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Impacts of New Income Tax Regime on Capital Formation in India

ORIGINAL ARTICLE

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Abstract

Income tax is direct tax. It is imposed on the income and wealth of taxpayer. It is very important source of income of the Government of India. Income-tax law consists of the 1961 act, Income Tax Rules 1962, Notifications and Circulars issued by the Central Board of Direct Taxes (CBDT), annual Finance Acts, and judicial pronouncements by the Supreme and high courts. New Tax Regime will be decreasing capital formation in Indian Economy. Old Tax regime is promoting investment in India Economy. This research paper based on secondary data collected by published data in book, magazine, journal and internet. There is less tax burden in new tax regime than old tax regime but new tax regime will be promoted to consumption expenditure and old tax regime promote capital expenditure. So old tax regime will be increasing capital formation. If Government provide deduction under deafferents investment scheme in new tax regime then new tax regime will be supper tax system in Indian economy and it will be helped a developed county in 2047.

Key Words

Old tax regime, New tax regime, Capital formation, Saving, Investment.

Introduction

Income tax is direct tax. It is imposed on the income and wealth of taxpayer. It is very important source of income of the Government of India. Income-tax law consists of the 1961 act, Income Tax Rules 1962, Notifications and Circulars issued by the Central Board of Direct Taxes (CBDT), annual Finance Acts, and judicial pronouncements by the Supreme and high courts.

The Government taxes certain income of individuals, Hindu Undivided Families (HUF's), companies, firms, LLPs, associations, bodies, local authorities and any other juridical person. Personal tax depends on residential status. The CBDT administers the Income Tax Department, which is part of the Ministry of Finance's Department of Revenue.

The Income Tax Department is the central Government's largest revenue generator; total tax revenue increased from ₹ 1,392.26 billion (US$17 billion) in 1997–98 to ₹ 5,889.09 billion (US$74 billion) in 2007–08.[3][4] In 2018–19, direct tax collections reported by the CBDT were about ₹ 11.17 lakh crore (₹ 11.17 trillion).

The first Income-tax Act was introduced in February 1860 by Sir James Wilson (British India's first finance minister). A new Income-tax Act were passed in 1918. The Act of 1922 significantly changed the Act of 1918 by shifting income-tax administration from the provincial to the central Government. Another notable feature of the act was that the rules would be outlined by annual Finance Acts instead of the act itself. A new Income-tax Act was passed in 1939. The Direct Taxes Administration Enquiry Committee, under the chairmanship of Mahavir Tyagi, submitted its report on 30 November 1959 and its recommendations took shape in the Income-tax Act, 1961. The act, which became effective on 1 April 1962, replaced the Indian Income Tax Act, 1922. Current income-tax law is governed by the 1961 act, which has 298 sections and four schedules.

Hypothesis

1. New Tax Regime will be decreasing capital formation in Indian Economy.
2. Old Tax regime is promoting investment in India Economy

Objectives

1. Find out the impacts of reform in income tax on saving, investment and capital formation.
2. Find out the tax burden on taxpayers.
3. Possibilities of reform in new tax regime.
4. How can make progressive tax system in India.

Methodology

This research paper based on secondary data collected by published data in book, magazine, journal and internet.

Review of Literature

Shalini Ojha, Amal Kumar Agarwala:- A Brief Insight into the Introduction of a New Tax Regime in India (International Journal of Economics and Financial Issues 14 (5), 92-101, 2024).

Since the inception of a new regime for filing taxes, there has been a discourse among taxpayers. The old tax regime provides opportunities to save taxes while, building a portfolio for fulfilling their financial goals. After the introduction of the new tax regime with less exemptions and deductions, one is free to choose between any of the two regimes. This would depend on many factors but purely on the quantum of exemptions and deduction one hopes to avail. For individuals, with awareness about their financial condition for the year, choices are clear. Otherwise, it may end in a deadlock. A commentary on the tax regimes could be an added factor in the selection. However, due to unavailability of the acceptance rate for new tax regime, taxpayers are unable to gauge whether the new tax regime is favourable. Amidst this, the finance minister has made some vivid introductions to the new tax regime in the union budget of 2023 by increasing the tax rebate limit. This introduction is a valuable step for the tax system of India which has the potential to be advantageous for taxpayers. Hence, this research is conducted to understand the new tax regime and the role it can play for the welfare of taxpayers. This study also sheds some light on the factors which might influence the selection of the tax regime. The findings show that the new tax regime simplifies the decision structure available to the taxpayers by reducing complexity and increasing the ease of compliance. The acceptance of the new tax regime has also increased since the reforms introduced in the Union budget of 2023. Age Groups, Yearly Income and Number of investments are factors that influence the selection of the tax regime. It is also observed that the younger age groups are inclining towards the new tax regime. The collected data has been analysed using the Year over Year growth, Chi-Square test and One-way ANOVA test along with post hoc tests.

