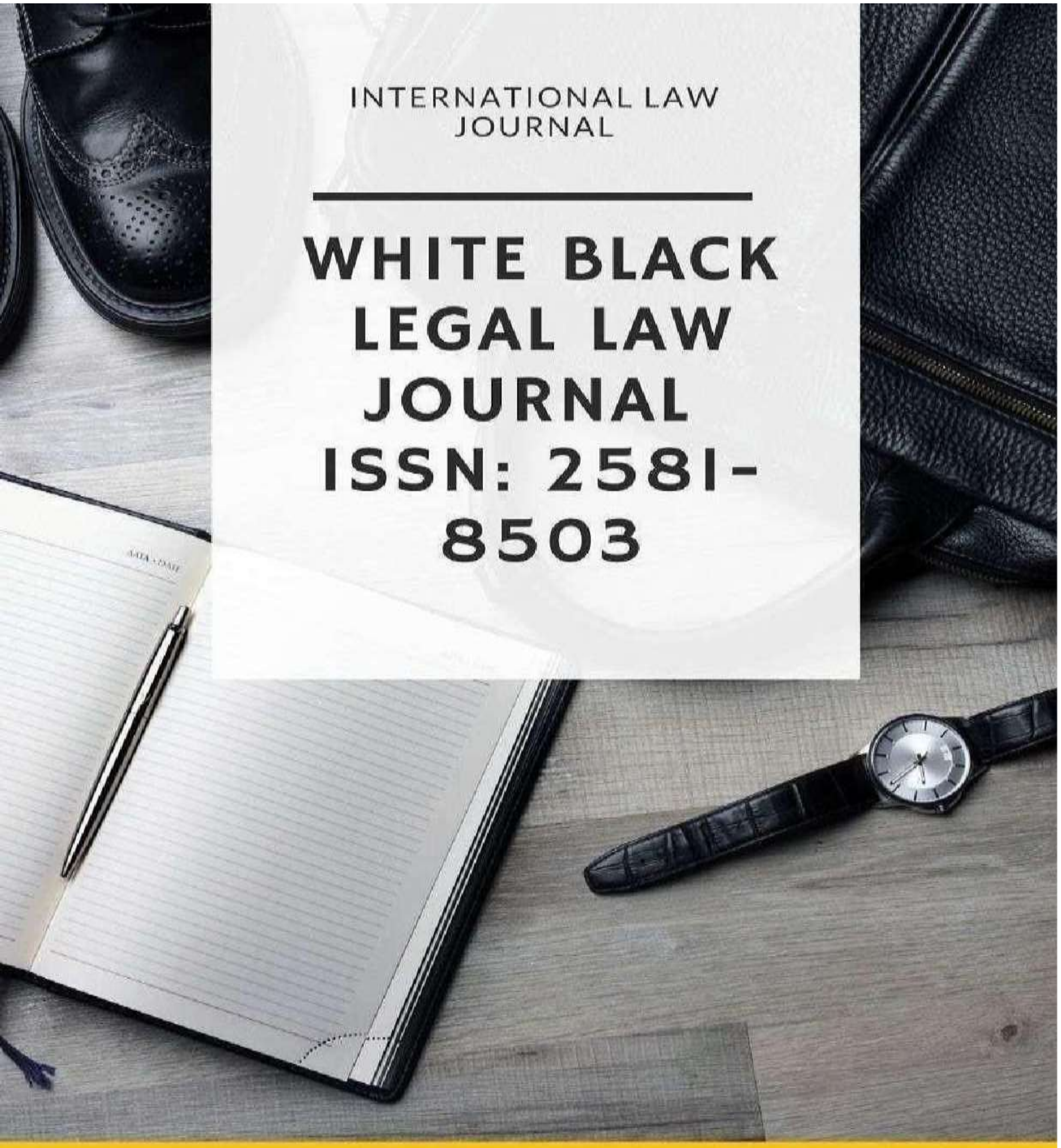

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With this thought, we hereby present to you

