

Impact of New Regime on Middle Class Taxpayers in India: A Comparative Study with The Old

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Abstract

The implementation of India's new tax regime in 2020 was a significant shift in India's tax landscape, offering taxpayers lower rates of taxation at the expense of exemptions and deductions available under the previous regime. This study has contrasted both regimes to determine the implications of their effect on taxpayers belonging to the middle-income group, in this instance, those earning between ₹7 lakh and ₹15 lakh annually. With a quantitative design, the study computes tax paid at various income levels under the two regimes and with and without deductions to assess financial impacts. Impacts are that although the new regime is favourable to those with few deductions in terms of simplicity of computation and lower rate, those who in the past maximized exemption in the old regime—e.g., by availing PPF, ELSS, and HRA claims—must pay more tax. The study also looks at behavioural change in savings and investment habits, raising questions on the erosion of long-term financial planning incentives in the new regime. The study also examines compliance efficiency, which says that the simplified design of the new regime minimizes administrative costs but can deter disciplined saving. Segmenting taxpayers into groups which benefit more from each regime, the paper offers practical suggestions to taxpayers and policymakers. It ends with recommendations for reforms balancing simplicity with fair tax relief, without compromising the regime being progressive and middle-class focused. The research adds to the debate on India's tax policy and offers evidence-based advice for maximizing tax strategies and guiding future fiscal reform.

Introduction

Taxation is a potent tool of fiscal policy that immediately affects the economic conduct of citizens and the economy as a whole. In India, the taxation system has been extensively reformed over time to suit evolving economic conditions and provide ease of compliance. One of the most robust pieces of work over the past few years was bringing in the new tax regime during 2020, which tried to simplify the tax system by reducing tax rates but removing a large majority of the exemptions and deductions available under the previous tax regime. This move has precipitated uniform flak, largely from middle-class taxpayers, backbone of Indian economy and source of a large percentage of Indian tax revenues.

The middle class, commonly taken to mean the people earning ₹5 lakh to ₹15 lakh annually, have always made use of tax-saving instruments such as Public Provident Fund (PPF), Equity-Linked Savings Scheme (ELSS), life insurance premium under Section 80C, and House Rent Allowance (HRA) relief to reduce their taxable income. The earlier regime encouraged long-term saving and investing by providing for these deductions and thereby imposing financial discipline on the taxpayers. But the new regime, while simplifying tax calculations, deprives most of these benefits, raising concerns about its impact on disposable income, saving culture, and long-term financial health.

Literature review

Since the launch of the new tax regime in India in 2020, middle-class taxpayers have been compelled to rethink their tax planning. The new regime, which provides lower tax rates but eliminates several exemptions and deductions under the old regime,

has raised questions about how it would affect the financial well-being of middle-class taxpayers. This literature review considers the implications of this change from 2021 onwards, juxtaposing the new regime with the previous system and its impact on middle-class Indian taxpayers.

Basic Tax Structure: A Move Towards Simplicity

The biggest difference between the old and the new tax regimes is in the structure of taxes.

The previous regime permitted the taxpayers to deduct their taxable income by availing different exemptions like house rent allowance (HRA), standard deduction, and investments under sections 80C. The new tax regime lowers the tax rates for all income slabs but discontinues these exemptions. As per Ghosh (2021), middle-class taxpayers with income between ₹5 lakh and ₹15 lakh, who earlier availed these exemptions, now see their tax liabilities increase under the new regime.

Effect on Tax Burden

Middle-class citizens have hitherto depended on deductions to limit their taxable income and, therefore, their tax burden. Patel (2021) argues that, while the new tax regime's lower tax rates might benefit individuals without significant deductions, middle-class taxpayers who made use of tax-saving instruments like PPF, ELSS, and insurance premiums face a higher tax burden. This shift disproportionately affects taxpayers in the middle-income range, as they no longer benefit from the tax breaks they once received under the old regime.

Behavioural Shifts in Tax Planning

Tax planning activities have witnessed a significant change as a result of the new tax regime. Kumar (2021) finds that middle-class taxpayers, particularly those with dependents, have traditionally used exemptions to minimize tax payments. Under the new regime, several have chosen to dispense with complicated tax-saving tools in place of the simplicity provided by reduced tax rates. This change may, however, result in lowering overall savings and investments, having long-term budgetary implications on middle-class families.

