



# Impact of Indian Tax Policies on Middle-Class Families: Evidence from Direct Taxes, GST, and Household Consumption Data

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**Abstract** - The tax system influences the standards of living of the middle classes in India in three main ways, namely: (i) via direct taxes on income (personal income tax, surcharge, cess and payroll-based compliance), (ii) via indirect taxes (particularly the Goods and Services Tax- GST-, and the excises), and (iii) the interaction between tax design and factors such as inflation, housing costs and consumption baskets. In this paper, the recent policy changes as well as empirical literature are synthesized to determine the impact of Indian tax policies on the disposable income, consumption, savings, and perceived fairness of the middle-class families. We chart mechanisms and document distributional implication using secondary evidence of the Income tax department Budget FAQs, slabs, and PRS Legislative Research and GST council rate rationalisation documentation and household consumption fact-sheets of Ministry of statistics and Programme Implementation (MoSPI). The findings suggest that the recent income-tax relief (an increase in tax-free threshold through the Section 87A rebate and standard deduction under the new regime) hikes post-tax income and can stimulate consumption of the lower and lower-upper middle segments, and decreases the relative merit of deduction-intensive tax planning under the old regime. Indirect tax reforms that cut the taxes on much of mass-consumption, and on some of the aspirational durables, can reduce the cost of living; but consumption taxes are structurally retrogressive when compared to annual income, particularly where essentials are higher than household budgets. Complexity of administration and compliance expenses also have a role to play: there is evidence that compliance burdens need not be trivial, and simplification will lead to welfare beyond the tax rate itself. The paper is rounded off with policy alternatives, such as indexation versus inflation, superior targeting of GST relief, and a reduction in compliance costs, that can promote welfare of the middle classes without compromising on revenue adequacy.

**Keywords**- Indian tax system; Middle class; Personal income tax; Section 87A rebate; New tax regime; Goods and Services Tax (GST); Indirect taxation; Disposable income; Consumption expenditure; Tax incidence; Tax progressivity; Tax compliance costs; Cost of living; Inflation indexation; Fiscal policy; Welfare analysis; Distributional impact; Revenue adequacy.





Evidence is India-specific: it is possible to conclude that the redistributive effect of income taxes, though it exists, may be small in comparison with the level of inequality. To illustrate it, the evidence on India emphasizes the importance of progressivity and redistributive impacts but also demonstrates the limitations caused by the arrangement of the taxpayer base and general fiscal design (Datt et al., 2022). The associated strand is based on long-run income-tax data to record the dynamics of the top-income, to explain why progressivity discussions often target the top tail, but not necessarily the so-called middle (Banerjee and Piketty, 2005).

It is also distributionally important that the choice is between the new and the old regime. The old regime subsidizes deductions (e.g. savings instruments, insurance, housing loan interest) and this is more likely to favor households that have stable consistent formal income and are able to tie their money in eligible instruments. The new regime minimizes the position of deductions and decreases rates with large tax-free brackets, which may help those who do not have significant deductibles, but who have constant wage revenue- usually a broad middle-income group. The 202526 policy documents expressly highlight new levels and new slabs in the new regime.

#### **Indirect taxes (GST) and cost-of-living effects**

Evidence in international studies on the consumption taxes, measured relative to the annual income, tends towards regressive (lower-income households consume a greater share of income) but lifetime incidence may vary (Keen and Lockwood, 2010; Blasco et al., 2023). Consumption taxes can then subsidize a significant share of redistribution obtained by direct taxes and transfers in cross-country evidence, which explains why the design of GST becomes an issue to the welfare of middle-income earners (Blasco et al., 2023).

In the case of India, implementation of GST has been analyzed in various areas which include pass-through to prices, efficiency and compliance and distributional implications. Empirical studies of GST pass-through effects among states in India observe weak or conflicting short-term inflationary impacts based on identification approach (Das, 2018). Other studies consider the efficiency of GST by state and discover a variation dependent on administrative capacity and feature which suggests that the welfare effect of GST is partially mediated by the quality of implementation (Mukherjee, 2020).

The 2025 GST rationalisation which shifts many goods to a simplified framework with extremely large rate cuts on mass-consumption products reinforces the cost of living arm of the middle-income families. The official records provide massive reduction of rates on household goods and food products.

