Taxation Across Borders: A Comparative Study of the Economic Impact and Policy Divergence in India and the United States

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Abstract

This paper provides a comparative analysis of the tax systems of India and the United States during the period of 2018 to 2021. It examines key differences in tax structures, rates, reforms, and their economic impacts. By analyzing these aspects, the paper aims to offer insights into how each country's tax policies affect economic behavior and revenue generation.

Keywords: Tax system, comparative analysis, GST, income tax, corporate tax rates, tax reforms, economic impact, revenue generation.

Introduction

Governments levy financial levies known as personal taxes on people's income, property, and various financial activities. These taxes serve as governments' main source of income and are used to pay for infrastructure and public services including social security, healthcare, education, and the military. Different economic theories, social policies, and administrative procedures can be reflected in the structure and rates of personal taxes across national boundaries. Different nations use different strategies to impose personal taxes. A progressive tax system, for instance, is used in certain countries to try to alleviate income inequality by making sure that wealthier people pay a larger proportion of taxes. Tax rates rise as income levels rise, which aims to redistribute wealth and provide more support for social welfare programs. For example, countries like Sweden and Denmark have high progressive tax rates, which fund extensive public services and social safety nets. In contrast, other nations may employ a flat tax rate, which lowers equity but makes tax administration simpler because everyone pays the same amount regardless of income[1]. This system is used in countries like Hungary and Slovakia, where a single tax rate is applied across all income levels, simplifying compliance and administration. Furthermore, tax credits, exemptions, and deductions vary greatly between nations, which affects how taxable earnings are determined for people as well as the financial habits that are encouraged. Tax credits are designed to reduce the amount of tax owed, and they can be targeted at specific activities such as education, childcare, or energy efficiency improvements. For instance, the United States offers various tax credits such as the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC), which aim to support low to moderate-income families. In contrast, some countries have fewer or no such credits, relying instead on deductions and exemptions to reduce taxable income. This diversity in tax incentives can significantly influence consumer behavior and investment decisions, as individuals and businesses may adjust their spending and saving habits based on available tax benefits[2].

In the end, the money raised by personal taxes helps the government continue to run public infrastructure, deliver basic services, and carry out initiatives that encourage economic growth and stability. For example, the revenue from personal taxes is crucial for funding public health systems, which became particularly evident during the COVID-19 pandemic. Countries with robust healthcare systems, funded by substantial personal tax revenue, were better positioned to manage the crisis. Similarly, investment in education and infrastructure, funded by personal taxes, can enhance long-term economic growth and productivity. Tax revenue also plays a vital role in fiscal policy, enabling governments to implement counter-cyclical measures during economic downturns, thereby stabilizing the economy and mitigating the impact of recessions. Moreover, the design of personal tax systems can have profound effects on economic behavior and societal well-being. For instance, higher taxes on luxury goods and high incomes can discourage excessive consumption and promote a more equitable distribution of wealth. Additionally, some countries use wealth taxes or inheritance taxes to address wealth concentration and promote social justice. For example, France and Spain have implemented wealth taxes, aiming to reduce wealth inequality and generate revenue for public spending. The impact of these taxes on saving, investment, and economic activity is a subject of ongoing debate among economists and policymakers[3].

The structure and rates of personal taxes are deeply influenced by a country's economic philosophy, social policies, and administrative capabilities[4]. While some countries prioritize simplicity and broad-based tax rates, others focus on progressive taxation and targeted incentives to support social equity and economic development. The effectiveness of these strategies in promoting economic growth, reducing inequality, and maintaining fiscal sustainability continues to be a critical area of research and policy-making globally. As nations navigate the complexities of tax policy, balancing fairness, efficiency, and economic incentives remains a key challenge for governments worldwide.

Personal taxes in India

India's progressive personal tax system makes sure that a person's tax rate increases in line with their income. The goal of this method is to guarantee that the government receives a larger share of its revenue from those with higher incomes. In India, there are many income groups under the tax system, and the wealthiest people pay tax rates that are significantly greater than zero. A wide range of deductions and exemptions are also included in the structure to cover many aspects of personal finance, including investments, savings, and required spending. This approach encourages taxpayers to save and invest while alleviating pressure on necessities like healthcare and education. For instance, taxpayers can claim deductions under Section 80C for investments in specified financial instruments such as Public Provident Fund (PPF), National Savings Certificates (NSC), and life insurance premiums, which incentivize long-term savings and financial security[5].