Ms Jincy P Babu, G Raju, - 'Prior vs default personal income tax regime: An analytical perspective with reference to the implications on the indian economy' [The Online Journal of Distance Education and e-Learning 11 (2), 2023]

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.

Sushobhan Paul, Debarati Basu, 'The Evolution of the Tax Regime and its Impact on Investment and Savings' (SSRN 4994235, 2024).

This paper examines the evolution of tax regimes in India and their impact on individual savings and investment behaviours. Using primary data from a survey of Indian taxpayers, the study investigates the shift from the old tax regime, which offered investment-based deductions, to the new regime with lower rates but fewer deductions. The analysis reveals a significant increase in consumption patterns and a decline in investments in traditional retirement and higher-risk avenues under the new regime. Probit regression results show that higher disposable income under the new regime drives these shifts, potentially impacting longterm financial security. The findings suggest that tax policy changes while boosting short-term consumption, may weaken long-term savings, necessitating adjustments in social security provisions to ensure economic stability.

There are two regime of income tax in India:

A. Old Regime of tax

There were no changes made to the tax slabs under the old regime in the budget 2024. The tax slabs under the old regime are as follows:

Old Tax Regime Slabs

Individuals aged below 60 years & HUF

Income Slabs	Tax rate
Up to Rs 2,50,000	NIL
Rs 2,50,001 - Rs 5,00,000	05%
Rs 5,00,001 to Rs 10,00,000	20%
Rs 10,00,001 and above	30%

Note

- The income tax exemption limit is up to Rs 2,50,000 for Individuals, HUF below 60 years aged, and NRIs.
- Surcharge and cess will be applicable.

Individuals aged below 60 years to 80 years

Income Slabs	Tax Rate
Up to Rs 3,00,000	NIL
Rs 3,00,001 - Rs 5,00,000	05%
Rs 5,00,001 to Rs 10,00,000	20%
Rs 10,00,001 and above	30%

Note

- The income tax exemption limit is up to Rs.3 lakh for senior citizens aged above 60 years but less than 80 years.
- Surcharge and cess will be applicable.

Individuals aged above 80 years

Income Slabs	Tax Rate
Up to Rs 5,00,000	NIL
Rs 5,00,001 to Rs 10,00,000	20%
Rs 10,00,001 and above	30%

Note

- Income tax exemption limit is up to Rs 5 lakh for super senior citizen aged above 80 years.
- Surcharge and cess will be applicable.

Income Tax Slabs for FY 2025-26 (AY 2026-27)

As per the budget 2025, the income up to Rs.12,00,000 will have zero tax liability for the FY 2025-26 (AY 2026-27) under the new tax regime. The revised tax slabs are as follows:

Annual Income Tax Slabs	Income Tax Rates
Up to Rs.4,00,000	NIL
Rs.4,00,001 - Rs.8,00,000	05%
Rs.8,00,001 - Rs.12,00,000	10%
Rs.12,00,001 - Rs.16,00,000	15%
Rs.16,00,001 - Rs.20,00,000	20%
Rs.20,00,001 - Rs.24,00,000	25%
Above Rs.24,00,000	30%

With the revised tax structure, individuals earning up to Rs.12,00,000 will have no tax liability due to the increased rebate of Rs.60,000. For salaried individuals, the tax liability will be zero for incomes up to Rs.12,75,000, due to the Rs.75,000 standard deduction.

