Impact of Recent Income Tax Reforms on Indian Taxpayers Analysis of changes in tax slabs, deductions, and exemptions in recent budgets.

Dr. Kiran Kumar M[1], Nikhil Jha[2], Sujan Sai S[3], V Smilee[4]

Assistant Professor-Finance[1], MBA Finance Students[2,3,4]

Faculty of Management Studies, CMS Business School, JAIN (Deemed to be University), Bengaluru, Karnataka, India

Kiranm287@gmail.com, Nikhil_jha24@cms.ac.in, sujan_sais24@cms.ac.in, V_smilee24@cms.ac.in

Abstract

Direct taxes play a key role in the economy. They influence money choices for individuals and the entire country. This study takes a closer look at how direct taxes are set up, how well they work, and what kind of impact they have. We can make direct tax policies better. Let's look at our tax systems, check out new laws, and learn from other countries' successes. The goal is to get more people to pay their taxes fairly, and to keep the economy sustainable. We use different methods to do this, like looking at data and checking how well policies work. The study highlights major issues. People often avoid taxes. The tax system is slow and inefficient. Also, online businesses create tricky situations. What we learned shows that we need tax policies that can change with the times. They need to bring in money for the government but also give people reasons to work and invest. This approach helps the government stay financially healthy and treat taxpayers fairly. This study adds to the conversation about how to make tax policies better. It helps lawmakers, economists, and financial experts improve direct tax systems.

Key words: Tax Compliance ,Behavioral Economics ,Effective Tax Rate ,Regime Switching ,Deduction Optimization ,Progressive Taxation,Fiscal Sustainability,Informal Sector

Introduction

India's income tax reforms (2020–2024) are a paradigm shift towards simplification, but their behavioural and distributive implications are contentious. In this analysis, we analyse the trade-offs between the pre-reform regime (simple but deduction-rich) and the reform regime (simplified but exemption-poor), noting the selective impact of the policies on taxpayers by income segments, changing fiscal behaviours, and reconfiguring compliance categories. Riding the twin strengths of granular tax data and first-hand surveys, we address five foundational goals to facilitate fair policymaking.

Policy Context

The optional new regime (2020) and default (2023) were intended to lower compliance costs by lowering rates (5–30%) and removing 70+ exemptions (e.g., HRA, Section 80C). Early evidence has mixed trends:

•Revenue gains: Personal income tax collections increased to ₹9.1 lakh crore (FY23), but 57% of filers chose the new regime even if there were possible savings in the old regime (CBDT, 2024).

• Behavioural changes: 22% drop in ELSS inflows (AMFI, 2023) and 15% drop in health insurance penetration (IRDAI, 2023) indicate erosion of long-term savings incentives.

Literature Review

1. **Optimal Taxation Theory (Mirrlees, 1971)**:This foundational theory argues that tax systems must balance equity (progressive taxation) and efficiency (minimizing economic distortions).Saez (2001) later refined this, showing that simplified regimes reduce compliance costs but may inadvertently favor higher-income groups due to flatter tax slabs, a concern evident in India's new tax regime.India's reform reflects this tension: while it eases filing burdens, critics argue it reduces progressivity, particularly for middle-income taxpayers.

2. **Behavioural Economics & Default Effects (Thaler & Sunstein, 2008)**:The nudge theory explains why India's 2023 default switch to the new regime led to rapid adoption—people tend to stick with pre-selected options.However, Chetty et al. (2014) caution that defaults don't always align with optimal financial decisions; taxpayers may sacrifice long-term savings (e.g., ELSS) for short-term simplicity.This behavioural inertia suggests that policy design must carefully weigh convenience against fiscal prudence.

3. **Fiscal Contract Theory (Moore, 2004) & Trust in Taxation**:This theory posits that **tax** compliance depends on citizens' trust in government fairness.RBI (2023) data shows a rise in small cash transactions (₹<50k), which could indicate growing tax evasion or eroding confidence in the reformed system.If taxpayers perceive the new regime as less equitable, informal transactions may rise, undermining compliance.

4. **Global Flat Tax Experiments (IMF, 2019)**:Countries like Estonia and Slovakia adopted flat taxes, boosting compliance but worsening income inequality.India's quasi-flat structure (lower slabs but no true flat rate) faces similar risks—while it simplifies filing, middle-class taxpayers (₹10–15L) may face higher effective rates.This highlights the trade-off between simplicity and redistribution.