#### **Compliance costs, complexity, and “hidden taxes”**

In addition to statutory liabilities there are compliance costs, time, money to intermediaries, record-keeping burdens, uncertainty, which cause welfare losses which acts as an implicit tax. Indian evidence is pointing to compliance costs of personal income taxation being significant and disproportionately salient to the small taxpayers who are forced to negotiate through rules, documentation, and filing (Singh, 2010). The syntheses of the world also indicate that simplification is capable of creating efficiency



without altering the rates (Eichfelder and Vaillancourt, 2014). The content in the literature of public finances does not consider administration and enforcement as an afterthought when the design of optimal tax is concerned (Slemrod and Yitzhaki, 2002).

### III. Methodology

#### Research design

- The policy-synthesis and secondary-data analytical research design is employed in this study. It integrates:
- Direct tax policy parameters (slabs, rebates, standard deduction, cess) of official budget FAQs, and Union Budget analyses;
- The GST Council press information varies by the changes in indirect tax (GST);
- Household consumption patterns using HCES fact-sheets of MoSPI to relate taxes to baskets of typical expenditures;
- Empirical evidence of incidence and compliance costs interpretation using peer-reviewed literature.

#### Data sources

- Income-tax policy: Budget 2026 FAQs (cap on rebate and thresholds) ; Budget 202526 press release (slabs in terms of thresholds and standard deduction) ; PRS Budget analysis tables summarising revised slabs.
- Answering GST: 56 th GST Council recommendations (press release); supporting coverage of simplification and effective date .
- Consumption trends: MoSPI HCES 202223 fact-sheet.

#### Analytical framework

We apply the three-channel incidence framework (Figure 1) in which tax policies are connected with middle-class results:

Channel A (Direct tax): Alterations in effective tax liability to disposable income to saving/consumption.

- Channel B (Indirect tax): GST/excise in prices will result in real purchasing power, which will result in cost-of-living stress.
- C (Administration): administration costs and uncertainty in the channel to compliance burden monetary/time cost to welfare and trust.

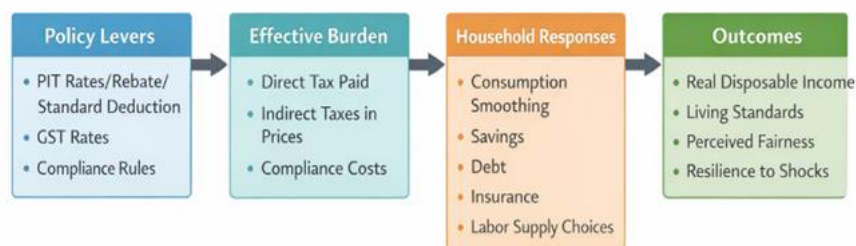


Figure 1. Conceptual framework (tax policy → middle-class welfare)