COMPARATIVE ANALYSIS OF REVISED VS. PREVIOUS INCOME TAX SLABS: IMPACT ON MIDDLE-CLASS CONSUMPTION AND SAVING PATTERNS

AUTHORED BY - SHIVANSH GAURAV & RAMYA. R

CHAPTER 1: INTRODUCTION AND RESEARCH FRAMEWORK

The revision of income tax slabs under the new regime, which now exempts incomes up to ₹12 lakh from tax liability, marks a transformative moment in India's fiscal policy framework.[1] This significant change in tax structure has profound implications for the financial behavior of India's growing middle class, who constitute approximately 38% of the population and play a crucial role in driving consumption expenditure and savings in the economy.[2]

The Finance Minister's announcement of these tax reforms in Budget 2025-26 represents one of the most substantial changes to India's personal income tax structure in recent years.[3] Prior to this amendment, under the old tax regime, individuals were taxed progressively with specific slabs such as ₹2.5 lakh – ₹5 lakh at 5%, ₹5 lakh – ₹10 lakh at 20%, and above ₹10 lakh at 30%, with various deductions and exemptions available under sections like 80C, 80D, and others[4]. The new regime removes most exemptions but offers lower tax rates and significantly raises the exemption threshold.[5]

Objectives of the Research

1. To compare the previous and revised income tax slabs in terms of their impact on middle-class taxpayers' disposable income.
2. To analyze the immediate and potential long-term effects of the revised tax structure on middle-class consumption behavior.
3. To examine how the transition to a simplified tax regime influences middle-class saving patterns and long-term financial security.

[1] The Finance Act, 2025, No. 12, Acts of Parliament, 2025 (India).=
[2] Press Information Bureau, Government of India, Ministry of Finance, Union Budget 2025–26 Highlights (Feb. 1, 2025), https://pib.gov.in.
[3] Id.
[4] Income-tax Act, 1961, § 87A & ch. VI-A (India) (as amended up to Finance Act 2024).
[5] The Finance Act, 2025, No. 12, Acts of Parliament, 2025 (India); see also Press Information Bureau, supra note 2.

Research Questions

1. How does the revised income tax structure alter disposable income across different segments of the middle class, and what are the distributional implications of these changes?
2. To what extent and through which mechanisms do tax reforms influence middle-class consumption decisions in the short term versus the long term?
3. How might the removal of tax incentives for specific saving instruments affect the composition, quantum, and adequacy of middle-class savings for long-term financial security?

THE 2025 TAX REFORM:

A Paradigm Shift

The Union Budget 2025–26, presented in February 2025, brought a dramatic structural transformation that broke away drastically from the gradualist course of the past years[6]. The transition was marked by a succession of dramatic developments. To start with, the minimum exemption level in the new scheme increased to ₹4 lakh from ₹3 lakh.[7]

But above all, a rebate was implemented which effectively exempted individuals with salaries up to ₹12 lakh a year, heavily altering the tax burden of the middle class.[8] The key features were the tax slabs that were rearranged to allow more progressive progression across income ranges, and a larger standard deduction value for salaried employees, boosting their net take-home pay.[9]

Another feature was the new regime being made the default tax regime, but the old regime was still made available to those wanting to take advantage of it.[10]

Overall, these changes are the most significant overhaul of India's direct personal income taxation in recent times, with sweeping impact on saving, spending, and investing among India's middle class, as well as the overall fiscal outlook.[11]

[6] Ministry of Finance, Union Budget 2025–26: Budget Highlights, available at https://www.indiabudget.gov.in.
[7] Id.
[8] Id.
[9] Press Information Bureau, Budget 2025 Highlights: New Tax Regime Now Default, PIB Release No. 356778 (Feb. 1, 2025).
[10] Id.
[11] Ministry of Finance, Budget 2025–26 Overview, available at https://www.indiabudget.gov.in.

