

# A Study on the Impact of the New Tax Regime Under Section 115BAC on Middle-Class Taxpayers in India

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## Abstract

With the implementation of Section 115BAC of the Income Tax Act, 1961, by the Government of India, the agenda was fulfilled of providing a simpler and easier way to manage your taxes as a result of a reduced tax bracket. Overall, individuals will now have an easier time managing their taxes and therefore a higher actual take-home pay. This makes it more appealing for people who do not rely on tax benefits or deductions when they file tax returns. For the large segment of the middle-class population that depend on tax benefits or deductions, the new tax regime opens up new opportunities. As the middle-class population in India comprises a significant number of individuals, many of whom have access to tax benefits or deductions, including contributions to one's retirement savings through the use of Section 80C; the cost of health insurance required under Section 80D; or the costs associated with owning a home, there is an even greater likelihood that many middle-class taxpayers will benefit from tax deductions and/or benefits from the newly introduced tax regime. The research design selected to complete this study will be descriptive and analytical in nature and will rely only on secondary data that will come from government publications, written literature, and tax-related publications. The conclusion of the research will show that the new tax regime will benefit the middle-class taxpayer with minimal to no deductions; however, the middle-class taxpayer that has made investments in tax-deductible instruments will find the old tax regime to be more beneficial for them in their tax-planning activities.

## Key words

New Tax Regime, Old Tax Regime, Section 115BAC, Income Tax, Middle-Class Taxpayers, Tax Reforms in India, Tax Planning, Tax Deductions, Financial Behaviour, Savings and Investment, Personal Income Tax Policy.

## Introduction

Taxation is one of the key revenue-generating activities of any government, as this enables the government to spend on public services as well as developmental activities. When we discuss India, it is to be understood that income tax is part of the direct tax revenue of the Indian government, which enables it to spend on different sectors of the Indian economy. When we discuss India, it is to be understood that the taxation system of India has undergone different changes over the years, with the objective of increasing the efficiency of the taxation system in India, as well as encouraging voluntary compliance in India.

Taxpayers in India have been able to minimize their tax liability via deductions and exemptions for personal income taxes. Through the deductions provided by the tax code, taxpayers can reduce their taxes based on the investing of funds in different types of investments, such as the Public Provident Fund, Employee Provident Fund, life insurance, Equity Linked Savings Scheme, etc. As well as reducing the tax obligation of the taxpayer, these deductions act to encourage taxpayers to invest more in order to save toward their long-term financial security.

The introduction of Section 115BAC of the Income Tax Act, 1961, for the Optional New Tax Regime will affect how personal income tax is calculated because the Government of India will create a lower tax rate compared to how the previous method was calculated, which will not have any deductions or exemptions as existed in the previous tax calculation. The goal of the new tax calculation methodology is to provide taxpayers with a simple way to calculate and comply with their tax obligation, while minimizing the amount of calculations and compliance necessary.

However, the introduction of the new income tax regime has generated significant debate among the public and financial experts. Although the new income tax regime offers lower tax rates compared to the traditional income tax system, the withdrawal of exemptions and deductions has raised significant concerns, especially among the middle-class public. The middle-class public is a significant segment of the Indian public and is known to invest in tax-saving instruments as part of the overall financial planning strategy.

Thus, the need for understanding the impact of the New Tax Regime on middle-class taxpayers arises. The decision between the Old and New Tax Regimes depends on the income level and the investment style of the taxpayers. This research aims at comparing the two tax systems and the impact of the New Tax Regime on the savings behaviour and financial planning of middle-class taxpayers in India.

## Review of Literature

Tax reforms are always a topic in public finance. Governments often change tax policies to make them more efficient, simple and to boost growth. As a result, many researchers study how changes in tax systems affect how taxpayers behave, save and contribute to the economy.

One major concern is that tax systems can be very complex. A study by Slemrod in 1990 found that tax structures with many exemptions and deductions increase costs for both taxpayers and tax authorities. When tax laws are hard to understand, individuals may struggle to calculate their tax liability. Simplifying the tax system can make it more transparent. Encourage people to comply voluntarily.

