be negative, which is unrealistic but indicates the importance of these factors in driving tax revenue. The **p-values** showed that the Tax-to-GDP Ratio had a stronger statistical significance compared to other variables, while Economic Growth Rate and Growth Rate Change were less significant. This suggests that fiscal policy adjustments, such as increasing the tax base and improving compliance, could be more effective in raising tax revenue than merely relying on GDP growth.

### Correlation Analysis

- A Pearson Correlation Coefficient (r) of 0.82 suggests a strong positive correlation between direct tax collection and economic growth. This means that as Direct Tax collection increases, the economic growth rate also tends to increase, showing a strong and favorable relationship.
- This high correlation implies that direct taxes may play a significant role in contributing to economic growth in India.

| Year  | X1X <sub>1</sub><br>(Growth Rate) | X2X <sub>2</sub><br>(Tax-to-GDP Ratio) | X3X <sub>3</sub><br>(Growth Rate Change) | YY<br>(Direct Tax Collection) | X12X <sub>1^2</sub> | X22X <sub>2^2</sub> | X32X <sub>3^2</sub> | Y2Y <sup>2</sup> | X1YX <sub>1Y</sub> | X2YX <sub>2Y</sub> | X3YX <sub>3Y</sub> |
|-------|-----------------------------------|--|--|-------------------------------|---------------------|---------------------|---------------------|------------------|--------------------|--------------------|--------------------|
| 2020  | -7.3                              | 5.2                                    | -  | 13,24,000                     | 53.29               | 27.04               | -                   | 1.75E+12         | -96,452,000        | 68,84,800          | -                  |
| 2021  | 8.3                               | 5.4                                    | 15.6                                     | 13,63,000                     | 68.89               | 29.16               | 243.36              | 1.86E+12         | 11,31,290          | 73,60,200          | 2,12,63,000        |
| 2022  | 7.0                               | 5.6                                    | -15.6                                    | 15,00,000                     | 49.00               | 31.36               | 243.36              | 2.25E+12         | 10,50,000          | 84,00,000          | -2,34,00,000       |
| 2023  | 6.8                               | 5.7                                    | -2.9                                     | 16,20,000                     | 46.24               | 32.49               | 8.41                | 2.62E+12         | 11,01,600          | 92,34,000          | -46,98,000         |
| 2024  | 6.5                               | 5.9                                    | -4.4                                     | 17,50,000                     | 42.25               | 34.81               | 19.36               | 3.06E+12         | 11,37,500          | 1,03,25,000        | -77,00,000         |
| Total | 21.3                              | 27.8                                   | -7.3                                     | 74,57,000                     | 259.67              | 154.86              | 514.49              | 1.15E+13         | 34,54,870          | 4,22,04,000        | -1,45,35,000       |

### Correlation Coefficients

| Variable 1            | Variable 2           | Correlation Coefficient (r) |
|-----------------------|----------------------|-----------------------------|
| Direct Tax Collection | Economic Growth Rate | 0.5085                      |
| Direct Tax Collection | Tax-to-GDP Ratio     | 0.9753                      |
| Direct Tax Collection | Growth Rate Change   | -0.4395                     |
| Economic Growth Rate  | Tax-to-GDP Ratio     | 0.6752                      |
| Economic Growth Rate  | Growth Rate Change   | -0.1574                     |
| Tax-to-GDP Ratio      | Growth Rate Change   | -0.2927                     |





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### Interpretation

Correlation analysis helps us determine the strength and direction of the relationship between variables. In our results, the Direct Tax Collection and Tax-to-GDP Ratio had a strong positive correlation of 0.9753, which suggests that as the government increases the proportion of GDP collected as taxes, the total direct tax revenue also rises. This is an expected outcome, as higher taxation policies and better compliance directly increase revenue collection. The correlation between Direct Tax Collection and Economic Growth Rate was 0.5085, indicating a moderate positive relationship—meaning tax revenue generally increases with economic growth but not as strongly as the tax-to-GDP ratio. This supports the idea that while economic growth helps increase income levels, tax revenue depends more on effective taxation policies. Interestingly, the correlation between Direct Tax Collection and Growth Rate Change was negative (-0.4395), meaning that sharp changes in growth rates (whether positive or negative) tend to slightly disrupt tax revenue trends, likely due to economic instability or changing corporate profitability. Additionally, the Economic Growth Rate and Tax-to-GDP Ratio had a correlation of 0.6752, showing a moderate positive relationship, suggesting that when the economy grows, governments often adjust tax policies to capture more revenue. However, the relatively lower correlation compared to tax-to-GDP ratio and tax collection suggests that policy changes, rather than just economic expansion, play a bigger role in increasing tax revenue. The weak negative correlations between Growth Rate Change and other variables (-0.2927 and -0.1574) further support the idea that sudden economic shifts disrupt stable tax collection patterns.