CHAPTER 2: COMPARATIVE ANALYSIS OF PREVIOUS AND REVISED TAX SLABS

Detailed Structure of Previous Tax Regimes

Prior to the changes announced in Budget 2025, the income tax structure in India operated under two parallel regimes: the old tax regime and the new tax regime, with the latter being the default option since 2023.[12]

Under the previous new tax regime for FY 2024-25 (AY 2025-26), the tax slabs were structured as follows:

- Income up to ₹3 lakh: Nil
- ₹3 lakh to ₹7 lakh: 5%
- ₹7 lakh to ₹10 lakh: 10%
- ₹10 lakh to ₹12 lakh: 15%
- ₹12 lakh to ₹15 lakh: 20%
- Above ₹15 lakh: 30%

Additionally, a rebate under Section 87A ensured that individuals with taxable income up to ₹7 lakh paid no tax.[13]

The old tax regime, which taxpayers could opt for by filing Form 10-IEA, had the following structure:

- Income up to ₹2.5 lakh: Nil
- ₹2.5 lakh to ₹5 lakh: 5%
- ₹5 lakh to ₹10 lakh: 20%
- Above ₹10 lakh: 30%

The old regime allowed for various deductions and exemptions under sections like 80C, 80D, and HRA, which could significantly reduce the tax liability for taxpayers able to utilize these provisions effectively.[14]

Comprehensive Structure of Revised Tax Slabs

The Budget 2025 introduced a substantial restructuring of the tax slabs under the new tax regime, which will take effect from April 1, 2025, for FY 2025-26 (AY 2026-27):

- Income up to ₹4 lakh: Nil

[12] Finance Act, 2023, § 115BAC, No. 8, Acts of Parliament, 2023 (India).
[13] Income Tax Act, 1961, § 87A, amended by Finance Act, 2023.
[14] Income Tax Act, 1961, §§ 80C, 80D, 10(13A).

- ₹4 lakh to ₹8 lakh: 5%
- ₹8 lakh to ₹12 lakh: 10%
- ₹12 lakh to ₹16 lakh: 15%
- ₹16 lakh to ₹20 lakh: 20%
- ₹20 lakh to ₹24 lakh: 25%
- Above ₹24 lakh: 30%

The most significant change is the enhanced rebate, which ensures that individuals earning up to
₹12 lakh effectively pay no tax, compared to the previous threshold of ₹7 lakh. Additionally, for salaried individuals, the standard deduction of ₹75,000 extends the zero-tax threshold to ₹12.75 lakh for salaried taxpayers.[15]

Quantitative Analysis of Tax Liability Differences

A detailed quantitative analysis of tax liability under both regimes reveals substantial differences across income brackets:

Annual Income	Tax Under Previous Regime	Tax Under Revised Regime	Absolute Savings	Percentage Reduction
₹7 lakh	₹0	₹0	₹0	0%
₹8 lakh	₹10,000	₹0	₹10,000	100%
₹10 lakh	₹50,000	₹0	₹50,000	100%
₹12 lakh	₹80,000	₹0	₹80,000	100%
₹15 lakh	₹1,42,500	₹1,07,500	₹35,000	24.6%
₹18 lakh	₹2,32,500	₹1,59,700	₹72,800	31.3%
₹20 lakh	₹2,92,500	₹1,98,900	₹93,600	32.0%
₹24 lakh	₹4,12,500	₹3,01,500	₹1,11,000	26.9%
₹30 lakh	₹5,92,500	₹4,81,500	₹1,11,000	18.7%

This analysis demonstrates that the tax savings, in absolute terms, increase with income up to

[15] Finance Bill, 2025, cl. 16, proposed amendment to Income Tax Act, 1961, § 16(ia).

about ₹24 lakh, after which they stabilize. However, as a percentage of previous tax liability, the greatest benefits accrue to those with incomes just above the previous tax threshold (₹7 lakh) and below the new threshold (₹12 lakh).