Simplicity versus Complexity: Administrative Cost and Compliance

The simplicity is one of the strengths of the new tax code. The complex old system involving several exemptions and deductions meant taxpayers had to keep elaborate records and invest time sorting out their financial affairs. The new system, as per Sharma (2021), lessens compliance costs, primarily for salaried individuals who no longer have to concern themselves with keeping documents for different exemptions. The simplification of this is viewed as a welcome aspect, especially for taxpayers who feel that the earlier regime is cumbersome. At the same time, this simplification comes at the expense of giving up valuable tax-saving options.

Financial Planning and Savings Behaviour

The previous government was also responsible for motivating savings from the middle class, as taxpayers needed to invest in tax-saving instruments to minimize their tax liability. Verma and Singh (2021) indicate that the new tax regime might dissuade long-term planning, as it no longer encourages people to save. Specifically, middle-class people who were used to saving by way of tax-saving vehicles might lose the incentive to invest in these schemes, and hence financial security in

the future could be less.

Impact on Urban vs. Rural Middle Class

The effect of the new tax system differs widely between urban and rural middle-class taxpayers. Jain (2022) points out that urban taxpayers, being more likely to have access to instruments for maximizing exemptions, could be negatively impacted by the new regime. Rural taxpayers, lacking access to such instruments, could be advantaged by the ease of the new tax regime. Hence, the new regime is likely to benefit rural middle-class citizens, who typically do not participate in as much tax-deferral investments as urban residents.

Redistribution of Tax Liabilities

The new tax system has created some fear regarding redistribution of tax liability across income brackets. Chakrabarti and Sen (2022) contend that although the new regime offers lower tax rates for lower-income classes, it fails to address the tax burden of middle-class families, especially those with incomes ranging from ₹5 lakh to ₹15 lakh per annum. The previous regime, being progressive, provided greater tax relief to these middle-class families, whereas the new regime's flat-rate tax system yields a comparatively higher effective tax rate for this group.

Economic Impact: Consumption and Savings

The removal of exemptions in the new regime may have a wider economic effect, in consumption and savings. Rao (2021) states that middle-class households, which mostly utilized tax-saving vehicles to pay for healthcare, education, and house purchases, might now have fewer disposable incomes. This decrease in disposable income may reduce consumption in real estate and education sectors, in which the middle class has traditionally been a source of major demand.

Taxpayer Preferences: A Shift Towards Simplicity

Despite the possible detriments, most middle-class taxpayers have switched to the new tax regime because of its simplicity. Kaur (2021) adds that younger taxpayers, who are less inclined to take part in intricate tax-saving investments, tend to favour the simplicity of the new tax regime. For them, the lower rates are preferable to the complexity of availing exemptions under the old regime. Taxpayers with large investments or dependents might still find the old regime preferable since they can lower their taxable income through a variety of deductions.

Middle-Class Strain: Equity vs. Efficiency

The transition to the new tax regime has brought to the fore a trade-off between equity and efficiency. Sharma and Gupta (2021) contend that although the new system is intended to make taxation more efficient through streamlining the process and minimizing administrative costs, it might not be as fair for middle-class taxpayers, who have long enjoyed the progressive nature of the old tax regime. The elimination of deductions can be interpreted as disproportionately hurting middle-income earners who utilized those exemptions to balance their financial requirements.

Effect on Long-Term Wealth Generation

Withdrawal of tax-saving options under the new regime might impact the middle-class taxpayer's long-term capacity for

building wealth. Bhat (2021) highlights that tax-saving options like PPF and ELSS not only brought tax relief but also fostered disciplined long-term investment practices. Withdrawal of these incentives could lead to a decline in total savings and investments, thereby prejudicing the long-term financial welfare of middle-class families.

Compliance and Tax Evasion

The introduction of the new tax regime may also have an effect on tax compliance levels.

Patel (2022) indicates that elimination of exemptions and deductions can contribute to increased compliance levels, since taxpayers will have fewer avenues through which they can avoid paying taxes using sophisticated financial techniques. Yet, there is also a risk that taxpayers might feel less inclined to declare their entire income since they are no longer benefiting from exemptions.

International Comparisons and Perspectives

Comparisons of tax systems internationally offer useful lessons on the relative strengths of the new Indian system. Jha (2022) compares the Indian system to those in other nations like the US and the UK, noting that although India's new system streamlines the tax process, it may not be as progressive as other developed nations' tax systems. This is a cause for concern that middle-class Indian taxpayers might be subject to an unfair tax burden in relation to their peers in nations with stronger tax-saving mechanisms.