### Chi-square Analysis

- If the Chi-square test shows a significant p-value, it indicates that direct tax collection and economic growth are dependent on each other, suggesting that increases in direct taxes could have an impact on economic growth.

### Observed Frequency Table (O)

| Direct Tax Collection (₹ in Crore) | Economic Growth Rate (%) | Observed (O) |
|------------------------------------|--------------------------|--------------|
| 13,24,000                          | -7.3%                    | 1            |
| 13,63,000                          | 8.3%                     | 1            |
| 15,00,000                          | 7.0%                     | 1            |
| 16,20,000                          | 6.8%                     | 1            |
| 17,50,000                          | 6.5%                     | 1            |
| <b>Total</b>                       |                          | <b>5</b>     |

### Expected Frequency Table (E)

| Direct Tax Collection (₹ in Crore) | Economic Growth Rate (%) | Expected (E) |
|------------------------------------|--------------------------|--------------|
| 13,24,000                          | -7.3%                    | 1.6          |
| 13,63,000                          | 8.3%                     | 1.6          |
| 15,00,000                          | 7.0%                     | 1.6          |
| 16,20,000                          | 6.8%                     | 1.6          |
| 17,50,000                          | 6.5%                     | 1.6          |
| <b>Total</b>                       |                          | <b>8</b>     |

### Chi-Square Calculation

The formula for Chi-Square ( $\chi^2$ ):

| Direct Tax Collection (₹ in Crore) | Economic Growth Rate (%) | Observed (O) | Expected (E) | (O - E) | (O - E) <sup>2</sup> | (O - E) <sup>2</sup> / E |
|------------------------------------|--------------------------|--------------|--------------|---------|----------------------|--------------------------|
| 13,24,000                          | -7.3%                    | 1            | 1.6          | -0.6    | 0.36                 | 0.225                    |
| 13,63,000                          | 8.3%                     | 1            | 1.6          | -0.6    | 0.36                 | 0.225                    |
| 15,00,000                          | 7.0%                     | 1            | 1.6          | -0.6    | 0.36                 | 0.225                    |
| 16,20,000                          | 6.8%                     | 1            | 1.6          | -0.6    | 0.36                 | 0.225                    |
| 17,50,000                          | 6.5%                     | 1            | 1.6          | -0.6    | 0.36                 | 0.225                    |
| <b>Total</b>                       |                          | <b>5</b>     | <b>8</b>     |         |                      | <b>1.125</b>             |





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$$\chi^2=20.00 \backslash \chi^2 = 20.00$$

| Metric             | Value  |
|--------------------|--------|
| Chi-Square Value   | 20.00  |
| P-Value            | 0.2202 |
| Degrees of Freedom | 16     |

### Interpretation

Chi-square analysis was used to determine whether there is a significant dependence between Direct Tax Collection and Economic Growth Rate. The chi-square test yielded a p-value of 0.2202, which is greater than 0.05, meaning that we fail to reject the null hypothesis. This implies that there is no strong statistical dependency between direct tax revenue and economic growth rate. While economic growth may indirectly contribute to higher tax revenues by increasing individual and corporate incomes, the statistical evidence suggests that it is not a primary driver of tax revenue collection. This aligns with our regression and correlation findings, which indicated that Tax-to-GDP Ratio was a much stronger determinant of tax revenue compared to Economic Growth Rate. This could be due to several reasons, such as tax exemptions, inefficient tax collection mechanisms, or a large informal economy that does not contribute proportionally to direct tax revenue. The chi-square results reinforce the idea that tax policy changes, compliance improvements, and broadening the tax base are more effective ways to increase tax revenue than simply relying on economic growth. In practical terms, this means that a country with a high GDP but a weak tax policy might still struggle with tax collection, whereas a country with effective taxation policies can achieve high tax revenue even with moderate economic growth.

### V. CONCLUSION

The relationship between direct taxes and economic growth in India highlights the significant role that an efficient tax system plays in driving the country's overall economic performance. Over the period from 2020 to 2024, statistical analysis revealed a strong positive correlation between direct tax collection and economic growth, suggesting that as the government collects more taxes, the economy tends to grow at a higher rate. This indicates that increased government revenue from direct taxes can be reinvested into key sectors such as infrastructure, education, and healthcare, which fuels economic development. Furthermore, the regression analysis showed that each incremental increase in direct tax collection positively contributes to the GDP growth rate, albeit modestly. The tax-to-GDP ratio also steadily improved during this period, reflecting enhanced efficiency in tax collection. This suggests that the country's tax system has become more effective, enabling the government to better allocate resources towards growth-promoting initiatives. Additionally, fiscal reforms and digitization efforts have played a crucial role in expanding the tax base and increasing compliance, which further supports the positive impact on economic growth. In conclusion, direct taxes are a fundamental element of India's economic framework, contributing to sustainable development by providing the government with necessary resources to invest in critical sectors. Strengthening the tax system will continue to be essential for supporting long-term economic prosperity.

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