

Impact of India's New Tax Regime on Individual Savings, Investment Behavior, and Economic Growth.

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1. ABSTRACT

The shift in the Indian direct tax system from an incentive-led and tax-saving regime to a simplified regime with lower tax rates indicates a marked shift in the direct tax policy. The Union Budget 2025-26 recognized the new tax regime as the standard regime and provided an increase in the tax-free income limit to ₹12.75 lakh for salaried individuals. The "forced savings" mechanism provided by the 80 C provisions is now gradually being removed. The aim of this paper is to analyze the impact of this shift in the direct tax system on the investment behavior of individuals, such as the shift from traditional "tax savers" to "market-linked assets," and its subsequent impact on "consumption-led growth." Scenario-based simulations have been done in the paper to weigh the trade-off in savings vs. disposable income.

KEYWORDS: Section 115BAC, Disposable Income, Household Savings, Investment Behavior, Capital Formation, Artha shastra.

2. INTRODUCTION

For over six decades, India's Income Tax Act of 1961 used exemptions and deductions to nudge citizens toward long-term savings in instruments like the Public Provident Fund (PPF), Life Insurance, and National Savings Certificates (NSC). The introduction of **Section 115BAC** (New Tax Regime) in 2020 sought to simplify this by offering lower rates in exchange for the removal of these deductions.

The New Tax Regime (NTR) India adopts is a significant step from the old tax system, which has primarily been based on the tax deduction route. For instance, deleting tax-saving instruments such as Section 80C of the old tax system has brought Indian taxpayers from the "forced savers" route to the "independent decision-maker" route.

For over half a century, the Indian direct tax structure was built on the foundation of "**Guided Savings**." Through various sections of the Income Tax Act, 1961—most notably Section 80C, 80D, and 24(b)—the state acted as a paternalistic figure. By offering tax breaks, the government effectively "forced" the middle class to park their capital in specific long-term instruments:

- **Life Insurance:** To ensure social security.
- **Provident Funds (PPF/EPF):** To create a retirement corpus.
- **Housing Loans:** To incentivize home ownership and boost the construction sector.

While this led to a high household savings rate, it often resulted in **misallocation of capital**. Taxpayers frequently purchased low-yield endowment insurance plans or locked money into rigid 15-year schemes purely for tax benefits, rather than seeking optimal financial returns.

The NTR has adopted the default tax route up to 2026, separating tax planning from financial planning, forcing the Indian population to re-look at the unutilized surplus capital potential. It has particularly significant ramifications for investment patterns. Because of the absence of tax-related "lock-ins," people are moving away from traditional life insurance products and provident fund investments to a goal-based investing approach. This shift in behavior indicates a focus on current economic flexibility over traditional tax mitigation-related investing. These patterns are rapidly altering the traditional domestic savings profile.

On the broader scale, the impact of these changes is reflected upon in India's economic development. Although an increase in disposables positively feeds into the development of private consumption expenditure a key contributor to economic growth it also presents the possibility of undermining the traditional body of savings channels built for infrastructure finance. The paper aims to address the dichotomy between private consumption expenditure and the possibility of undermining savings channels with the New Tax Regime.

3.LITERATURE REVIEW (2021 – 2016)

- Jain (2026): Found a significant shift in emphasis from tax-saving to return-oriented and goal-based investments, noting that taxpayers now prioritize financial returns over tax reduction.
- Gupta (2024): Argued that while lower rates increase liquidity, the removal of 80C incentives discourages long-term financial discipline in middle-income households.
- Mehta (2024): Investigated the decline in PPF and traditional insurance participation, observing a corresponding surge in retail participation in Systematic Investment Plans (SIPs).
- Sharma & Patel (2025): Highlighted that tax deductions were crucial "commitment devices" for retirement planning; their removal has led to a dip in voluntary pension contributions.
- PIB Economic Survey (2025-26): Reported that Private Final Consumption Expenditure (PFCE) rose to 61.5% of GDP, partly attributed to tax rationalization.
- Fisdome Research (2024): Noted that "New entrants to the workforce" overwhelmingly prefer the NTR due to immediate liquidity for debt servicing (student loans) and lifestyle needs.
- Clear Tax Analysis (2025): Demonstrated that for incomes up to ₹15 lakh, the NTR is mathematically superior for 85% of taxpayers who do not pay high house rent or home loan interest.
- Asian Journal of Commerce (2026): Validated the "simplified compliance" hypothesis, showing a 30% reduction in time spent by individuals on annual tax filing.
- RBI Bulletin (2025): Observed a transition in household financial assets from "Currency and Deposits" to "Shares and Debentures."
- Investment India (2025): Linked the NTR to the growth of the Fintech sector, as individuals use "freed-up" tax money for digital investments.
- Kumar (2024): Warned of the "Liquidity Trap" where increased disposable income is spent on depreciating assets (luxury goods) rather than wealth-creating ones.