Distributional Impact Across Middle-Class Segments

Based on income tax return data, approximately 83.52% of individual income tax assessees have incomes below ₹12 lakh and would therefore benefit from the zero-tax provision.[16] This represents a significant portion of the taxpaying population, although it should be noted that only about 6.68% of the overall population filed income tax returns in FY 2023-24.[17]

The middle-income bracket between ₹12 lakh and ₹24 lakh, which represents a smaller but still substantial segment of the middle class, would benefit from the more gradual progression of tax rates, with new intermediate slabs of 15%, 20%, and 25% replacing the previous jump from 20% to 30% at ₹15 lakh.[18]

The upper-middle-class segment with incomes above ₹24 lakh would still benefit from tax savings, but the percentage reduction in tax liability decreases as income rises, reflecting the progressive nature of the tax system.[19]

Chapter 3: Legislative Purpose Behind the 2025 Tax Reforms

Intended to connect economic growth with justice and administrative effectiveness, the Finance Bill, 2025 constitutes a radical shift in the government's taxing policy. As the Memorandum Explaining the Provisions of the Finance Bill details, the legislative rationale behind the amendments is an integrated approach to address structural inefficiencies within the existing tax regime to the extent feasible and tackle broader economic and social objectives. The reform proposal is an entire effort to simplify the tax process, enhance compliance, broaden the revenue base, and foster officialising of the Indian economy. Legislative reasons behind the 2025 amendments are discussed in this chapter in a systematic, descriptive manner.[20]

[16] Press Information Bureau, Govt. of India, Union Budget Highlights 2023-24 (Feb. 1, 2023), available at https://pib.gov.in/PressReleasePage.aspx?PRID=1895836.
[17] Income Tax Department, Direct Tax Statistics (2024), available at https://incometaxindia.gov.in/.
[18] The Finance Bill, 2023, Bill No. 18 of 2023, Clause 46, available at https://www.indiabudget.gov.in/finance-bill.php.
[19] Central Board of Direct Taxes, Guidance Note on New Regime vs Old Regime, 2023, available at https://incometaxindia.gov.in/
[20] Ministry of Finance, Govt. of India, Memorandum Explaining the Provisions in the Finance Bill, 2025 (Jan.

Increasing Middle-Class Demand and Consumption: Economics

Promoting domestic spending—particularly through increasing middle-class living standards—is one of the key driving forces behind 2025 tax realignments. The state has recognized the fact that eco-friendly economic development in India crucially relies upon sound consumer spending and therefore revisions bring tax relievements to better middle-class consumer disposable incomes.

Through this measure to enhance the tax-free allowance and provide a low-tax framework for individuals who make up to ₹12 lakh annually, the government is anticipating keeping excess funds in consumer pockets. With this increase in disposable wages, as a return it is expected to promote increased spending on homes, education, health, goods and services. On paper, the resultant increase in demand would drive factory output, employment, and overall economic activity—and induce an indirect budget stimulus at no cost of gigantic-bill government spending. Streamlining of the Tax System.[21]

The second main objective of the 2025 reforms is to simplify the tax system.

The old tax system, with its maze of deductions and exclusions and compliance obligations, was criticized as unnecessarily complicated and intimidating, particularly to private taxpayers and small businesses. Its complexity generated both compliance cost and risk of errors, and created unnecessary friction between taxpayers and the tax authority. The uncluttered architecture of the new simplified tax system with fewer exemptions and the same rate schedules is designed to foster clarity and predictability.

Simplification is consistent with best practice in taxation worldwide because ease of understanding and consistency have been made essential to promoting voluntary compliance. Exemptions have been minimized to avoid room for interpretation and litigation, historically a cause of strain to the judiciary and extending lengthy periods of uncertainty to taxpayers. Transparency and rule-bound taxation rather than discretion is anticipated by the government to promote trust among taxpayers and the government. Expansion of tax base India has always had a limited tax base, with comparatively low percentages of citizens in a position to pay direct tax revenues. Even with a booming economy and increasing wages, tax response remains weak, especially in the unorganized and unregulated sectors. The 2025 plans attempt

2025), available at https://www.indiabudget.gov.in.

[21] Income-tax Act, No. 43 of 1961, § 115BAC, amended by Finance Act, 2025 (India).

to face this head-on by making taxation easier and more enjoyable[22]. A less complicated tax system with lower threshold rates and fewer procedure-related constraints will promote extensive participation. More people who hitherto avoided returns due to complexity or cost-benefit-related disincentives find it attractive now.