Calculation: New tax regime. If total income is 15,00000 then:

Gross Income	Deductions	Tax Rate	Tax Amount
15,00000			
-75,000	S.D.		
14,25,000	Taxable Income		
0 – 4,00000	4,00000	0%	000
4,00000 – 8,00000	4,00000	5%	20,000
8,00000 – 12,00000	4,00000	10%	40,000
12,00000 – 16,00000	2,25,000	15%	33,750
		total	93,750
		Cess 4%	3750
		Total	97,500

Old tax regime. If total income is 15,00000 then

Gross Income	Deductions	Tax Rate	Tax Amount
15,00000			
-50,000	S.D		
-1,50,000	80C		
-2,00000	24B		
-25,000	80D		
-40,000	80DDB		
10,35,000	Taxable Income		

0 – 2,50,000	2,50,000	0%	0000
2,50,000 – 5,00000	2,50,000	5%	12,500
5,00000-10,00000	5,00000	20%	1,00000
Above 10,00000	35,000	30%	10,500
		total	1,23,000
		Cess 4%	4920
		Total	1,27,920

According above table total income is same but tax amount 1,27,920 in old tax regime and 97,500 in new tax regime 30,420 less amount paid new tax regime but it will be increase consumption expenditure not increase capital expenditure. In the old tax regime 4,65,000 invested in different fund and new tax regime only 75,000 is deduction. 4,65,000 tax relief under invested in deafferents fund will be increase investment and capital formation. So, we can say new tax regime will negative impact on capital formation in economy.

Saving

Savings can be accumulated in various forms, including bank deposits, investments in stocks and bonds, retirement accounts, and real estate.

S = Bank deposits + Investment in Stocks and Bonds + Retirement A/C + Real Estate

Savings play a vital role in personal financial planning, as they provide a safety net for emergencies, enable individuals to achieve financial goals, and contribute to long-term.

Saving Ratio

The savings ratio is calculated by dividing total savings by gross income and multiplying the result by 100 to obtain a percentage.

$$\text{Saving Ratio} = \frac{\text{Total saving}}{\text{Gross income}} 100$$

A higher savings ratio indicates a greater proportion of income being saved, while a lower ratio signifies more income being spent on consumption. Understanding the savings ratio is vital for individuals to manage their personal finances effectively and for policymakers to gauge the economic stability of a country. A high savings ratio signifies that individuals are financially secure and can afford to invest in their future, whereas a low ratio may indicate financial strain and limited capacity for investment. A variety of factors can influence an individual's or a country's savings ratio, such as income levels, cultural values, access to financial services, economic stability, and Government policies.

Saving Saving Ratio In Old Tax Regime

Item	Amount
S.D	50,000
80C	1,50,000
24B	2,00000
80D	25,000
80TTA	10,000
80TTB	50,000
80DDB	40,000
Total saving = 5,25,000	

Suppose that a service mane's yearly total income is 14,00000 then –

Saving Ratio= (Total saving)/(Gross income) X100

Saving Ratio = (5,25,0000)/14,00000 100= 37.5

Saving Ratio In New Tax Regime

Only S.D = 75,000 is total saving in the new tax regime. Suppose that a service man's total income is 14,00000 then

Saving Ratio = (Total saving)/(Gross income) X100

Saving Ratio = (75,000)/14,00000 100= 5.35

Saving ratio is 37.5 %in the old tax regime and 5.35% saving ratio in new tax regime. Saving ratio in old tax regime is greater than saving ratio in new tax regime.

Investment

Investment is a function of saving.

$$I = f(S)$$
$$S = I$$

If saving amount is large than investment will be also large. Investment will be grater in old tax regime because saving ratio is more than new tax regime.

Capital formation

Capital formation refers to the accumulation of net capital within a specific nation over an accounting period.

There are 3 steps of capital formation:

Creation of saving – Effective Mobilization of saving – Investment of saving

If

Large Saving – Large Investment – Large Capital Formation

K = K + I – dk

Where-

K = capital in current year

I = Investment

Dk = depreciation rate

If investment is large than capital formation will be large in the economy.

So we can say capital formation will be large in old tax regime because large saving in the old tax regime than new tax regime.

Conclusions

There are two types of tax regime in India old tax regime and new tax regime. There is less tax burden in new tax regime than old tax regime but new tax regime will be promoted to consumption expenditure and old tax regime promote capital expenditure. So old tax regime will be increasing capital formation. If Government provide deduction under deafferents investment scheme in new tax regime then new tax regime will be supper tax system in Indian economy and it will be helped a developed county in 2047.

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