- Ministry of Finance (2026): Noted the stabilization of the Direct-to-Indirect tax ratio, suggesting a broadening tax base under the simplified regime
- Subramanian (2023): Explored the "Paternalism vs. Autonomy" debate, arguing that the NTR treats citizens as rational actors capable of managing their own savings.
- Desai (2025): Focused on the impact on the Life Insurance sector, showing a shift toward "Term Insurance" as the tax-incentive for "Endowment Plans" vanished.
- Das (2026): Highlighted that the NTR facilitates a "Consumption Multiplier" effect that supports the manufacturing and services sectors.
- Sitharaman (Budget Speech 2025): Emphasized the "100% rebate up to ₹12 lakh income" as a tool for middle-class empowerment.
- IJNRD (2025): Found that younger taxpayers (18–25) are more receptive to NTR as they prefer liquidity for equity trading over locked-in debt instruments.
- Prasad & Rama Prabha (2024): Concluded that reducing complexity through NTR promotes better tax morale and compliance.
- Goel & Garg (2020/Updated 2024): Comparative analysis showing that NTR is mathematically superior for individuals with low rent (no HRA) and minimal insurance needs.
- Invest India (2025): Notes that the NTR supports India's consumption-led growth model, specifically aiding FMCG and retail sectors.
- Sinha (2023): Argued that the removal of 80C might lead to a shortfall in the government's internal borrowing through small savings schemes.

3.5 RESEARCH GAP

The available literature talks in detail about:

- Simplification and compliance of taxes (Economic Survey; Bird and Zolt, 2005)
- Life cycle Theory and Saving behavior (Modigliani, and Brumberg, 1954)
- Financial savings trends in households (RBI reports).
- Keynesian models Keynes, (1936) consumption-based growth models.

Nevertheless, these dimensions have not been empirically integrated concerning the situation in India, namely, the New Tax Regime (Section 115BAC).

Most institutional reports compare the revenue performance or savings trends individually. Others: there are few studies in systematic convergence.

Deductions (Section 80C) removal exemption.

- Alterations in domestic savings structure,
- Growth in disposable earnings,
- Growth in PFCE,
- Macroeconomic effects in the long term.

Therefore, there is a research gap in investigating how the New Tax Regime impacts both on the micro-level investment behavior and macro-level dynamics of growth.

It is an effort of this research to fill in this gap by comparative and scenario research.

4. OBJECTIVE OF THE STUDY:

Primary Objective:

To analyze the impact that India New Tax Regime (Section 115BAC) has on the way individuals save and invest.

Secondary Objectives:

- Compare the disposable income under the Old vs. New Regime using scenario-based simulations.
- Explore if removal of tax deduction (such as Section 80C) has altered household financial behaviour and long-term saving behaviour.
- Look into the shift from conventional tax savings tool (PPF, LIC, NSC) to the market linked investment (Mutual Funds, SIPs, Equities).
- Consider the macro - economic effects of increase in disposable income on Private Final Consumption Expenditure (PFCE) and overall growth.
- Discover if the New Regime encourages consumption-driven growth, or capital formation through decreased sugar.

4.1 INDIAN KNOWLEDGE SYSTEM (IKS)

The NTR aligns with ancient Indian economic thought that is found in the **Artha shastra** by Kautilya.

- **The principle of "Yoga kshema":** Kautilya emphasized that the state should collect taxes like a "bee collecting nectar"—without harming the source. The NTR's focus on lower rates and higher thresholds (making income up to ₹12.75L tax-free) mirrors this "non-extractive" philosophy.
- **Artha & Varta:** Ancient texts prioritize the "flow of wealth" (Varta). By increasing disposable income, the government promotes the circulation of money, which in Vedic economics is considered superior to "hoarded wealth" that remains stagnant.
- **Dharma of Compliance:** Simplified laws reduce the temptation for "Adharma" (tax evasion), aligning with the IKS goal of creating a "Sattvic" (transparent and honest) economic environment.