More transparented regulations reduce the risk of unintended non-compliance, and hence encourages potential participants in the tax system to be more confident.

The administration is attempting to move towards incentive-based compliance rather than coercive compliance and towards increasing overall filer volumes and collection of revenues at zero rate increase. Encouraging Formalization of the Economy The most strategically relevant goal of the 2025 reforms potentially can be to persuade India's vast informal economy to formalize. The majority of India's workers are still beyond the purview of formal labor laws and taxation regimes, and this presents gargantuan challenges of governance, provision of welfare, and financial oversight. By decreasing the tax burden on registered businesses and salaried workers, the government aims at curbing the incentive to operate informally.

If labor and registration in the formal economy yields greater economic incentives in the form of access to credit, government subsidization, and access to law, businesses and individuals are likely to make the transition into formality. Moreover, integration into the goods and services tax network and linkage with PAN-Aadhaar would be the sequel to this change by enhancing effective means of tracking and compliance.[23]

Greater formalization consolidates institutions like Employees' Provident Fund Organisation (EPFO), Employees' State Insurance Corporation (ESIC), and broader social security architecture. Formalization protects workers and enables governments to take data-driven, informed policy choices.[24] In the long run, this shift ensures macroeconomic stability, improved employment quality, and sustainable growth. Reducing litigation and increased trust Another significant but lesser known aim of the measures is reducing tax conflicts. A significant percentage of tax conflicts in India are caused due to interpretation difficulties with respect to deductions, exclusions, and classification problems. The disputes are time and

[22] Government of India, Economic Survey 2024–25, Ministry of Finance, ch. 6 (2025), https://www.indiabudget.gov.in/economicsurvey/.
[23] Central Board of Direct Taxes, Simplified Tax Compliance Framework for Individuals and HUFs under New Tax Regime (2025), https://incometaxindia.gov.in.
[24] Id at 6.

expense-consuming and frequently include long uncertainty for the taxpayer and the exchequer. By abridging exclusions and embracing standardization of measurement parameters, the government seeks to remove interpretational vagueness. It makes appellate courts' and tribunals' task easier as well as fosters cooperative compliance culture. Taxpayers do this on voluntary terms if they are assured the unambiguity of law and parity in application. Finance Bill, 2025 is therefore a step in the right direction towards preventional legal expertise rather than curative litigations.

CHAPTER 4: IMPACT ON MIDDLE-CLASS CONSUMPTION PATTERNS

Theoretical Models of Tax Policy and Consumer Behavior

Tax reform policies such as the 2025 Budget alter consumption behavior based on most economic models. Milton Friedman formulated the Permanent Income Hypothesis (PIH) hypothesis that states people make consumption choices in terms of permanent income, not in terms of current income.[25]

Structural tax changes, therefore, such as the 2025 budget proposals, will be more enduring in their effect than ad hoc tax cuts. Similarly, Franco Modigliani's Life-Cycle Hypothesis (LCH) suggests that consumers forecast their consumption and saving over a lifetime.[26] Taxation policy to raise people's lifetime disposable income—i.e., significant relief to the middle class—can influence life-stage decisions in housing, education, and retirement. Behavioral economics reveals that at times consumer rationality is absent. Individuals have mental accounting and the desire to maintain tax rebate separate from overall income and spend above normal in the short term[27]. A study has shown that approximately 25–30% of tax rebate is consumed during the first quarter, with the effect more pronounced under liquidity constraints.[28]

Empirical Evidence of Consumption Responses to Tax Changes

Empirical studies back these theories with concrete data. In the United States, the 2008 tax rebate program led to 12–30% of rebates being spent on non-durable goods within three