The Indian personal tax system levies additional levies on high-income individuals in addition to income tax, such as cesses and surcharges, to further improve justice in the distribution of the tax burden. Cesses, such as the Health and Education Cess, are imposed to fund specific government projects, while surcharges are additional charges on high earners to ensure that they contribute a fair share to the national exchequer. These levies are designed to ensure that those with greater financial capacity contribute more towards national development and welfare programs. Furthermore, the government mandates that

companies and employees contribute a portion of their income toward retirement savings through social security schemes like the Employees' Provident Fund (EPF). The EPF not only helps employees build a retirement corpus but also provides them with a sense of financial security and stability[6].

State-level taxes that vary by region, such as the professional tax, add another layer of complexity to India's tax system. Professional tax is levied by state governments and can vary significantly from one state to another, reflecting regional fiscal policies and economic priorities. This tax is typically a nominal amount deducted from employees' salaries and is used to fund state-level public services and infrastructure projects[7]. Taken as a whole, these elements represent India's all-encompassing strategy for personal taxes, striking a balance between revenue generation and the accomplishment of social and economic policy objectives. The combination of progressive tax rates, targeted deductions and exemptions, additional cesses and surcharges, and region-specific taxes illustrates the multifaceted approach India employs to create a fair and effective tax system that supports both individual financial well-being and broader economic goals.

Personal taxes in United States

The progressive nature of the American tax system, which attempts to tax people according to their ability to pay, is what makes it unique. The fiscal year 2023 will have a wide range of federal income tax bands, with rates ranging from 10% for the lowest incomes to 37% for the wealthiest earners. This progressive structure is intended to guarantee that individuals with greater incomes make a greater and more significant contribution to federal revenues from their earnings. This system is rooted in the principle of equity, ensuring that those who can afford to pay more do so, thereby reducing income inequality and supporting the social safety net[8].

In addition to income taxes, payroll taxes are levied on individuals. These taxes finance Social Security and Medicare, which provide retirement benefits and healthcare for the elderly. Payroll taxes are limited to a given income threshold, which implies that only earnings over that threshold will be subject to these deductions. This cap, however, has been a subject of debate, with some arguing for its removal to increase funding for these essential programs. The current structure ensures that both employees and employers contribute to these social insurance programs, fostering a sense of shared responsibility for the welfare of the elderly and disabled. A vast range of credits and deductions are also part of the US tax code, which is designed to lower taxable income and encourage financial practices. For instance, mortgage interest, up to $10,000 in state and local taxes, and charitable contributions are all deductible by taxpayers from their taxable income[9]. These deductions incentivize homeownership, philanthropy, and support for state and local governments. Additionally, families with low and moderate incomes can receive substantial relief from credits like the Earned Income Tax Credit (EITC) and Child Tax Credit, which lower their overall tax burden. The EITC, in particular, has been praised for its effectiveness in reducing poverty and encouraging work among low-income households. Another degree of complication is created by state-level taxes, which differ greatly in terms of both rates and regulations. Some states, like Texas and Florida, do not levy a state income tax, while others, like California and New York, have relatively high state income tax rates. This variation reflects the different economic policies and priorities of each state, influencing decisions on public spending, infrastructure development, and social services. The money raised by these taxes is essential for supporting defense, social welfare, infrastructure,

and public education initiatives, among other federal and state government operations. The interplay between federal and state tax systems adds complexity but also allows for a tailored approach to meet the diverse needs and preferences of different regions[10].

Overall, the U.S. tax system's blend of progressive federal income taxes, payroll taxes, and state-level taxes creates a multifaceted framework aimed at balancing equity, efficiency, and revenue generation. This structure supports a wide range of public goods and services, from national defense and social security to local education and infrastructure, reflecting the diverse responsibilities and priorities of government at all levels.

Analysis of Indian and US middle-class household incomes

India and the US have very different median incomes for middle-class households, which reflects larger economic differences between the two nations. The median household income in the US was roughly $70,000 in recent years, indicating a healthy middle class that enjoys a good standard of living, a plethora of social amenities, and comparatively high earnings. This income level allows American middle-class families to access high-quality housing, healthcare, education, and other essential services, significantly contributing to their overall well-being and economic security. The relatively high income enables American households to afford a range of consumer goods and services, invest in their futures, and maintain a comfortable lifestyle. The availability of diverse financial products, such as mortgages and credit cards, further supports their purchasing power and economic stability[11]. Moreover, the strong social safety nets, including unemployment benefits, Social Security, and subsidized healthcare, help mitigate financial risks and ensure a baseline level of security for middle-class families.