5. **U.S. Tax Cuts & Jobs Act (TCJA, 2017) – Lessons for India**:The TCJA curbed itemized deductions, leading to a 60% drop in itemizers (CBO, 2019)—similar to India's decline in ELSS investments.This suggests that reducing deductions shifts taxpayer behavior but doesn't always enhance savings.India's new regime, which removes most deductions, may see a similar decline in tax-advantaged investments.

6. **Pre-2020 Indian Tax System (Gupta, 2020)**:The old regime disproportionately benefited high earners (₹15L+), who optimized deductions (80C, HRA, etc.).Only 12% of taxpayers fully utilized these benefits, leaving middle- and lower-income groups with fewer advantages.The new regime attempts to democratize tax benefits but may inadvertently increase the burden on middle-class earners.

7. **Post-Reform Data (CBDT, 2023 & Jain, 2024)**:57% of taxpayers adopted the new regime, indicating strong initial uptake due to simplicity.However, Jain's (2024) microsimulations reveal that middle-class taxpayers (₹10–15L) saw an 11–14% rise in tax liability—suggesting the reform may be regressive for this group.This raises concerns about whether the new regime truly benefits all income brackets equally.

8. **Investment Behaviour Shifts (Patel & Sharma, 2022)**:The 26.9% decline in ELSS investments post-reform aligns with behavioural loss aversion—taxpayers prefer immediate tax savings (via lower slabs) over long-term gains (via deductions).This trend could weaken India's equity culture, as fewer taxpayers invest in market-linked instruments.Policy interventions may be needed to rebalance incentives for savings.

9. **Sweden's "2+1" Model (OECD, 2021) –** A Hybrid SolutionSweden's system combines two primary deductions + a basic relief, maintaining simplicity while preserving savings incentives.This could be a model for India—e.g., allowing 2 key deductions (e.g., 80C + NPS) alongside the new regime's slabs.A hybrid approach might better balance ease of compliance and long-term financial security.

10. **Simplicity vs. Equity Debate (Choudhary, 2022 vs. NITI Aayog, 2023)**:Proponents argue the new regime boosts compliance by reducing complexity.Critics, however, highlight declining financial inclusion, as

fewer taxpayers engage with formal savings instruments.The challenge is designing a system that is both simple and progressive.

11. **Gender-Based Tax Preferences (Kaur et al., 2024)**:Women are 23% more likely to prefer the old regime, likely due to greater reliance on deductions (e.g., health insurance, home loans).This suggests that one-size-fits-all tax policies may not account for demographic differences.Customized tax nudges (e.g., gender-sensitive defaults) could improve outcomes.

Research Methodology

1. Research Design

This research applies a sequential explanatory mixed-methods design in three stages:

• Phase 1 (Quantitative): Analysis of tax incidence and behaviour trend based on government statistics.

• Phase 2 (Qualitative): Survey to reveal decision drivers.

• Phase 3 (Synthesis): Policy simulation to assess reform options.

2. Study of Objectives

1. To Examine the variation in the incidence of taxation between the new and old regimes over different income classes (e.g., ₹5L, ₹10L, ₹20L annual income).

2. To Assess how taxpayers were able to alter their investment patterns (e.g., decline in ELSS, health insurance) and compliance behaviour post-reforms.

3. To Decompose taxpayers' share choosing the new regime (2020–2024) and study trends by taxpayer type (salaried vs. businessmen).

4. To Investigate whether the reforms favour particular income groups or raise tax burdens on middle-class households.

5. To Suggest reforms to balance ease (new regime) and saving incentives (e.g., reinstating limited deductions).

3. Data Collection

A. Primary Data

Instrument	Sample	Variables Measured	Objective Addressed
Stratified Survey	30 taxpayers (₹5L–₹20L income)	Regime choice rationale, investment shifts	2, 3, 4

Sampling Framework:

- **Income Groups**: 30 respondents from different income groups of ₹5–10L, ₹10–15L, ₹15–20L.
- **Occupation Mix**: 30% salaried, 10% business owners, 13.3% freelancers.

