

## **PRIOR VS DEFAULT PERSONAL INCOME TAX REGIME: AN ANALYTICAL PERSPECTIVE WITH REFERENCE TO THE IMPLICATIONS ON THE INDIAN ECONOMY**

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### **ABSTRACT**

The role of the personal tax system is crucial in the economy of any country. It is essential to implement reforms to ensure a fair and equitable distribution of wealth. In the Union Budget, 2023, significant amendments were made to India's existing tax structure through the introduction of an alternate tax regime aimed at simplifying the system. The proposed regime is designed to boost consumption, savings and investment through lower tax rates and cuts. This paper utilises secondary sources to analyse the implications of new regime on the Indian Economy. Additionally, it aims to examine the key features of the proposed regime and highlight the differences from the previous tax structure.

**Keywords:** Tax cuts, tax rates, consumption, investment, savings

### **Introduction**

Tax is one of the major arms of public exchequer which acts not only as an instrument to augment public finances but it is also linked with welfare maximization. Personal income tax plays a pivotal role in the Indian Economy with adequate tax capacity and tax potentiality. Tax capacity depicts the need for widening the tax base whereas tax potentiality shows the optimistic evaluation of a country's growth prospects. India follows a progressive tax slab system by maintaining the principles of horizontal equity and vertical redistribution.

The erratic pattern of revenue deficit in India continues to be a serious fiscal challenge and tax reforms were considered as one of the key strategies to counter the drastic effect of revenue deficit in the Fiscal Responsibility and Budget Management Act 2003. The tax reforms measures have resulted in a subsequent rise to the tax – GDP ratio in 2021-2022 to 11.7% and the tax buoyancy showed a significantly healthy figure of 2.8 for direct taxes.

The Union Budget 2023, introduced an alternate tax regime to offer substantial relief to individual taxpayers through streamlining the filing process. The practical implications of these changes should be analysed in order to have a thorough understanding of the probable effect on the taxpayers along with their savings and investment pattern.

The fundamental presumptions underlying about the economic consequences of income tax on a country can be depicted as follows:

- Savings and investment play a predominant role in the development of an individual and nation, but when tax rates are high that may adversely affect marginal propensity to save.
  - Magnitude of tax burden has ample influence on the investment and savings pattern of the individuals
  - The time spent on tax evasion and the rate of evasion is proportionate to the increased tax rates.
- These premises justify the rationale behind studying the implications of an old over simplified, concessional tax regime on taxpayers.

### **Review of literature**

The different researchers illustrated the relationship between tax rates, revenue generation, tax compliance, tax system and tax burden. An inverse correlation exists between government revenue and tax rates Canto (1981).

The analysis of the economic effects of direct taxes on individuals and businesses indicated that both average and marginal tax rates play a crucial role in shaping people's perception of their tax burden. As a result, it is vital to adopt a professional approach to the current tax system to ensure that taxpayers make accurate and timely tax payments Lall, (1982).

The main reasons in revenue generation when interpreting the importance of direct taxation were the low rates and abundance of exemptions Das (1995).

The reduction in revenue is the result of a combination of factors, including the impact of tax rates, the effect of the statutory base and influence of tax evasion Gang (2000).

Assuming that tax reductions, tax reform, lower tax rates, and the elimination of exemptions are implemented, it is expected to lead to a notable increase in direct tax revenue Bhalla (2004).

While studying how taxpayers respond to tax avoidance, compliance, and tax planning, and found that legal compliance costs have a positive impact on tax collection, but a negative impact on tax evasion Chattopadhyay (2002).

Tax reforms in India should aim to decrease tax evasion and compliance costs, as well as eliminate most of the distortions that arise from tax avoidance Bernardi (2005).

A minor modification to the personal income tax system could result in significant advantages for both the government and its citizens. Specifically, this change would lead to a higher number of taxpayers, greater compliance with tax regulations, higher gross domestic product rate, and improved individual well-being Gupta (2009).

During the implementation of tax reform, it is important to consider maximizing revenue while minimizing administrative and compliance costs Vazquez (2010).

The following measures could be taken to enhance the tax system: simplifying the tax structure, expanding the tax base to boost tax revenue, enhancing tax administration and reducing compliance costs for austerity purposes Palande (2011).

A sound and rational tax structure is essential for encouraging saving and investing habits. A lower tax liability provides individuals with more disposable income, enabling them to save and invest more. Conversely, high tax rates lead to a heavy tax burden, which may increase the likelihood of tax evasion, resulting in negative consequences for both the nation and its citizen Gupta (2012).

There is evidence that supports the notion that taxation can significantly influence people's behaviour. However, it is crucial to know that the impact of taxation depends on the underlying rate and level of tax burden. This emphasizes the importance for governments to design their tax policies in a way that does not excessively burden their citizens while still generating sufficient revenue for public expenditure Saravanan (2017).