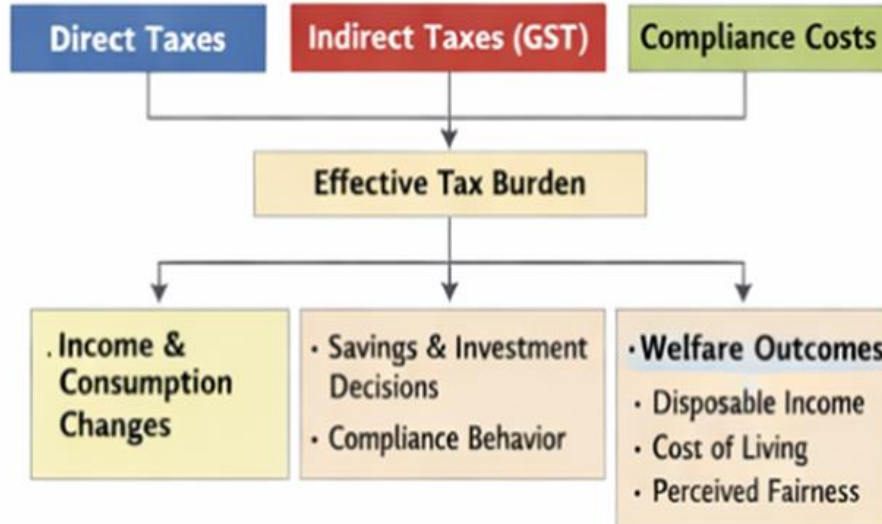


Figure 2. Conceptual Framework Linking Tax Policy and Middle-Class Welfare

**Results**

**Direct tax relief: higher tax-free thresholds and middle-class disposable income**

In outlines of the official budgetary 202526, no income tax is payable between 12 lakh and 12.75 lakh, respectively, of salaried taxpayers with a standard deduction of 75,000. The Budget 2026 FAQs further clarify that a maximum of 60,000 as a rebate can be received by a taxpayer that has a 12 lakh income under the new regime slabs, and offers a marginal relief boundaries that is slightly higher.

Middle-class wise, the primary welfare impact is greatest between households just above the line at which the rebate puts the household at zero liability: in many salaried families, this has the effect of zeroifying a positive tax payment and increasing the money left at home and liquidity. This does not apply uniformly across the middle class: still families with high housing-loan interest deductions, large Section 80C investments and other deductible expenses may be better under the old regime whereas those with no large deductible expenses may be better under the simple new regime and its higher rebate.

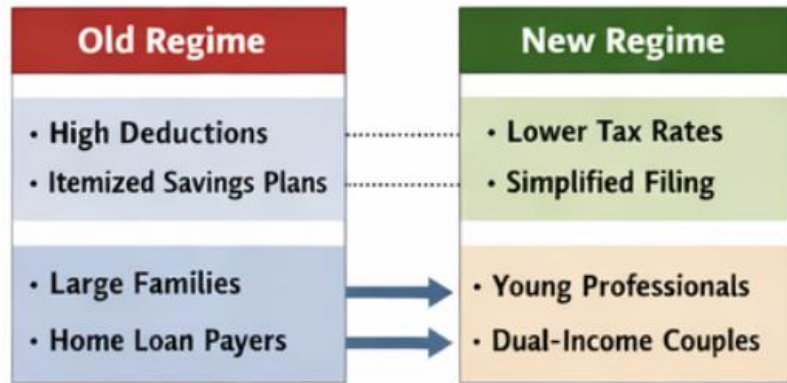


Figure 3. Comparison of Old vs New Income-Tax Regimes for Middle-Class Households

Table 1. Key direct-tax provisions most relevant to middle-class families (FY 2025–26 / AY

Provision	What changed/what matters	Expected middle-class effect
Section 87A rebate (new regime)	Maximum rebate described as ₹60,000; effective “no tax” up to ₹12 lakh in the new regime	Raises disposable income for lower/middle segments close to threshold; improves liquidity
Standard deduction (salaried)	Standard deduction highlighted as ₹75,000 in Budget 2025–26 messaging	Expands tax-free income band for salaried households; favors formal salaried middle class
Rate/slab restructuring (new regime)	Revised slabs summarized by PRS (e.g., nil up to ₹4 lakh; lower rates across bands)	Lowers average tax rates for many earners; reduces reliance on deductions
Health & Education Cess	Continued 4% on computed income tax	Moderately increases effective rates uniformly; small but salient

2026–27)



Figure 4. Structure of Direct Tax Relief under the New Income-Tax Regime (AY 2026-27)

Interpretation: The greatest felt relief in welfare terms is on a discrete jump in the disposable income (when the final rupee of tax is eliminated). This is consistent with the behavioral illustrations that homes are more responsive to salient changes in threshold change than marginal rate changes that are tiny (a stylized truth in tax salience research).

#### **Indirect tax reforms: GST rationalisation and cost-of-living pressures**

The recommendations of the 56th GST Council include general GST cuts: numerous common-man goods (e.g., personal care goods and household goods) fell to 5%/18% to 5%, and lots of packaged food were brought to 5%; several goods were brought to zero-rate. It is also reported that the transition to a simplified two-rate system (5% and 180 per cent) with a reduction in rates since 22 September 2025, and a projected revenue cost is in progress.