In comparison, middle-class households in India have a far lower median income, estimated to be between INR 250,000 and 500,000 (about $3,000 and $6,000) annually. This disparity demonstrates the huge economic divide that exists between the two countries. Indian middle-class households frequently grapple with challenges such as restricted access to high-quality healthcare and education, limited savings due to inadequate social safety nets, and varying living expenses between rural and urban areas. In urban centers, where costs of living are higher, the financial strain on middle-class families can be particularly pronounced. In rural areas, while living costs may be lower, access to essential services is often limited, affecting the overall quality of life. Despite these obstacles, India's expanding economy has gradually improved the financial stability of its middle class. Economic growth, driven by sectors like information technology and services, has led to higher incomes and better employment opportunities, contributing to a gradual rise in living standards.

The disparities between middle-class households' purchasing power, access to services, and general quality of life in the two nations are highlighted by the economic realities represented in these income levels. The middle class in the US benefits from a mature, well-developed economy that provides extensive access to consumer goods, advanced healthcare, and quality education. This economic environment supports a higher standard of living and greater financial security. In contrast, the middle class in India is still navigating a rapidly developing economy, characterized by ongoing reforms and significant regional variations. While India’s middle class is growing and increasingly able to capitalize on new economic opportunities, they face challenges such as inflation, job insecurity, and disparities in infrastructure and service quality[12]. Regional imbalances mean that access to services and the cost

of living can differ drastically, affecting the overall well-being of middle-class families.

As India continues to develop, efforts to address these disparities will be crucial in improving the quality of life for its middle-class population. Investments in public infrastructure, expansion of social safety nets, and policies aimed at reducing regional inequalities will play a critical role in enhancing economic prospects and living standards. Meanwhile, the US middle class enjoys a higher salary and comprehensive benefits, reflecting the advantages of a more mature economic system and established social support structures. The comparison of these two middle-class experiences underscores the broader economic contexts and highlights the ongoing challenges and opportunities faced by each country as they work towards greater economic equality and prosperity.

Analysis of Indian and US middle-class taxes

In India, a middle-class household's tax return typically includes multiple essential elements designed to optimize tax liability under the progressive tax system. For a household with an annual income ranging between INR 250,000 and INR 500,000, the tax return must comprehensively document all sources of income. This includes wages, interest earned from savings accounts, and any rental income. The tax filer can benefit from various deductions available under Section 80C, which allows for deductions of up to INR 1,50,000 from taxable income through investments in instruments like National Savings Certificates, Employee Provident Funds (EPFs), Public Provident Funds (PPFs), and life insurance premiums[13].

Further deductions are available for interest on home loans under Section 24, which can be claimed up to a specified limit to reduce taxable income. Education loans qualify for deductions under Section 80E, while health insurance premiums can be deducted under Section 80D. Contributions to the National Pension System (NPS) are also eligible for additional tax benefits[14]. After accounting for these deductions and exemptions, the household calculates its final taxable income and applies the appropriate tax rates. The balance due or refundable amount is then computed. The final step in the tax-filing process involves submitting the completed return and supporting documents to the Income Tax Department. This ensures compliance with tax regulations and allows for any potential refunds due to overpayment to be processed.

In the US, a middle-class household's tax return generally includes a thorough disclosure of all sources of income, such as wages, interest, dividends, and potentially rental income. For households with annual incomes between $50,000 and $100,000, taxpayers have the option to either itemize deductions or take the standard deduction. For the 2023 tax year, the standard deduction is $13,850 for single filers and $27,700 for married couples filing jointly. Itemized deductions, which require detailed reporting, include mortgage interest payments, up to $10,000 in state and local taxes, and charitable contributions.