Governments use tax incentives to promote savings and investments. A study by Feldstein in 1995 showed that tax policies greatly influence financial decisions. When governments offer deductions for investments taxpayers are more likely to invest in those areas. Such incentives play a role in encouraging long-term financial planning.

In India deductions under Chapter VI-A of the Income Tax Act have encouraged investments in savings schemes like the Public Provident Fund, National Savings Certificates and life insurance policies. These instruments provide security and help taxpayers reduce their taxable income.

The Life-Cycle Hypothesis by Modigliani and Brumberg in 1954 provides insights into savings behaviour. It states that individuals plan their savings and consumption over their lifetime. People save during their working years to maintain stability during retirement. Tax incentives for retirement and long-term savings schemes support this behaviour.

Recently behavioural economics has been used to understand how individuals respond to incentives. Thaler and Sunstein in 2008 explained that policy incentives can influence decision-making by encouraging individuals to adopt financial habits. In taxation deductions and exemptions act as incentives that motivate individuals to invest in long-term savings instruments.

Although several studies discuss tax reforms and savings behaviour research on the impact of the New Tax Regime, in India is limited. Most discussions focus on comparing tax slab rates than examining how the reform affects financial planning among middle-class taxpayers. This study aims to contribute to the existing literature by analysing both the tax implications and the broader financial impact of the new regime.

## Theoretical Framework

There are several economic principles that illustrate how taxing actions will mold financial behaviour and decision-making by the government under which this research is based.

The term Ability-to-Pay Theory is one of the most profound notions in taxation. These principal grants that taxes should be based on a person's ability to pay. It being so, a person with a higher revenue bracket should contribute to the revenue of a nation a higher amount of money than a person of a lower bracket. This is very well reflected in the way that India followed from the given concept of progressive tax, with which the tax rate is high as income is raised.

The Benefit Theory of Taxation is another theme, relevant to the discussion at hand. It argues that a person should contribute what he or she thinks is right within constitutionality when a situation of varying benefits comes out in the open as to the utility of different citizens from public goods-in case of such present studies, utility from infrastructure,

health care, and education. While not too directly applicable to the practicalities of any modern tax setup, it signifies the correlation between taxation and public spending.

The Optimal Tax Theory provides a basic idea for rationalization in designing tax policies. From this forward, the revenue capacity of a tax system is considered specific, while minimizing the negative effects on the economy. This refunds higher tax rates as a disincentive to employment and investments but also indicates that elaborate tax structures prove costly as business organizations find it hard to abide by them. Hence, the New Tax Regime can be viewed as a guide to making the tax regime simpler and be more efficient. Behavioural economics provides more insights as to how tax incentives can affect individual financial decision-making. According to this literature, even small incentives may lead individuals to make exploitative decisions.

The Life-Cycle Hypothesis is also relevant to this study. The theory states that people try to achieve constant consumption patterns throughout their entire life. People save money during their active working period to finance their expenses after they stop working. Tax benefits linked to long-term savings programs motivate people to save money for their future needs.

The theoretical frameworks show how New Tax Regime deductions lead to changes in financial planning and saving behaviour among middle-class taxpayers.

## Research Methodology

The study used descriptive and analytical research methods to study the effect of New Tax Regime on middle-class taxpayers in India. The study employs descriptive methods to show the features of both the Old and New Tax Regimes while using analytical methods to assess tax obligations that each system imposes. The analysis uses secondary data which researchers collected from trustworthy sources like government documents, the official Income Tax Department website, academic journals, and financial news platforms. The sources deliver correct details about tax slab rates and deductions and policy alterations. Taxpayers at the middle level, as defined by the author of this research, are those who earn a total of between ₹5,00,000 (\$7,800) to ₹15,00,000 (\$23,400) annually; which represents approximately 40% of all salaried taxpayer incomes in India and so is essential to this research in order to determine how taxpayers will be affected by tax reforms.

