IJARSCT
ISSN (Online) 2581-9429
International Journal of Advanced Research in Science, Communication and Technology (IJARSCT)
International Open-Access, Double-Blind, Peer-Reviewed, Refereed, Multidisciplinary Online Journal
Impact Factor: 7.301
Volume 3, Issue 7, January 2023

Effects of Income Tax Changes on Economic Growth

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Abstract: *The impact of changes to individual income taxation on long term growth is examined in this paper. To achieve growth, it is vital to structure and finance a change in taxation. Tax cuts may encourage people to work, save, and invest, but they are likely to lead to an increase in the federal budget deficit, which in the long run will reduce national savings and raise interest rates, if they are not financed by immediate spending cuts. It's estimated to be either little or not at all. Base broadening measures may reduce the effect of tax rate cuts on budgetary deficits, while also reducing their impact on labour supply, savings and investment in a way that makes growth less directly affected. But, in order to enhance efficiency and increase the size of the entire economy, they also move resources from one sector to another into its most productive use at an even higher value. between equity and efficiency. The results indicate that there will be no equivalent impact on growth of all tax changes. The growth of the long term size of the economy will be facilitated by reforms that increase incentive, decrease subsidies, prevent windfall profits and avoid deficit financing but may also lead to trade disruptions.*

Keywords: Economic growth, National saving, Budget, Growth, tax rate.

I. INTRODUCTION

The extent to which potential changes in the tax system on personal income affects the size of the economy has always been a matter of interest for policy makers and researchers. Earlier this year, for example, Representative Dave Camp (R-MI) proposed a sweeping reform to the income tax system that would reduce rates, greatly pare back subsidies in the tax code, and maintain revenue- and distributional- neutrality (Committee on Ways and Means 2014). We're going to look at how economic growth is being affected by tax changes on this paper. There are two types of tax changes that we're focused on, a reduction in individual taxes rates and income tax reform. The latter is a change that broadens the income tax base and reduces the statutory income tax rates, but maintains the overall level of revenue and the distribution of the tax burden imposed by the current income system. We're focusing on a reform of individual income taxes, leaving consideration of reforms to the corporate income tax (forwhich, see Toder and Viard 2014) and reforms that focus onconsumption taxes for other analysis.

We're looking at impacts on economic expansion in the supply side and potential GDP. Product (GDP). This expansion can be accompanied by a yearly increase in GDP growth, which is not directly affected by future growth but increases the size of the economy and thus leads to higher growth rates or both. We're focusing on the supply side of the economy and the long term. The importance of the topics addressed here derive fromthe income tax's central role in revenue generation, its impact on the distribution of after-tax income, and its effects on a wide variety of economic activities. The importance is only heightened by recent weak economic performance, concerns about the long-term economic growth rate, and concerns about the long-term fiscal status of the federal government.

We find that, while there is no doubt that tax policy caninfluence economic choices, it is by no means obvious, on an ex ante basis, that tax rate cuts will ultimately leadto a larger economy. While the rate cuts would raise the after-tax return to working, saving, and investing, they would also raise the after-tax income people receive from their current level of activities, which lessens their need to work, save, and invest. The first effect normally raises economic activity (through so-called substitutioneffects), while the second effect normally reduces it (through so-called income effects). In addition, if they are not financed by spending cuts, tax cuts will lead to an increase in federal borrowing, which in turn, will further reduce long-term growth. The historical evidence and simulation analysis is consistent with the idea that tax cuts that are not financed by immediate spending cuts will have little

ISSN 2581-9429 IJARSCT

positive impact on growth. On the other hand, tax rate cuts financed by immediate cuts inunproductive spending will raise output.

Tax reform is more complex because it involves tax cuts and base broadening. In the long term, there is a theoretical economy with significant uncertainty as to its effects and level of impact. The expansion of the tax base is one particular fact that often goes unnoticed. The reduction or elimination of tax expenditures increases the effective tax rate that people and businesses face and thus will operate in a way that is contrary to the reduction of tax rates. But base-broadening has the additional benefit of reallocating resources from sectors that are currently tax-preferred to sectors that have the highest economic (pre-tax) return, which should raise the overall size of theeconomy.

A fair assessment would conclude that well designed tax policies have the potential to raise economic growth, but there are many stumbling blocks along the way and certainly no guarantee that all tax changes will improve economic performance. Given the various channels through which tax policy affects growth, a growth- inducing tax policy would involve (i) large positive incentive (substitution) effects that encourage work, saving, and investment; (ii) income effects that are small and positive or are negative, including a careful targeting of tax cuts toward new economic activity, rather than providing windfall gains for previous activities; (iii) a reduction in distortions across economic sectors and across different types of income and types of consumption; and (iv) minimal increases in the budget deficit.

1.1 Objective of the study

- To analyze the theoretical foundations of the income tax and economic growth relationship.
- To examine empirical evidence from diverse economies and time periods.
- To identify potential mechanisms through which income tax changes influence economic growth.

II. RESEARCH METHODOLOGY

A comprehensive survey of secondary data collected from different literatures, national and international periodicals, government reports published on various website with a view to some aspects of goods and services taxation has been carried out in the study.

III. CONCLUSION

Economic activities can be influenced, but not all tax changes have a corresponding or even positive impact on long term growth, either by changing the level of revenues and reforming the structure of the tax system. Often the argument that income tax cuts boost growth is echoed and even taken as gospel. However, the other and more complex picture is presented by a number of different theoretical, evidence or simulation studies.in productive economic activity, and they may subsidize old capital, which provides windfall gains to asset holdersthat undermine incentives for new activity. In addition, tax cuts as a stand-alone policy (that is, not accompanied by spending cuts) will typically raise the federal budget deficit. The increase in the deficit will reduce national saving—and with it, the capital stock owned by Americansand future national income—and raise interest rates, which will negatively affect investment. The net effect of the tax cuts on growth is thus theoretically uncertain anddepends on both the structure of the tax cut itself and the timing and structure of its financing.

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