

Impact of the ₹12 Lakh Tax-Free Threshold on Middle-Class Disposable Income in India: A Legal and Economic Analysis

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Abstract- The 2025 Union Budget saw a major transformation in the personal income tax in India, as the tax threshold on which income taxes were paid without payment was increasing to 12 lakh in the new tax regime. This policy measure is aimed to boost the disposable income for the middle class taxpayers and stimulate economic growth through consumption led growth. This study analyses the legal framework and economic implications of the 12 lakh tax-free threshold from a particular angle, i.e. its implications on the disposable income of the middle class. Using secondary data sources such as budget documents, statutory provisions and economic reports, the study conducts a comparative analysis of tax liability before and after the implementation of the revised threshold. The findings suggest a significant decrease in tax burden for those who are eligible to pay the tax which leads to a higher disposable income, better saving prospects and positive consumption effects. However, the benefits are unequally distributed among different income groups and are dependent on choice of tax regime. The paper then wraps up by pointing to the economic applicability of the policy, but also points out limitations concerning long-term fiscal sustainability, inflation and disparity based in the regime.

Keywords- Tax; Disposable Income; tax regime; income tax; middle class; income tax; tax regime; tax free amount; tax policy; income tax; India.

I. INTRODUCTION

Taxation is among the most significant tools of the government policy by which governments mobilize revenue, shape the behavior of the economy as well as social and developmental goals. The system of personal income tax in the environment of a

developing economy such as India is very important not only to fund the expenditure of the population but also to influence the household consumption, saving and investment. The income tax system in India has been through a number of reforms over the years that are directed to balance the revenue needs with the necessity to alleviate taxpayers, especially the middle classes, which is the workforce and domestic demand of the country.

Simplification, transparency, and convenience to the taxpayer have become a focus of the Indian tax policy in the past few years. This change can be seen through the slow transition towards deduction-intensive tax regime to lower slab rates and more extensive tax base. The optional new tax regime was a great move in that direction that promises more low rates to the taxpayers at the cost of eliminating numerous exemptions and deductions. Congruent with this strategy, the new tax regime in the Union Budget 2025 brought a significant change, which is to increase the income-tax free limit to 12 lakh. This reform is one of the largest direct tax relief changes on individual taxpayers in a long time.

The main aim of raising the tax-free limit is to boost the disposable incomes of the middle-class taxpayers. Disposable income is the income, which is left behind after the tax has been paid to the government according to the stipulated law and can be consumed or saved. The rise of the disposable income has a direct impact on the household financial well-being through the household purchasing power, higher savings, and financial security in the long-run. Macroeconomically, the increased disposable income in the middle-income households can boost the aggregate demand, fuel

consumption-led growth, and lead to the overall economic stability.

The Indian economy has a middle-ground class held by the middle-class. It forms a substantial portion of wage earners, professionals and self-employed who pays a regular contribution to the revenues of income tax as well as contributes to consumption in other areas such as housing, education, health, transport and consumer goods. Any alteration in tax policy that will impact this group has far-reaching consequences on the economy. By taxing income to a limit of 12 lakh under the new regime, the government aims to tax middle-income earners less by taxing their incomes and enable them to have more financial freedom.

Nevertheless, the economic effects of such a reform cannot be evaluated only by the declared purpose of this reform. The real value of the 12 lakh tax free threshold would vary depending on various factors such as distribution of income in the middle class segment, the option taken between the old and the new tax regime and the form of applicable tax slabs and rebates. Although the new tax regime provides lower rates and high exemption limit, there are also several exemptions and deductions that taxpayers will no longer enjoy as they did in the previous tax regime. Consequently, the magnitude of disposable income fluctuation among individuals and levels of income differs.

In addition to that, there are other implications of changes in tax policy besides immediate relief of income. The real value of tax benefits can also be affected over the time; this may be as a result of inflation, shift in consumption habits and fiscal limitations. Increase in tax-free floor can offer temporary relief yet long-term usefulness will rely on its periodic change and general fiscal viability. Besides, tax relief measures can help boost consumption but this also begs the question of the revenue implications to the government and fairness in allocation of benefits to various sections of the society. It is considering these factors that there is a necessity of a systematic and analytical analysis of the 12 lakh tax-free amount and its effect on disposable income to the middle classes. Although the intended benefits of the reform are noted in budget announcements, and policy statements, empirical and analytical studies that evaluate the real economic impact of the reform are scarce. It is thus necessary to have a focused analysis that would integrate legal analysis of tax system with

a corresponding economic analysis of disposable income changes.

This paper aims to fill this gap by illustrating the legality of the 12 lakh tax-free threshold in the new tax system and its effect on middle-class disposable income in terms of comparative tax calculations. The study will examine the effect of the reform on household financial outcomes, consumption potential and savings behavior by comparing changes in the tax liability prior to the implementation of the revised threshold and the changes in the tax liability after the implementation of the revised threshold. By doing that, the paper will help to understand the effectiveness and constraints of the recent reforms in direct taxation in India and their overall impacts on the economy.