[25] Milton Friedman, A Theory of the Consumption Function (1957).
[26] Franco Modigliani & Richard Brumberg, Utility Analysis and the Consumption Function: An Interpretation of Cross-Section Data, in Post-Keynesian Economics 388 (1954).
[27] Richard H. Thaler, Mental Accounting and Consumer Choice, 4 Marketing Sci. 199 (1985).
[28] David S. Johnson, Jonathan A. Parker & Nicholas S. Souleles, Household Expenditure and the Income Tax Rebates of 2001, 93 Am. Econ. Rev. 1589, 1589–1610 (2006)

months, particularly by lower-income households.[29] Similarly, Indian research suggests that a 1% rise in post-tax income results in an approximate 0.7% increase in consumption, with middle-income households showing the highest responsiveness.[30] Sector-specific studies also reveal that consumption is more elastic for discretionary items such as recreation, education, and durable goods compared to necessities.[31]

Sectoral Analysis of Consumption Effects

The 2025 tax reforms are expected to affect various sectors differently due to increased disposable income. In the **FMCG sector**, urban consumption has been sluggish, with just 0.5% year-on-year growth by late 2024. Industry experts anticipate that the tax relief will rejuvenate demand, potentially increasing FMCG growth by 2–3 percentage points.[32]

In **discretionary retail**, segments such as apparel, beauty products, and restaurants, which saw reduced growth in 2024, may experience a revival as consumers are expected to prioritize spending over saving.[33] This will particularly benefit aspirational and premium brands preferred by the middle class.

The **durable consumer goods** segment is also poised for growth, with analysts predicting a 4–5% rise in sales for items like refrigerators and air conditioners, driven by increased purchasing power.[34]

The **automotive sector**, especially passenger vehicles and two-wheelers, could see demand recover as higher disposable incomes make vehicle purchases more feasible.[35] Two-wheelers, being more income-sensitive, are likely to benefit sooner.

The **housing and real estate sector**, particularly in the affordable and mid-segment categories, is expected to witness a boost as well. With increased affordability and stable interest rates[36],

[29] Matthew D. Shapiro & Joel Slemrod, Did the 2008 Tax Rebates Stimulate Spending?, 98 Am. Econ. Rev. 374 (2009).
[30] NIPFP Working Paper No. 361, Consumption and Tax Policy in India: Evidence and Implications, Nat'l Inst. Pub. Fin. & Pol'y (2022).
[31] Economic Survey of India 2023–24, Ministry of Finance, Govt. of India, Ch. 5, available at https://www.indiabudget.gov.in/economicsurvey/
[32] CRISIL Research, Sectoral Outlook: FMCG, Q4 FY2024.
[33] Ernst & Young, India Retail Report 2024.
[34] ICRA Ratings Report, Consumer Durable Sector Outlook 2025.
[35] Society of Indian Automobile Manufacturers (SIAM), Market Trends Report 2024.
[36] Knight Frank, India Real Estate Outlook 2025.

analysts project an 8–10% rise in inquiries and a 3–5% increase in sales within a year of the reforms.

Short-term vs. Long-term Consumption Effects

The effects of the tax reforms on consumption are expected to evolve over time. In the **short term (1–2 years)**, consumption is likely to surge in categories with pent-up demand, especially discretionary goods. Historical patterns suggest that 25–35% of tax savings will be spent in the first year, particularly by lower-middle-income households.[37]

In the **medium term (2–5 years)**, as households adjust to the new tax regime, spending may shift to long-term investments like automobiles, education, and home upgrades. The consumption multiplier during this period is estimated at 1.5 to 2.0, meaning each rupee of tax savings could generate up to ₹2 in additional consumption.[38]

In the **long term (beyond 5 years)**, the sustained impact will depend on the stability of the tax structure and overall economic conditions. If the reforms lead to job creation and consistent growth, they could establish a virtuous cycle of rising income and consumption. However, risks such as inflation or macroeconomic instability could weaken these positive effects.[39]

CHAPTER 5: IMPACT ON MIDDLE-CLASS SAVING PATTERNS

Theoretical Relationship Between Tax Incentives and Saving Behavior

Tax incentives influence saving through the substitution effect (encouraging saving by reducing its cost) and the income effect (increasing wealth, leading to higher consumption)[40]. In India, the substitution effect has generally prevailed among middle-class households. Behavioral economics adds layers to this, highlighting how tax incentives act as attention grabbers, social norms, and commitment devices through lock-in periods.[41] Empirical evidence shows mixed results. While overall financial savings haven't significantly increased due to tax incentives, their structure strongly influences how households allocate savings—especially among those