In the case of middle-class families, the welfare channel functions with real purchasing power: when frequently purchased goods switch the 18 percent to 5 percent in percentage, the price impact might be significant, particularly among the households with high proportions of expenditures on packaged foods, toiletries and household products. Nevertheless, the achieved advantage is determined by the pass-through: in case, the supply chains and market structure transfer the part of tax cut, the change in retail price can be less than the statutory change. Pass-through Experimental evidence on the GST pass-through varies by state shows that short-term inflationary impacts may be dampened and heterogeneous (Das, 2018), implying that pass-through is not automatic.

We take the case of the household welfare, using the HCES fact-sheets in MoSPI, we observe that the budget section of food, housing, transport, and health/education consumption is significant. Consequently, GST cuts on high frequency commodities are able to alleviate cost-of-living pressure also without income-tax relief (as in the case

of households out of tax net but facing elevated prices). To the middle class which is paying taxes, GST relief with direct tax relief augments perceived welfare.



Figure 5. GST Rate Rationalisation and Its Cost-of-Living Impact Channels

Table 2. Illustrative “basket” impact logic for middle-class households (directional, not a price forecast)

Expenditure category	Typical middle-class salience	Tax-policy linkage	Expected direction
Packaged foods, household consumables	High frequency purchases	GST rate reductions on many packaged foods/household items	↓ cost of living (if pass-through occurs)
Personal care & hygiene items	Monthly recurring	Many items shifted toward 5%	↓ cost of living
Durable “aspirational” goods (ACs, TVs)	Occasional, high-ticket	Selected durables moved from 28%→18%	↓ purchase price, can pull demand forward
Health & insurance	High risk exposure	Changes in GST treatment can affect premiums (policy-dependent and ITC-related)	Potential ↓ out-of-pocket risk costs

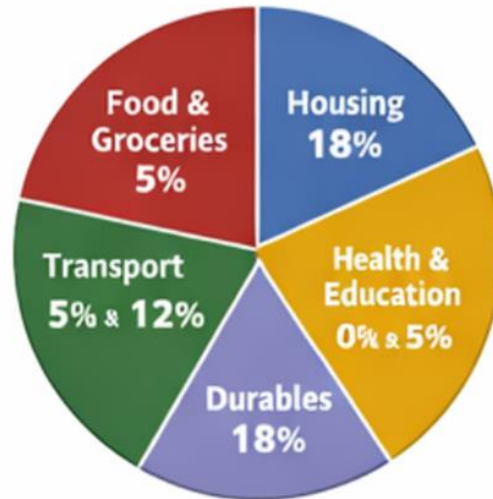


Figure 6. Middle-Class Household Consumption Basket and GST Exposure

**Compliance and administrative burden: welfare effects beyond the tax rate**

The compliance burdens are important to middle classes families in three ways:

- Costs of time and anxieties in filing, documents, and responding to the notices;
- Money expenditures on the services of tax preparers; and
- Timing effects and timing refunds of liquidity.

Indian evidence indicates that compliance expenses in individual taxpayers may be high in comparison to their paid tax in small taxpayers, which would mean that simplification is beneficial even in the absence of rate reductions (Singh, 2010). International experience also indicates the tax compliance costs and the administrative complexity to be economically relevant and to be included in a policy analysis (Eichfelder and Vaillancourt, 2014; Slemrod and Yitzhaki, 2002).



Figure 7. Compliance Costs as an Implicit Tax on Middle-Class Households



Table 3. Channels Through Which Compliance Costs Affect Middle-Class Welfare

Compliance dimension	Nature of cost	Welfare implication
Time costs	Filing returns, responding to notices	Loss of productive/leisure time
Monetary costs	Fees to tax consultants	Acts as an implicit tax
Psychological burden	Stress, uncertainty, fear of penalties	Reduced trust in tax system
Liquidity delays	Refund delays, mismatches	Temporary income stress

#### IV. Discussion & Conclusion

##### What the combined evidence implies for the Indian middle class

One, the immediate tax reforms that focus on higher rebates and greater tax-free income under the new regime adds disposable income and liquidity to a vast segment of middle-income households that are on salaries--especially those at the rebate cutoff. The 12 lakh limit on tax (i.e. no tax up to 12 lakh) and the 60,000 rebate limit are clearly mentioned in official documentation. The new regime can be conclusively effective in households with lower deductible expenditures, and the opposite, where a household has large deductions on housing-loan interest and savings to concession, the old regime can be competitive, making the policy impact heterogeneous.