B. Secondary Data

Source	Dataset	Usage
Income Tax Department	AY 2020–24 taxpayer filings	Tax burden comparison (Obj. 1)

AMFI	ELSS inflow reports (2019–24)	Investment behaviour analysis (Obj. 2)
RBI Bulletins	Banking transaction data	Compliance trends (Obj. 4)

4. Analytical Procedures

A. Tax Incidence Analysis (Obj. 1)

•Estimate effective tax rates over income groups (₹5L, ₹10L, ₹20L) under both regimes.

•Adjust for deductions (HRA, 80C) under old regime using CBDT's reported claim averages.

B. Behavioural Shift Evaluation (Obj. 2)

•Compare pre-reform (2019) and post-reform (2024) investment splitting (ELSS, FDs, insurance).

•Control for macroeconomic factors (GDP growth, interest rates).

C. Adoption Trend Decomposition (Obj. 3)

•Estimate multinomial logit models to determine:

•demographic predictors (age, profession) of regime choice.

•Income cliffs threshold effects (e.g., ₹15L surcharge).

D. Equity Assessment (Obj. 4)

•Estimate post-tax Gini coefficients for all regimes based on taxpayer income distributions.

•Test statistically significant differences using bootstrapping.

5. Validation & Limitations

Robustness Checks:

•Sensitivity analysis: Vary deduction assumptions (±15%) in tax models.

•Endogeneity control: Instrumental variable regression for regime selection bias.

Limitations:

•Temporal lag: FY 2023–24 data may be incomplete.

•Urban bias: Survey samples may underrepresent rural taxpayers.

6. Ethical Considerations

•Anonymity: No personally identifiable data collected.

•Informed consent: Digital consent forms for interview participants.

•Data security: Encrypted storage with restricted access.

Research Gap

Prior studies have focused on **revenue impacts** (Choudhary et al., 2022) or **macroeconomic effects** (RBI, 2023), but few examine:

- **Behavioral responses** (e.g., how taxpayers actually choose between regimes).

- **Psychological factors** (stress, trust in the system).
- **Distributional equity** across income groups.

Data Analysis and Interpretation

Dataset 1: Tax Regime Adoption by Income Group (2020–2024)

(Source: Income Tax Dept. Annual Reports)

Year	Income Bracket (₹)	Old Regime Taxpayers (Lakhs)	New Regime Taxpayers (Lakhs)	Adoption Rate (%)
2020–21	5–10 L	48.2	12.7	20.9%
2021–22	5–10 L	45.1	18.3	28.9%
2022–23	5–10 L	39.8	32.6	45.0%
2023–24	5–10 L	35.4	42.9	54.8%

Interpretation: The adoption of the new tax regime surged 2.6 times between 2020–24, with the 2023 policy change (making it the default option) driving a significant 9.8 percentage point increase in uptake. As a result, the new regime surpassed the old regime in popularity during 2023–24, marking a clear shift in taxpayer preference.

Regression analysis(Old tax and New tax Regime)

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.992041
R Square	0.984145
Adjusted R Square	0.976218
Standard Error	0.023641
Observations	4

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	0.069384	0.069384	124.1442	0.007959
Residual	2	0.001118	0.000559		
Total	3	0.070502			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.0795	0.028954	2.745709	0.110993	-0.04508	0.20408	-0.04508	0.20408
X Variable 1	0.1178	0.010573	11.142	0.007959	0.07231	0.16329	0.07231	0.16329

Key Findings:

Strong Model Fit

$R^2 = 0.984$ → Model accounts for 98.4% of the variance in adoption rates

Adj. $R^2 = 0.976$ → Still very good after adjustment

Yearly Growth

Coefficient (X1) = 0.1178 (p=0.008)

There is an 11.78 percentage-point increase in new regime adoption per year

Baseline Adoption

Intercept = 0.0795 (7.95%) → Theoretical baseline adoption (p=0.111, NS)

In Plain Terms

"New regime adoption rose consistently by ~11.8% per year, with essentially perfect fit to the data. The 2023 default shift presumably sped this along."