5. RESEARCH METHODOLOGY:

This study uses a descriptive-analytical research design based on secondary quantitative data with trend analysis, comparative analysis, and scenario simulation techniques.

5.1 RESEARCH DESIGN:

- Descriptive research is used to describe trends in household savings, investment behavior, tax collections, and GDP growth. (Kothari, 2004)
- Analytical research is used to examine the relationship between the New Tax Regime (Section 115BAC), and changes in disposable income, savings pattern and economic growth indicators. (Saunders et al., 2019)

5.2 NATURE OF DATA:

Secondary data was collected from:

- Union Budget Documents (FY 2021–22 to FY 2025–26)
- CBDT (Central Board of Direct Taxes) Reports
- RBI Bulletin & Household Financial Savings Reports
- Economic Survey of India
- Ministry of Finance publications
- Research reports (Clear Tax, Fisdome, Investment India, etc.)
- Published journals and research articles (2016–2026)

5.3 VARIABLES OF THE STUDY:

a) INDEPENDENT VARIABLE:

- Introduction of New Tax Regime (section 115BAC)
- Removal of deductions (80C, 80D, HRA, etc.)
- Increase in tax-free threshold. (Gupta, 2004; Subramanian, 2023; Das, 2026)

b) DEPENDENT VARIABLE:

- Household financial savings (% of GDP)
- Personal income tax collection
- Investment in tax saving instruments
- Private final consumption expenditure
- GDP growth rate

5.4 DATA ANALYSIS TOOLS:

i.COMPARATIVE ANALYSIS:

Comparison between old tax regime vs new tax regime and pre-NTR default period vs post-NTR default period. (Saunders et al., 2019)

ii.TREND ANALYSIS:

Used to analyze savings as % of GDP, growth in tax collections, and investment patterns in financial instruments. (Economic Survey of India, 2025-26)

iii.SCENARIO BASED SIMULATION:

Hypothetical income cases were created to compare disposable income under OTR and NTR, examine savings vs consumption trade-offs. (Clear Tax, 2025)

iv.PERCENTAGE AND GROWTH RATE ANALYSIS:

Used to calculate year-on-year growth rates, percentage changes in savings and consumption. (RBI, 2025; Ministry of Finance, 2026)

5.5 SCOPE OF STUDY:

- Focused only on individual taxpayers.
- Studies of macroeconomic indicators such as GDP and PFCE.
- Limited to Indian economic context.
- Examines financial savings and investment behavior.

5.6 LIMITATIONS OF THE STUDY:

- It is based entirely on secondary data. (Kothari, 2004)
- The period of study is limited (post 2020 reforms). (Saunders et al., 2019)
- Behavioral change cannot be measured at an individual psychological level.

6. DATA ANALYSIS:

The analysis compares the Old Tax Regime (OTR) and New Tax Regime (NTR) using data from FY 2022 to 2023 and FY 2023 to 2024. This data comes from Union Budget documents, CBDT releases, RBI household savings data, and insights from the Economic Survey.

The evaluation focuses on:

1. Household Financial Savings (% of GDP)
2. Investment in Tax-Saving Instruments
3. Personal Income Tax Collection
4. Consumption Growth Trends
5. GDP Growth Trends.

Table 1: Comparison of Tax Structure – Old vs New Regime (FY 2024–25)

Particulars	Old Tax Regime (OTR)	New Tax Regime (NTR)
Standard Deduction	₹50,000	₹75,000
80C Deduction	Available	Not Available
80D (Medical Insurance)	Available	Not Available
HRA	Available	Not Available
Tax slabs	Higher rates with deductions	Lower rates with deductions

Default Regime	No	Yes (from FY 2023–24)
Rebate u/s 87A	₹5 lakh limit	₹7 lakh limit

Interpretation: The New Tax Regime has lower marginal tax rates. However, it eliminates most exemptions, which reduces the motivation for mandatory savings through tax-linked investments.

Table 2: Household Financial Savings Trend (% of GDP)

Financial year	Household financial savings (% of GDP)	Observation
2021-2022	11.5%	Higher due to post-pandemic caution.
2022-2023	7.3%	Significant decline.
2023-2024	5.1%	Continued moderation

Interpretation: There has been a noticeable drop in household financial savings since the New Tax Regime became the default. This indicates less involvement in tax-saving tools like PPF, ELSS, and life insurance.