Second, GST rationalisation in 2025 will presumably ease cost-of-living pressures on many middle-class households due to focusing on high-frequency consumption goods and some of the big-ticket durables, and known reductions between 12/18 and 5 and between 28/18 and 18 in a wide range of categories. However, as the rest of the literature suggests, consumption taxes are usually retrogressive to the annual income (Blasco et al., 2023). This implies that GST relief could be welfare enhancing to the middle-income class and yet not close the distributional question of whether the poor can equally enjoy as a result, particularly in cases where the essentials make the majority of their basket.

Third, compliance costs and design of administration is at the center. Indian empirical studies and international surveys indicate that welfare cost of compliance can be substantial and simplification can increase effective welfare in the same way that a reduction in rate does (Singh, 2010; Eichfelder and Vaillancourt, 2014). This is important to the middle-class taxpayers who not only have to pay taxes, but also go through the process of tax payment in the form of paperwork, uncertainty, and even professional fee as well.

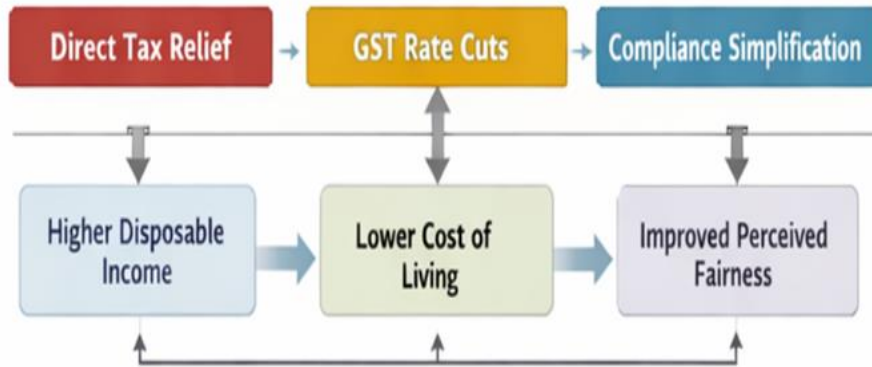


Figure 8. Integrated Welfare Impact of Indian Tax Policies on Middle-Class Families

**Policy implications (middle-class welfare + revenue adequacy)**

- Index key thresholds to inflation (or revise them on a rule based cycle) to minimize the bracket creep effects of real terms increases in the effective burden which otherwise can be caused without explicit increases in rates.
- The target GST relief to high-budget-share commodities and starkly restrain spillovers into luxury consumption, as is consistent with the evidence that consumption taxes may undermine redistribution.
- Ease of compliance through simplification of forms, pre-filing with information, better redressal of grievances and less small-friction TDS/TCS mismatch that creates delays in refunds.
- Expand the base in a reasonable way (by the way of improved reporting and reduced distorting exemptions) to maintain progressivity and at the same time maintain income to fund the public services which the middle-income population cherishes (health, education, urban infrastructure).

**Conclusion**

The middle-class families are influenced by the Indian tax policy in a complex cash + prices + compliance approach. Recent direct-tax relief in the new regime can increase disposable income significantly among many middle-class households on salary plus cost-of-living pressure on many goods in high demand and chosen durables- although pass-through and basket effects have an impact on realised benefits. The fact that administrative simplicity is a factual welfare lever is also emphasized in the evidence: the cut in compliance costs can offer the gains of middle-class welfare that are as high as fiscal relief, and may raise the confidence in the system. In future, inflation-sensitive thresholds, meticulous GST targeting, and reduced compliance costs provides an effective course of action to save the welfare of the middle classes without compromising the requirement of India to have stable revenues.



Table 6. Integrated Welfare Effects of Indian Tax Policies on Middle-Class Families

Policy lever	Primary channel	Net welfare outcome
Direct tax relief	Higher post-tax income	Increased disposable income
GST rationalisation	Lower consumer prices	Reduced cost of living
Compliance simplification	Lower implicit tax	Improved perceived fairness
Combined effect	Income + price + administration	Enhanced overall household welfare

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