Dataset 2: Investment Trends Post-Reform

(Sources: AMFI, IRDAI, RBI*)*

	ELSS Inflows (₹ Cr)	**Health Insurance Premiums (₹ Cr)**	**FD Investments (₹ Lakh Cr)**
2019–20	24,500	58,300	15.2
2020–21	22,100	54,800	16.8
2022–23	19,200	49,500	19.4
2023–24	17,900	47,200	21.7

Interpretation:

Descriptive Analysis (Trends Over Time)

ELSS Inflows: Decreased from ₹24,500 Cr (2019–20) to ₹17,900 Cr (2023–24), by 26.9%. Health Premiums Insurance: Reduced from ₹58,300 Cr to ₹47,200 Cr, down by 19.0%. FD Investments: Increased from ₹15.2 Lakh Cr to ₹21.7 Lakh Cr, i.e., by 42.8%.

Dataset 3: Tax Liability Comparison

(Calculated using IT Dept. slabs + standard deduction)

Income (₹)	Old Regime Tax (₹) with 80C Deduction	New Regime Tax (₹)	Savings (New Regime) (₹)
7,50,000	23,400	19,500	3,900
12,00,000	1,17,000	71,500	45,500
20,00,000	3,66,600	2,78,200	88,400

Interpretation:

The new tax regime provides substantive relief on incomes of ₹7.5 lakhs and more because of reduced tax slabs (5% up to ₹7 lakhs and 10% up to ₹10 lakhs) and increased standard deduction (₹75,000 compared to ₹50,000 in the old regime), with ₹7.5 lakh earners saving ₹3,900 (16.7% less tax), ₹12 lakh earners saving ₹45,500 (38.9% less tax), and ₹20 lakh earners saving ₹88,400 (24.1% less tax)—dominating the relief of deductions like 80C under the old regime.

Dataset 4: Compliance Metrics

(Sources: RBI, IT Dept. Enforcement Reports)

	e-Filings (Cr)	Cash Deposits <₹50k (₹ Lakh Cr)	Search & Seizures (Cases)
2020–21	6.8	8.1	2,342
2023–24	7.9	9.7	3,115

Interpretation:

The trends indicate improved tax compliance and digitalization, where no-filings were up 16.2% (6.8Cr to 7.9Cr). Cash transactions of less than ₹2L rose by 19.8% (₹8.1L Cr to ₹9.7L Cr), which might require watching out for threats of tax evasion. Search and seizures rose by 33% (2,342 to 3,115), reflecting strict enforcement, possibly due to scrutiny of cash deposits.

Primary data analysis

What are the respondents' age groups, occupational categories, income brackets, and tax regime preferences?"

Category	Count	Percentage
Age Group		
Under 25	13	43.33%
25-35	10	33.33%
36-45	4	13.33%
46+	3	10%
Occupational Category		
Salaried Employee	9	30%
Other	9	30%
Homemaker	5	16.66%
Freelancer	4	13.33%

Business owner	3	10%
Income Bracket (₹)		
Below 5 lakh	9	30%
5–10 lakh	9	30%
10–15 lakh	5	16.66%
Above 15 lakh	7	23.33%
Tax Regime		
New Regime	20	66.7%
Old Regime	6	20%
Didn't file	4	13.3%

Interpretation: There was a clear age skew in the survey, 76.66% of whom were under 35 (43.33% under 25 years), more digitally savvy and tax-compliant from lower age ranges. Income ranging was bimodal clustering - 30% tax-free (<₹5L), 30% middle-income "swing group" (₹5-10L), and an over-represented high-income group (23.33% over ₹15L vs national 8%). The new regime swept (66.7% take-up), demonstrating Thaler & Sunstein's "default effect," while the 20% retaining the old regime were mostly high-income earners maximizing deductions (80C/80D) or home loan/insurance owners. Middle-income segments (₹5-10L) were victims of "simplicity bias," opting to select less-than-best regimes even when savings could be made available (₹14,400-25,600). Key limitations are sampling bias (excessively high proportion of high earners) and lack of observations from the ₹15-20L surcharge band. These conclusions imply: (1) targeted finance education to middle-income segments, (2) hybrid regime models with compromises on simplicity/cuts, and (3) responsive policy realignments to high earners' tax avoidance strategies.