[37] Shapiro & Slemrod, supra.
[38] Reserve Bank of India, Monetary Policy Report, April 2024, at 22–24.
[39] World Bank, India Development Update, Oct. 2024.
[40] James M. Poterba, Tax Policy and Household Saving in the United States: A Review of Recent Evidence, 52 Scand.
J. Econ. 347, 348–49 (2004).
[41] Richard H. Thaler & Shlomo Benartzi, Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving, 112 J. Pol. Econ. S164, S164–65 (2004).

in taxable income brackets[42]. Around 30–40% of investments in instruments like PPF, NPS, and ELSS are tax-driven.[43]The 2025 tax reforms, which reduce the appeal of tax deductions, may lead to a 15–20% decline in flows to traditional tax-saving instruments.[44] Households are likely to shift toward market-driven options such as equity mutual funds, direct stocks, and real estate, increasing exposure to market risk. There may also be a stronger preference for liquidity, with more savings going into short-term instruments. Long-term, this could weaken retirement security and reduce insurance coverage, increasing household vulnerability.[45] Financial experts suggest a 5–7% rise in voluntary retirement savings is necessary to offset reduced incentives.

CHAPTER6: RECOMMENDATIONS

To enhance the effectiveness of the 2025 income tax reforms and ensure balanced outcomes, several policy recommendations are proposed. First, complementary saving incentives should be introduced through mechanisms such as matching contributions under the National Pension System (NPS), employer-based automatic enrollment, and behavioral nudges to encourage long-term financial planning. Second, financial literacy programs are essential to help households make informed decisions in the absence of tax-driven motivations; these should focus on retirement planning, risk diversification, and insurance adequacy. Third, targeted consumption stimulus can direct increased spending toward high-multiplier sectors like housing, green technologies, and education through short-term incentives and promotions. Fourth, to maintain fiscal sustainability, the government must enhance tax compliance, gradually phase out deductions under the old regime, and closely monitor revenue impacts. Fifth, regular impact assessments should be institutionalized to evaluate how the reforms influence consumption, saving behavior, tax compliance, and overall fiscal health.

Future research should focus on long-term household behavior through longitudinal studies, sector-specific impact analysis, and behavioral insights into financial planning under the new regime. Comparative studies with other emerging economies and integrated assessments of

[42] Soumya Kanti Ghosh & Pulak Ghosh, Tax Incentives and Household Financial Savings: An Indian Perspective, 57 Indian Econ. J. 47, 48–50 (2009).
[43] Ministry of Finance, Economic Survey 2023–24, at 212 (India), https://www.indiabudget.gov.in/economicsurvey/ [https://perma.cc/R3Z9-JNQ2.
[44] RBI Bulletin, Household Financial Savings in India: Trends and Implications, Reserve Bank of India (2025), https://rbi.org.in/Scripts/BS_ViewBulletin.aspx [https://perma.cc/K5UG-RZ9M
[45] Pensions Fund Regulatory and Development Authority (PFRDA), Annual Report 2023–24, at 45–47, https://www.pfrda.org.in/ [https://perma.cc/MKJ6-TKEB.

direct and indirect tax reforms will provide broader policy perspectives. In conclusion, while the 2025 reforms stimulate consumption and growth in the short term, sustaining these benefits requires close monitoring and supportive policy measures to secure long-term savings and financial security for the middle class.

CHAPTER 7: CONCLUSION AND ANALYSIS

Meeting of Research Objectives

This comprehensive analysis has successfully addressed the four key objectives established at the outset:

1. <u>To compare the previous and revised income tax slabs in terms of their impact on middle-class taxpayers' disposable income.</u>

Analysis:'

The revised tax slabs introduced in Budget 2025–26 significantly reduce the tax burden on the middle class, especially for incomes up to ₹12 lakh. Under the previous regime:

- Tax was applicable beyond ₹7 lakh even under the "new regime."
- Higher effective rates due to multiple brackets starting from ₹5 lakh onward.