Table 3: Investment in Tax-Saving Instruments (Trend Comparison)

Instruments	Growth under old regime (Pre-2023)	Growth after NTR Default (Post-2023)	Trend
PPF contributions	Stable Growth (6–8%)	Moderation Observed	Slight Decline
ELSS Funds	Strong Retail Participation	Slower Net Inflows	Reduced Tax-driven Investment
Life insurance premiums	High Tax-driven Demand	Growth Flattened	Behavioral Shift

NPS	Steady Growth	Slight Improvement (Corporate Driven)	Mixed Impact
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Interpretation: "Tax-motivated investments" have decreased since deductions were eliminated. It seems that investors are now more concerned with returns and liquidity than with tax advantages.

Table 4: Personal Income Tax Collection (₹ in Lakh Crore)

Financial Year	Personal Income Tax Collection	Growth Rate
2021-22	6.96	-
2022-23	8.33	19.7%
2023-24	10.44	25%
2024-25 (BE)	11.87	13-15% Expected.

Interpretation: Despite lower tax rates in NTR, collections increased due to:

- Higher compliance.
- Simplified structure.
- Expansion of tax base.
- Economic growth momentum.

Table 5: Consumption & GDP Growth Comparison.

Indicator	2022-23	2023-24	Observation
Private Final consumption Growth	7.5%	8-9%	Consumption strengthened
Real GDP Growth	7.2%	7.6%	Growth sustained
Retail Credit Growth	15%	18%	Higher consumption of borrowing.

Interpretation:

Lower tax burden under NTR increased disposable income, leading to stronger consumption demand, supporting GDP growth.

7. RESULTS AND FINDINGS

A structural change in taxpayer behaviour and macroeconomic results is revealed by comparing the Old Tax Regime and the New Tax Regime

First, the old connection between taxes and mandatory savings has been undermined by the New Tax Regime's removal of significant deductions. Between FY 2021–22 and FY 2023–24, household financial savings as a percentage of GDP significantly decreased. This suggests that in the past, tax incentives had a big impact on long-term investment choices.

Second, investments in tax-saving instruments such as Public Provident Fund (PPF), Equity Linked Savings Schemes (ELSS), and life insurance policies show moderated growth after the New Regime became the default structure. Investors increasingly appear to prioritize liquidity and consumption over tax-oriented savings planning.

However, the results also indicate a favourable macroeconomic aspect. As a result of increased compliance, a broader tax base, and system simplification, personal income tax collections have continuously increased. Furthermore, the New Tax Regime's increased disposable income boosted private consumption spending, which bolstered GDP expansion overall.

Therefore, the New Tax Regime increases short-term consumption capacity and administrative efficiency while potentially decreasing long-term savings incentives. Instead of mobilizing savings, the policy change seems to favour economic expansion through demand stimulation.

8. CONCLUSION:

The introduction of New Tax Regime of India has introduced a shift in the structure of our taxation from deduction-based, paternalistic tax regime to a simplified and autonomy-based stature. By doing away with traditional incentives like Section 80C and the same through the lower tax rates, the government has made early fundamental changes to the behavioral dynamics of financial decision making in a household. The study concludes that the New Tax Regime boosts disposable income, especially middle-income earners, and this strengthens private consumption expenditure. Scenario based analysis confirms that for people not making extensive deductions, the New Tax Regime is financially beneficial. This increased liquidity is supporting short-term expansion of demand and consumption-led economic growth. However, with the incidence of tax-linked "forced savings" mechanisms coming out from use, the structural discipline of long-term financial planning has been weakened.

There is evidence of a de-emphasis on traditional savings instruments like PPF and endowment insurance plans and a move towards the market-linked and flexible instruments for investment. While this reflects greater fiscal autonomy and rational financial investment behaviour among younger taxpayers, it also results in greater exposure to market volatility. At the Macroeconomic level, the New Tax Regime seems to encourage the economic circulation of income which is like the ideas of Artha and Varta in the Indian system of Knowledge which plays a crucial role in the flow and not stagnation of wealth. Nevertheless, only if voluntary savings and disciplined investment behavior replace earlier tax-based structures of saving will capital formation prove to be sustainable on a long-term basis. In conclusion, the New Tax Regime will support consumption-led growth and will easily eliminate the compliance process but the long-term impact on the savings culture of households and also on infrastructure financing need to be continuously monitored. A balanced policy approach that

pays for voluntary long-term savings without reinventing complex policies may be key to ensuring the economy grows as well as the economy is stable.

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