Findings

The research identifies a 66.7% take-up rate of India's New Tax Regime by taxpayers in 2023–24, stimulated by its streamlined design and default registration—a 2.6× increase from 2020. But this change benefited only so much behavioural change: a 26.9% drop in ELSS investments and a 19% reduction in health insurance premiums, as taxpayers found immediate tax benefits more appealing than long-term benefits, and a 42.8% surge in FD investments. While the New Regime minimized tax outgo (e.g., ₹45,500 savings for ₹12L earners), middle-class taxpayers (₹10–15L) saw an 11–14% increase in effective tax outgo because of foregone deductions (HRA, 80C), providing a balance between convenience and financial security. Compliance patterns revealed a 16% increase in e-filings, but cash transactions (<₹50k) increased by 19.8%, leading to a 33% increase in enforcement actions. Demographic heterogeneity arose, with 76.6% of taxpayers below the age of 35 supporting the New Regime (simplicity bias), whereas older and high-income taxpayers (>₹15L) largely stuck to the Old Regime for deductions. Women were 23% more likely to support the Old Regime, possibly because they were more dependent on savings-linked benefits. The facts reveal telling gaps: (1) middle-class payers are disproportionately pinched by deduction losses, (2) default enrolment has the potential for suboptimal financial decisions, and (3) ongoing cash usage represents evasion threats in spite of digital innovation. Policy responses include hybrid solutions (e.g., partial deductions with reduced rates), focused literacy initiatives for middle-income households, and stepped-up cash transaction monitoring in an effort to achieve simplicity, equity, and compliance.

Conclusion and recommendations

To strike a balance between simplicity and equity, India must introduce a hybrid "2+1" strategy (e.g., retaining 80C and 80D allowances with lower rates) to reinstate incentives to save without increasing compliance complexity. Personalized financial education to middle-income taxpayers (₹5–15L) and pre-filled regime proposals by AI can enhance choices. To

prevent evasion, lower the limit for depositing cash to ₹20k and trace transactions with Aadhaar for transparency. Equity-based reforms can limit New Regime relief to the high net worth (>₹15L) and re-introduce middle-class deductible moderation (partial HRA, for instance). Smart defaults as nudges in behavioural economics, along with additional rebates to ELSS/insurance in the New Regime, could encourage taxpayer behaviour towards long-term financial security.

References

1. **Government Reports & Official Data**

- Central Board of Direct Taxes (CBDT). (2023). *Income tax filing statistics* (AY 2020–24). Government of India.
- Reserve Bank of India (RBI). (2023). Banking transaction and cash deposit reports.
- Income Tax Department. (2024). Annual enforcement and compliance reports.

2. **Academic & Theoretical Foundations**

- Mirrlees, J. (1971). An exploration in the theory of optimum income taxation. Review of Economic Studies, *38*(2), 175–208.
- Saez, E. (2001). Using elasticities to derive optimal income tax rates. Review of Economic Studies, *68*(1), 205–229.
- Thaler, R. H., & Sunstein, C. R. (2008). Nudge: Improving decisions about health, wealth, and happiness. Yale University Press.

3. **Empirical Studies & Global Comparisons**

- Chetty, R., Friedman, J. N., Leth-Petersen, S., Nielsen, T. H., & Olsen, T. (2014). Active vs. passive decisions and crowd-out in retirement savings accounts: Evidence from Denmark. Quarterly Journal of Economics, 129(3), 1141–1219.
- International Monetary Fund (IMF). (2019). Flat tax reforms in Eastern Europe: Compliance gains and inequality impacts.
- Organisation for Economic Co-operation and Development (OECD). (2021). Hybrid tax regimes: Balancing simplicity and savings incentives.

4. **Indian Context & Recent Studies**

- Gupta, A. (2020). Deduction disparities in India's pre-2020 tax regime. Indian Journal of Public Economics, 12(3), 45–67.
- Jain, R. (2024). Microsimulations of India's new tax regime: Middle-class burdens. NIPFP Working Paper No. 2024-01.
- Kaur, P., et al. (2024). Gender gaps in tax regime preferences: Evidence from India. Economic & Political Weekly, 59(15), 78–84.

5. **Industry Reports**

- Association of Mutual Funds in India (AMFI). (2023). ELSS inflow trends (2019–24).
- Insurance Regulatory and Development Authority of India (IRDAI). (2023). Health insurance penetration post-tax reforms.