Comprehensive, organised, and structured changes can be only achieved through tax reforms (Panda, Das, 2020).

In countries like India, policymakers need to develop a composite tax reform model that integrates tax policy reform, administrative reform and economic reform into a unified tax model. This will help ensure that tax reform efforts are comprehensive and well-structured, with a focus on achieving sustainable and equitable economic growth.

### **Objectives of the study**

The following objectives form the basis of the study:

- a. To study the differences between the old and new tax regime.
- b. To understand the implications of the proposed tax regime on tax payers and the Indian economy.

### **Research methodology**

The study is exploratory and descriptive and exploratory in nature. For the purpose of this study, secondary data collection has been conducted. The sources included journal articles, newspaper reports, government websites, Income Tax Act 1961, Union budget 2020 to 2023 and Finance Act 2020 to 2023. A sufficient number of research articles have been collected and were systematically reviewed.

### **Old vs new income tax regime**

Annual budget 2020 (Financial year 2020-2021) introduced an alternate personal tax regime which is also known as "simplified" tax regime for individuals and Hindu Undivided Family (HUF). Section 115 BAC was incorporated into the Income Tax Act 1961 providing reduced tax rates for not availing specific deductions and exemptions.

The remarkable differences of the new tax regime with old tax regime can be summarised as follows;

### Selection based regime

The new tax regime will be the default option whereas the assesses are given the opportunity to choose the old one based on their specific income sources. In addition to that the assesses are also given the option to switch in between the regimes. The switching option can be exercised either on a year-on-year basis or only once and the frequency of which depends on the source of income. In case if the income includes business or profession, if the taxpayer opts for new tax regime, then the new rates shall be applicable in the subsequent years and the option for switching back is available only once in a lifetime unless the taxpayer ceases to have any income from business or profession.

### Streamlined tax slab system

When the new tax regime was introduced, initially it had 7 tax slabs, which at present is reduced to 6, with lower tax rates. Table no. 1 depicts the comparison of post and pre-budget slabs in connection with the present and previous regime. It can be analysed that by introducing a preferential slab system the country expects to yield the benefits of lower outruns.

Old tax regime	New tax regime(previous)	New tax regime (Revised in 2023)
Less than 2.5 – nil	Less than 2.5 - nil	0 – 3 - nil
2.5 – 5 - 5%	2.5 – 5 - 5%	3 – 6 - 5%
5- 10 - 20%	5 – 7.5 - 10%	6 – 9 - 10%
Above 10 - 30%	7.5 –10 - 15%	9 – 12 - 15%
	10 – 12.5 - 20%	12 – 15 - 20%
	12.5 – 15 - 25%	Above 15 - 30%
	Above 15 - 30%	

Table 1 Income tax slabs (Rupees in lakhs)

### Rebate u/s 87A

The tax rebate limit was raised to ₹7 lakhs from ₹ 5 lakhs.

### Super rich tax cut

The highest surcharge on the income above ₹ 5 crore is reduced to 25% from 35%. The overall tax rate in the country was reduced to 39% from 42.27%.

### Form 101E

A new tax declaration form is introduced for simplifying and easing the filing under the new tax regime. The tax portal provides the opportunity to compare and evaluate the tax liability.

### Zero deductions and exemptions

Prior to the 2023 budget alternate personal tax regime does not include any provisions for deductions and exemption. The revised tax regime allows ₹ 50000 standard deduction for the salaried persons and a deduction for family pension either ₹15000 or 1/3<sup>rd</sup> of the pension whichever is lower and employers contribution to National Pension Scheme is allowed. The deductions under Chapter VI A except section 80 CCD (2), Leave travel allowance, House Rent Allowance, Interest on housing loan on the self-occupied property or vacant property (section 24), helper allowance, professional and entertainment tax on salaries, minor child income allowance, other special allowances under section 10(14), employees' own contribution to National Pension Scheme (NPS), donation to political parties/ trust etc cannot be claimed from salaries. The exemptions which cannot be benefitted include additional depreciation under section 32, investment allowance under section 32 AD etc. Apart from that individuals and HUF cannot claim set off of brought forward business loss or unabsorbed depreciation.

### Less attractive

The new regime is found to be less attractive in case of individuals preferring to claim deductions and exemptions. The previous regime provided the opportunity for tax savings and investment. Table no. 2 illustrates a comparison of old vs new regime if the annual taxable income of a salaried person is ₹ 750000.

Particulars	Old tax regime	New tax regime
Annual taxable income	750000	750000

Less: Standard deduction	50000	50000
Gross taxable income	700000	700000
Less: deduction under section 80 C Employees contribution to NPS under section 80 CCD(IB) Deduction under section 80 D	150000 50000 100000	Nil
Net taxable income	400000	700000
Tax payable	7800	25000
Less Rebate under section 87 A Net tax payable	7800 Nil	25000 Nil

Table 2 Illustration comparing the tax payable in case of old and new regime

As it can be interpreted from the table, if a taxpayer opts for a new tax regime, the benefits of deductions and exemption cannot be availed. Often deductions and exemptions act as a successful tool for tax planning.