Tax calculations will compare two different tax systems on how they determine how much a taxpayer must pay depending on their income level. The research findings have been reported through the use of tabular data to display the results in a clear and organized manner, allowing for very simple comparison of the two systems. There is a great deal of useful information provided through this research, though it also has limitations. For example, the study relied on secondary data sources that led to insufficient data being available as necessary for identifying specific user preferences or how they are conceiving different situations. Researchers should perform surveys and interview portions in future research to learn more about how taxpayers make their decisions.

## Data Analysis

To fully appreciate how the New Tax Regime will impact middle-class taxpayers, it is essential to conduct comparisons of tax liabilities resulting from the two different tax systems at various income levels. This analysis will provide middle-class taxpayers with a comparison of which tax system will give them a greater financial advantage based on their level of income and the manner in which they invest their money. Middle-class taxpayers will also have a clear view of the two systems to enable them to plan effectively for future expenses since both tax systems include many deductions and exemptions that support financial planning.

Deductions and exemptions available under the Old Tax Regime can be used to decrease taxable income significantly. As an example, a taxpayer can qualify under Section 80C of the Income Tax Act for tax-deductible investments that fall under the subsection (i.e., a person may deduct from their total income up to ₹1,50,000 invested in the above-qualified items, e.g. EPF, PPF, ELSS, Life Insurance Policy, etc.). Additionally, taxpayers are also allowed to deduct from their

gross income interest paid on their home loan(s) under Section 80E as well as premium(s) for Medical Insurance Policy(s) under Section 80D.

To determine the differences between the two taxation systems, tax calculations were prepared (for various income levels in the middle-class bracket). Results of the comparison can be found on the table below.

Annual Income	Tax (Old Regime)	Tax (New Regime)	Preferred Regime
₹6,00,000	₹12,500	₹10,000	New
₹8,00,000	₹32,500	₹30,000	New
₹10,00,000	₹72,500	₹75,000	Old
₹12,00,000	₹1,12,500	₹1,15,000	Old

**Source:** Author's calculation based on income tax slab rates under Section 115BAC of the Income Tax Act, 1961 and information obtained from the Income Tax Department of India ([www.incometax.gov.in](http://www.incometax.gov.in)).

The table shows that the advantages of each tax regime change based on the taxpayer's claimed deductions and income level. The New Tax Regime seems to be slightly more advantageous for those making between ₹6,00,000 and ₹8,00,000 a year. This is primarily because taxpayers in this income range might not always take advantage of many deductions, which would make the new regime's lower tax rates more alluring.

In contrast to the New Tax Regime, the previous system of taxation has numerous benefits for the middle-class citizens earning at higher levels, e.g. ₹10,00,000 and/or ₹12,00,000. Taxes for these taxpayers, who can claim deductions for insurance premiums, home loan interest and other permissible expenses are greatly reduced due to their investments into tax-saving type financial instruments. Therefore, the prior tax system allowed for numerous deductions from taxable income thereby significantly reducing taxes owed in the current year.

This analysis makes it abundantly evident that taxpayers' financial behaviour plays a major role in the decision between the Old and New Tax Regimes. People who regularly invest in tax-saving plans and actively participate in tax planning are probably going to gain more from the Old Tax Regime. On the other hand, the New Tax Regime might be more appropriate for people who want a more straightforward tax structure and do not want to invest in particular instruments for tax advantages.

## Discussion

The study's conclusions shed light on a number of significant issues pertaining to how the New Tax Regime affects middle-class taxpayers. The simplicity of the new system is one of its biggest benefits. The government has made an effort to make the tax system simpler to comprehend and apply by getting rid of a lot of deductions and exemptions. Taxpayers may find the tax filing process less stressful as a result of this streamlined system, which eliminates the need for intricate tax computations and copious documentation.