Political and Public Perception

The new taxation regime has elicited varied responses from the middle class. Bhattacharya (2020) observes that whereas some taxpayers are pleased with the simplification and the reduction in tax rates, others argue that the removal of exemptions unfairly burdens them. Whether the new regime is fair remains a topical issue in public debate, with the majority demanding a more balanced approach that preserves both simplicity and fair relief to the middle class.

Future Expectations and Reforms

In the future, experts foresee that tax reforms might be needed to correct the limitations of the new system. According to Saxena and Agarwal (2021), although the new regime provides simplicity and efficiency, it could be tweaked to ensure that middle-class taxpayers still enjoy adequate tax incentives for savings and investments. Reforms that balance simplicity and fairness will be pivotal to ensuring the middle class is well taken care of under India's tax code

In 2020, the rollout of a new tax system in India created a watershed change in the country's tax system that would considerably impact middle-class taxpayers. The new regime has lower tax rates for the various tax brackets, but it does not allow most exemptions and deductions that the previous system contained. Consequently, there has been a significant debate regarding the merits and effectiveness of the new regime. The previous tax system enabled middle-class taxpayers to substantially lower their taxable income through various exemptions and deductions like house rent allowance (HRA), standard deductions, and certain investments that are allowed deductions under sections such as 80C. These exemptions and deductions provided middle-class taxpayers with substantial financial relief during the most crucial tax brackets, specifically for individuals in the income range of ₹5 lakh-₹15 lakh. The new system does improve the simplicity of the tax structure with lower rates for each tax bracket, but taxpayers now do not receive the benefits of

exemptions and deductions.

Objectives of the Study

This research paper aims to analyse the impact of the new tax regime on middle-class taxpayers in India compared to the old tax regime. The key objectives of this study are:

1. To Compare Tax Liability Under Both Regimes
 - Assess the difference in tax liability for middle-class taxpayers under the old and new tax regimes across various income levels.
2. To Evaluate the Impact on Savings and Investments
 - Examine how the elimination of deductions in the new tax regime affects financial planning, investment behaviour, and long-term savings.
3. To Analyse the Simplicity and Compliance Benefits
 - Investigate whether the new tax regime has simplified tax filing and improved compliance among middle-class taxpayers.
4. To Identify Taxpayer Profiles Benefiting from Each Regime
 - Determine which groups of middle-class taxpayers (e.g., salaried, self-employed, young professionals, homeowners) benefit more from each regime.
5. To Provide Policy Recommendations
 - Suggest potential improvements to the new tax regime that could enhance its effectiveness and ensure a balance between tax savings and simplicity.

Research Methodology

1. Research Design

This study adopts a **comparative quantitative research design** to analyse the differences between the old and new tax regimes. The approach is **descriptive** in nature, aiming to provide insights into how each regime affects taxpayers in different income brackets.

2. Data Collection

a. Secondary Data Sources

The study relies on data from:

- **Government Reports:** Union Budget documents and Income Tax Department notifications.
- **Tax Laws & Regulations:** Official tax slabs and deductions available under both regimes.
- **Financial Publications:** Articles and analyses from reputed sources such as RBI reports and financial news portals.

3. Data Analysis Techniques

- **Comparative Tax Calculation:** Tax liabilities are computed for different income levels (₹7 lakh to ₹15 lakh) under both regimes.
- **Scenario Analysis:** Tax calculations include two cases—one where deductions are claimed under the old regime and one without deductions.
- **Visualization:** Bar charts are used to illustrate tax differences for better interpretation.

4. Sample Selection

The study focuses on **middle-class salaried individuals** earning between **₹7 lakh and ₹15 lakh annually**, as this group is most affected by the choice between regimes.