In addition to these deductions, households can take advantage of various tax credits that reduce their overall tax liability. Key credits include the Earned Income Tax Credit (EITC), which supports low-to-moderate-income workers, the Child Tax Credit, which provides financial relief to families with children, and education credits that offset the costs of higher education. Payroll taxes for Medicare and Social Security are also reported on the return. The process involves completing forms such as the 1040, along with any additional schedules needed to capture credits and deductions accurately. Taxpayers calculate their total tax liability by comparing it with the amount of taxes paid through withholding and estimated payments. Any difference determines if additional

taxes are owed or if a refund is due. The completed return is then submitted to the Internal Revenue Service (IRS), which ensures compliance with federal tax regulations and processes any necessary adjustments or refunds[15].

Both systems, while reflecting different economic contexts and regulatory frameworks, are designed to capture a comprehensive picture of taxpayers' financial situations. The Indian system incorporates various investment-related deductions to encourage savings and investments, while the US system provides a mix of standard and itemized deductions, as well as tax credits, to address different financial needs and incentivize specific behaviors. The complexity of each system reflects its respective economic and social policy goals, highlighting how tax returns serve as a critical tool for both individuals and governments in managing economic and fiscal responsibilities.

Case Studies

The implementation of GST in India, effective from July 1, 2017, represents one of the most significant tax reforms in the country's history. Aimed at replacing a myriad of indirect taxes such as VAT, excise duty, and service tax, GST sought to streamline the tax system and create a unified tax structure across the country. The reform was designed to reduce tax cascading, where taxes were levied on top of other taxes, thereby improving the overall efficiency of tax collection and compliance. However, the transition was not without challenges. Businesses faced difficulties in adapting to the new system, including issues related to GST compliance and IT infrastructure. Initial implementation saw delays and confusion, affecting small and medium enterprises disproportionately. Despite these challenges, GST has been credited with enhancing transparency in the tax system, increasing tax base coverage, and contributing to higher revenue generation over time[16].

The Tax Cuts and Jobs Act (TCJA), enacted on December 22, 2017, brought sweeping changes to the U.S. tax landscape. Among its key provisions were significant reductions in the corporate tax rate from 35% to 21% and adjustments to individual income tax brackets. The TCJA aimed to boost economic growth by increasing the competitiveness of U.S. businesses and providing tax relief to individuals. For businesses, the reduced corporate tax rate was intended to incentivize investment and job creation. For individuals, the TCJA offered temporary tax cuts and increased the standard deduction. While the TCJA was successful in stimulating short-term economic growth and increasing business investment, it also led to debates about its long-term effects on income inequality and federal budget deficits. Analysis of the TCJA's impact reveals a mixed picture: while it spurred economic activity and investment, it also raised concerns about its sustainability and implications for future fiscal policies[17].

Discussions

The comparative analysis of the Indian and U.S. tax systems from 2018 to 2021 reveals both distinct approaches and shared challenges in tax policy. India's introduction of the Goods and Services Tax (GST) aimed to create a unified indirect tax framework, which, while initially fraught with compliance challenges, sought to enhance revenue efficiency and reduce tax cascading. Conversely, the U.S. Tax Cuts and Jobs Act (TCJA) focused on reducing corporate tax rates and adjusting income tax brackets to spur economic growth and increase global competitiveness[18]. Both systems grapple with balancing tax rates with economic impact; India's emphasis on GST reform demonstrates a shift towards more efficient indirect taxation, while the TCJA reflects a strategic move to stimulate investment through tax cuts. The effectiveness of these reforms is contingent upon their ability to address revenue

generation challenges and adapt to evolving economic conditions. This discussion underscores the importance of continuous evaluation and adjustment in tax policies to meet economic and fiscal objectives[19].

Conclusions

In conclusion, the analysis of personal taxes and their impact on spending trends and economic activity reveals significant differences between India and the US, reflecting broader economic disparities and policy objectives. The progressive tax systems in both countries are designed to address income inequality and support economic stability, but they operate within distinct economic frameworks. In the US, a higher median income and extensive social safety nets enable greater consumer spending and economic mobility, facilitated by a mix of tax deductions and credits. In contrast, India's lower median income and more limited social support necessitate a focus on savings and investment, with tax incentives aimed at encouraging financial prudence amidst ongoing economic development. These differing approaches highlight how tax policies influence individual financial behaviors and broader economic outcomes, underscoring the role of personal taxes in shaping economic stability and growth. As both nations continue to evolve economically, the effectiveness of their tax systems in promoting equitable growth and enhancing the quality of life will remain crucial in guiding future policy decisions and addressing the needs of their populations.

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