<u>Under the revised regime:</u>

- Effective tax is zero up to ₹12 lakh because of the increased rebate.
- Salaried individuals (due to standard deduction) can earn up to ₹12.75 lakh without paying any tax.

<u>Impact:</u>

- Disposable income has increased sharply for a very large section of taxpayers.
- This shift from taxation to no-taxation for many will directly influence consumption patterns, lifestyle decisions, and saving potential.

2. <u>To analyze the immediate and potential long-term effects of the revised tax structure on middle-class consumption behavior.</u>

Analysis:

Short-Term Effects (1–2 years):

- Immediate jump in discretionary spending (gadgets, holidays, personal care, restaurants).

- Pent-up demand after pandemic and inflation years makes the middle class eager to spend extra cash.
- Sectors like FMCG, electronics, affordable housing, two-wheelers will see early benefits.

Medium-Term Effects (2–5 years):

- Big-ticket purchases (home upgrades, automobiles, private education) will increase as people feel more financially secure.
- Increase in service sector consumption (healthcare, entertainment, education) as middle-class spending shifts toward experiences and personal development.

Long-Term Effects (beyond 5 years):

- If incomes rise steadily and the tax system remains stable, middle-class consumption patterns will "upgrade" permanently toward branded goods, investments in children's education, and better housing.
- However, risks like inflation, rising living costs, or economic shocks could reduce this effect.

3. <u>To examine how the transition to a simplified tax regime influences middle-class saving patterns and long-term financial security.</u>

Analysis:

Reduction in Traditional Savings:

- With exemptions like 80C, 80D, etc., becoming less relevant under the new regime, people lose the "tax motivation" to save.
- Flows into instruments like PPF, ELSS, and life insurance may fall by 15–20%.

Shift to Alternative Investments:

- Households may prefer market-linked products (mutual funds, stocks, REITs) over fixed-return saving schemes.
- Higher exposure to financial markets could increase return potential but also raise risk levels.

Challenges to Long-Term Security:

- Without forced saving through deductions, voluntary saving discipline becomes critical.
- If people spend most of their extra disposable income without planning, they may face retirement insecurity, inadequate emergency funds, and exposure to financial shocks.

Policy Need:

- Financial literacy programs are needed to teach households the importance of voluntary savings and long-term planning without tax-based nudges.

Answers to Research Questions

Research Question 1: Distributional Impact of Tax Changes

The revised income tax structure significantly alters disposable income across different segments of the middle class, with the most substantial benefits accruing to those with incomes between ₹7 lakh and ₹12 lakh, who experience a 100% reduction in tax liability. The distributional implications include:

- A progressive pattern of absolute tax savings up to incomes of ₹24 lakh
- Relative benefits that decline as income increases beyond ₹12 lakh
- Particular advantages for salaried taxpayers due to the enhanced standard deduction

Research Question 2: Mechanisms of Tax Impact on Consumption

The research indicates that tax reforms influence middle-class consumption decisions through several mechanisms:

- In the short term, liquidity effects dominate, with increased disposable income leading to immediate consumption of postponed purchases and discretionary items.
- In the long term, expectations effects become more important, with the permanent nature of the tax changes influencing major consumption decisions related to housing, education, and durable goods.
- The impact varies significantly across income levels, with higher marginal propensities to consume among lower-middle-income households compared to upper-middle-income households.

Research Question 3: Impact on Saving Composition and Adequacy

The removal of tax incentives for specific saving instruments is likely to affect middle-class savings in several ways:

- The composition of savings will likely shift away from traditional tax-saving instruments toward more market-based and liquid investments.
- The quantum of formal long-term savings may decline, particularly for retirement and insurance.
- The adequacy of savings for long-term financial security may be compromised unless households consciously compensate for the reduced tax incentives with disciplined voluntary saving.