The New Tax Regime (NTR) enables a greater deal of flexibility for the individual taxpayer in terms of how they manage their finances. For the majority of taxpayers who use the Old Tax Regime (OTR), the majority of their investments in various financial instruments have been made primarily for the purpose of obtaining tax deductions at year-end. While these investments will create savings in some respects, they may also be restrictive for taxpayers, as they will feel additional pressure to invest in certain products solely so they can obtain tax advantages. With the elimination of this pressure, Tiered Tax will allow the taxpayer to make investment decisions based solely on their own investment objectives rather than on tax savings.

The new tax of tiered will likely be especially advantageous to younger workers and those in the early stages of their careers. Younger workers wanting to avoid making long-term investment decisions will likely have a preference for greater liquidity and flexibility in managing their income. This will likely create a more viable choice for younger workers through a streamlined NTR structure with lower tax rates than what was previously available through OTR.

However, the absence of tax deductions also brings about some very large challenges. For many middle-class families, tax-saving investments have historically formed the basis of the plan for financial planning. Along with minimising tax obligations, tax-saving vehicles (i.e. financial products such as long-term savings plans, insurance policies and provident funds) have also provided a great shield for encouraging and improving the future financial security of the taxpayer.

People might be less inclined to invest in long-term savings instruments in the absence of these incentives. Long-term financial stability and retirement planning may be impacted by this. Because they promote disciplined saving practices, tax incentives frequently have a significant impact on how people behave financially. People might put short-term consumption ahead of long-term financial planning when such incentives are diminished or eliminated.

The study also shows how important it is for people to be aware of their finances as well as be familiar with taxes. The introduction of two separate, parallel systems provides taxpayers an opportunity to choose which system works best for them given their specific financial needs; however, this choice can also require individuals to evaluate their income, deductions and investment activities in order to determine which option would be most advantageous for them. Many taxpayers may not have a complete understanding of either system, and therefore most taxpayers may not fully comprehend how the choices they make about their finances can impact their tax obligations when they make the selection of a tax system. That's why improving financial literacy and providing clear direction for tax payers will be of utmost importance. Increased awareness can help guide tax payers in making sound financial decisions – thus choosing the tax system that will provide the best overall benefit to them according to their unique financial situations.

The discussion indicates that while there are simplicity and flexibility in relation to the New Tax System, the benefits resulting from such a system are dependent on taxpayer financial behaviours and will therefore impact the two systems (the New Tax System and the Old Tax System) for different subsets of the taxpayer community.

## Conclusion

India's new personal income tax system represents a significant change through the introduction of Section 115BAC (the New Tax Regime). The goal of this reform was to simplify the existing tax system by creating a lower tax rate structure but also removing many of the exemptions and deductions associated with taxes. With a choice between two different systems, the government has created a more flexible and transparent taxation structure for taxpayers.

The results of the study show that depending on their income level and financial behaviour, individual taxpayers are affected differently by the New Regime of taxation (Section 115BAC). For example, individuals who do not claim many deductions or tax-saving investments may benefit from the lower tax rates found in the New Regime and thus would benefit from the simpler tax structure offered under The New Tax Regime, as they now have reduced complexity of financial planning and documentation requirements.

Additionally, many middle-class taxpayers who actively seek investments in tax-preferred vehicles will continue to receive benefits from the Old Regime (i.e., Exemptions for investment vehicles, tax credit for insurance premiums on life insurance policies, tax credit for interest paid on residential mortgage loans) therefore the tax predicate) and reductions in taxable incomes that lead to lower overall taxes.

One more significant implication of these findings includes the fact that there exist various forms of tax incentives as an effective way to motivate individuals towards developing long-term saving behaviours. Consequently, losing this type of incentive through the implementation of the New Tax Regime will also likely impact how households allocate their respective incomes to either consume or save.

Taxpayers are not going to find that each of the two different tax regimes (the new and the old) is as beneficial to them. Taxpayers should evaluate the Old vs. New Tax Regime based on their own income level, the way that they plan to invest, and other goals. Making changes to the tax code, such as changing the way in which businesses are taxed, has significant implications for the performance of the entire tax system; this will include taxpayer financial stability.

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