#### Leave encashment

The exemption limit for Non-Government Employees has been increased from ₹ 3 lakhs to ₹ 25 lakhs.

#### Break-even point

The break-even threshold is used to determine the regime to choose and it is the point at which the difference in tax liability between the two regimes is zero.

#### Practical implications on the Indian Economy

Eisenstein, (1961) presented three ideologies for taxation; the ideology of ability, the ideology of barriers and deterrents, and the ideology of equity. The ideology of ability refers to the underlying principle of a progressive tax system where it highlights the ability of an individual to pay and are measured based on their income. The ideology of barriers and deterrents in taxation is founded on the belief that progressive tax rates can dampen the motivation to work, discourage investment incentives, and hinder the flow of capital. On the other hand, the ideology of equity in taxation aims to achieve fairness and balance in the distribution of tax burdens among taxpayers, based on their ability to pay. It highlights the significance of horizontal and vertical equity. These are largely based on Adam Smiths' principle of equity which is considered as a pioneer model of ideology of distributive justice. These categories of ideologies propound that organised taxpayer's bargain for better tax deals and incentives along with that tax morality is largely dependent upon the fairness of the tax system.

On a transitional pathway towards a better, simpler and rational tax system, ensuring the principles of distributive justice, equity and fairness the Government of India introduced major changes to the existing tax structure through an alternate personal tax regime. The practical implications of the new regime on the Indian economy especially on the savings and investment pattern can be illustrated in the following ways:

- Absence of compulsory and mandatory tax saving investment can result in increased consumption pattern among the middle-class income group.
- Flexibility and diversification of investment is another key driver of the proposed regime. Individuals are given the opportunity to decide the schemes of investment.
- For those who have an annual income of up to 7 lakh rupees need not invest in anything as the income is tax free irrespective of the composition of investment. The rebate is applicable to all individuals and this can make effective tax to zero.
- The new regime provides more consumption power to the salaried class and it is considered as appealing amongst the inflation and stagnant growth since the middle-income group was struggling with the sustained economic conditions.

- The streamlined differential slab system will lessen the tax burden and will help individuals plan their long-term financial goals in a more efficient manner as the slab is designed considering average income of individuals.
- The various deductions and exemptions have subsequently resulted in reduced tax compliance due to the tedious administration of tax laws. The new regime forgoes tax exemptions and deductions for lower attractive, effective and specific tax rates. This can result in more disclosure, transparency and better compliance.
- The super-rich tax cut for high-net-worth individuals is expected to reduce the exodus of super – rich individuals from India. According to the Global Wealth Migration Review each year more than 8000 high net worth individuals migrate from the country. The tax cut can result in lower tax evasion, better revenue collection and unethical use of tax havens.
- Reduction in tax rates can have a positive impact on tax buoyancy.
- The Indian tax system is considered to be operating within the prohibitive range of Laffer Curve and hence the reforms to personal income tax structure can influence sustainability and enthusiasm for tax payments.
- The tax cuts can increase private investment, especially in banking, real estate and consumer durables as the substantial value of consumption for high-net-worth individuals increases. This can also result in strong valuation of the Indian equity markets.
- Each income level has their own break-even point which is based on the composition and sources of income. If the total eligible deductions and exemptions in the old tax regime are higher than the break-even point then the taxpayers can continue with the old tax regime.

However, the old tax regime has more scope for tax deductions to individuals with higher annual incomes and more investments as the taxable income of an individual can reduce drastically.

### Findings of the study

The essential feature of the Indian income tax system is its progressivity, based on the principle of redistributive justice. The progressivity of the tax system means the relationship between average tax rate and level of pre-tax income (Kakwani, 1977). Restricting income thresholds for higher marginal tax rates through alternative tax schedules is expected to have a greater impact on redistribution than limiting the use of tax exemptions. The Tax Reform Committee, led by R. J. Chelliah, proposed reducing income tax rates as a key component of taxation reforms in addition to simplifying and rationalising the tax system. The dimensions of personal income tax reforms can be attributed to the phenomena of broadening the tax base and reduction in income tax rates along with maintaining the current aggregate revenue generation and the distribution levels (Gale & Samwick, 2014). The measures are aimed at increasing investment and consumption.

### Conclusion

The tax structure is renewed, rationalised and the procedure is simplified. The rationalisation and simplification of the tax system tries to replace the old with a new one devoid of exemptions and deductions. This can result in substantial changes to the savings and consumption pattern of the middle-income group. The proposed pattern is expected to revive the consumption pattern. However, there can be a reduction in investment for government schemes as the investment pattern is decided by the taxpayer himself.

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