Comparative Tax Analysis: Old vs. New Regime

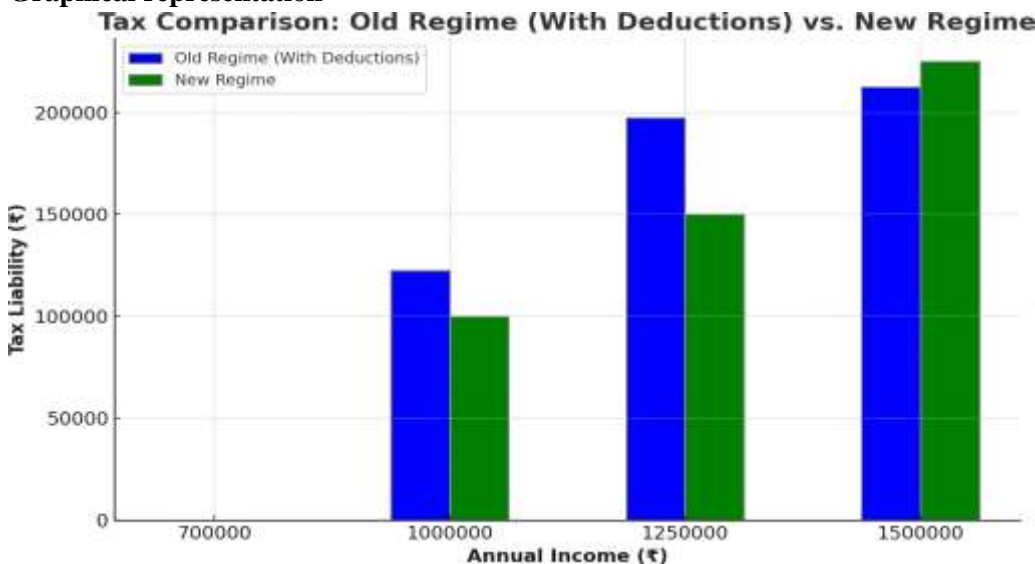
Key Differences Between the Old and New Tax Regimes

- **Old Regime:** Allows deductions under 80C (PPF, ELSS, LIC), 80D (health insurance), and HRA, which can significantly reduce taxable income.
- **New Regime:** Offers lower tax rates but eliminates most deductions. However, a ₹50,000 standard deduction was introduced in 2023.

Tax Comparison Based on Different Income Levels

Annual Income (₹)	Old Regime (With ₹2.5L Deductions)	Old Regime (Without Deductions)	New Regime
7,00,000	₹0 (rebate applied)	₹ 1,07,500	₹0 (rebate applied)
10,00,000	₹ 1,22,500	₹ 1,97,500	₹ 1,00,000
12,50,000	₹ 1,97,500	₹ 2,12,500	₹ 1,50,000
15,00,000	₹ 2,12,500	₹ 2,12,500	₹ 2,25,000

Graphical representation



Result

- **Income up to ₹7 lakh:** No tax under both regimes due to rebates.
- **₹7 lakh to ₹10 lakh:** The new regime is better if deductions are minimal; otherwise, the old regime with exemptions provides greater tax savings.
- **Above ₹12.5 lakh:** The old regime is beneficial for those utilizing deductions, while the new regime suits those preferring a simplified structure.

Conclusion The introduction of the new tax regime in 2020 marked a pivotal reform in India's taxation framework, aiming to simplify the system through reduced tax rates while eliminating a broad range of exemptions and deductions. This study has thoroughly analysed the comparative implications of both regimes on middle-class taxpayers earning between ₹7 lakh and ₹15 lakh annually, using a quantitative approach to compute tax liabilities under different scenarios. The findings reveal that the new tax regime offers significant benefits for individuals who do not extensively invest in tax-saving instruments. Its simplicity, ease of compliance, and lower tax rates appeal especially to younger professionals or those with fewer financial commitments. However, for middle-income earners who have traditionally relied on deductions under Sections 80C, 80D, and HRA to optimize their tax planning, the old regime continues to offer greater tax savings, particularly at higher income levels.

Moreover, the study highlights broader behavioural and economic implications. The removal of incentives for savings and long-term investments under the new regime may lead to a decline in disciplined financial planning, potentially affecting the financial security of middle-class households. While the new regime enhances administrative efficiency, it also raises concerns about equity and the potential erosion of a culture of saving and wealth creation.

In conclusion, while the new tax regime succeeds in offering a streamlined and taxpayer-friendly structure, it does so at the cost of long-term financial incentives. Policymakers must consider refining the regime to strike a balance between simplicity, fairness, and fiscal responsibility. Enhancing flexibility—such as allowing selective deductions within the new regime—could ensure that it remains progressive and continues to support the financial well-being of India's middle class. This study ultimately provides evidence-based insights to guide taxpayers in optimizing their tax strategies and contributes to ongoing discourse on future tax reforms in India.

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