This study will focus on examining the legal framework surrounding the ₹12 lakh tax-free threshold created by the new tax regime by evaluating the differences in tax liabilities that existed before and after the implementation of this new threshold. The effect of the ₹12 lakh tax-free threshold on the disposable income of the middle class population will be explored and the overall macroeconomic effects of this new tax threshold (i.e., consumer spending and saving behaviour) will be evaluated. The key limitations associated with the application of the new tax law will also be identified to provide an evaluation of the overall efficacy of the new tax law and thematic distributional issues surrounding the new tax law.

CURRENT TRENDS

The recent developments in the personal income tax policy in India indicate that there is progressive movement towards simplification, transparency, and pro-friendly tax reforms. The launch of the optional new tax system represented the shift away from deduction based taxation towards slab rates and simplification in taxation. The later budgets have culminated this strategy by increasing limits that are tax free and justifying tax slabs.

The other theme is the policy shift which is devoted to giving greater attention to domestic consumption in order to drive economic assistance. Tax relief measures targeted at middle income groups are seen as a good method of boosting aggregate demand, especially during the post-pandemic recovery phase. The partially tax-free limit of 12 lakh is in line with this larger chapter by creating a rise in disposable

economics and spurring disposable consumer spending.

Moreover, fiscal policies in the recent past focus on increasing the tax base with equity. Although the new tax regime has lower rates, it imposes tradeoffs among the taxpayers, in the form of forgoing several exemptions and deductions, thus reducing the simplicity of the tax regime. These trends point out the significance of considering not just the immediate tax cut offered by the restructured threshold directly, but its wider economic and spread effects as well.

Despite the introduction of 12 lakh tax-free threshold in the new tax regime, very less empirical and analytical research is done to offset its real impact on the disposable income of the middle class in India. While the policy is designed to offer tax relief and boost economic activity, there are questions about the degree of the benefits of the policy at different income levels, the policy's distributional and broader economic effects. This research is responding to the demand for a concentrated analysis on the effects of the revised tax-free threshold on disposable income and financial behaviour for middle-class taxpayers.

II. REVIEW OF LITERATURE

Bharadwaj (2025)¹ The Union Budget 2025 suggests a tax regime to enhance the disposable income of middle classes through a change in the income tax slabs.¹ The Union Budget 2025. Nevertheless, there are no specifications of detail provisions on the proposed 12 lakh tax-free limit in the budget. Consequently, although there is good will to offer relief, it is not clear in what form and the level of benefits that taxpayers will get. S (2025)² The literature review gives a conceptual and empirical basis to understand the impact of the new tax regime on the middle-income groups. It generalizes on the research on tax policy change, disposable income and saving behavior, assisting in highlighting gaps in research. The quantitative design of the study is also informed by the literature and also assists in development of hypotheses and interpreting the results. Kumar et al. (2025)³ The 2025 changes in the Goods and Services Tax (GST) system have had both positive and negative impacts on the household budget of the middle classes. Although cuts in GST rates of basic commodities and certain services have made them more affordable and favorable to consumption, the rise in taxes charged on

luxury and luxury goods has made the general financial burden bigger. Thus, the effects of these changes on the disposable income and spending patterns of the middle-income households are unevenly distributed. Rao and Neeraja (2018)⁴ The current research is a structured survey, aimed at investigating the effects of Goods and Services Tax (GST) on the prices of basic necessity goods and the resulting impact on the middle income earners (Rao and Neeraja, 2018). The insight of the research can be seen through the analysis of consumer perception and modification in purchasing behavior, which will make an empirical contribution in the nature of economic demands that households encounter and the overall evaluations of the GST effect on consumption behaviour. Gupta (2011)⁵ High income taxation rates will make people and businesses dislike working, saving, and investing as it will lower the incentives to economic effort. These are discouraging incentives that can slow down capital formation and long run growth. Thus, to promote investment, productivity, and general economic development without influencing economic decision-making, the tax reforms directed at the reduction of effective tax rates and enhancement of efficiency are frequently promoted. Gale et al. (2018b)⁶ The Tax Cuts and Jobs Act will likely offer short-term economic stimuli; nevertheless, it is likely to exert minimal effect on the GDP in the long term. This policy would most probably decrease federal incomes and increase income inequality. Such effects could in the long run offset the short run advantages thus reducing the real disposable income of many households especially the middle-income groups. Bharadwaj (2025b)⁷ Bharadwaj (2025b)⁷ The 2025 Union Budget provides a proposal of income tax reforms to boost the disposable income of the middle classes by reforming the tax slabs. But the budget documents fail to explicitly state the operation and implication of the proposed 12 lakh of tax free income threshold. This ambiguity causes confusion as to what the actual gains of the middle-income earners are, and constrains accurate evaluation of the distributional effect of the reform. S (2025b)⁸ The literature has emphasized that the new tax regime, even as it will be providing the lower slab rates, will decrease the benefit of the exemptions and deductions which may further increase the tax burden of the middle-income earners. Previous research highlights its ease of calculation of

taxes but expresses concerns that it has lowered incentives towards the long-term savings. These researches offer a basis on which the quantitative analysis of the variation in the disposable income and saving behavior of middle-income populations can be conducted. Chanda and Cook (2020)⁹ Demonetization was also linked to a higher level of economic activity in the poorer districts as indicated by growth in GDP per capita. Increase of bank deposit was also associated with increase in GDP per capita by 4%. In addition, the consumption expenditure and income gains were lower in poorer households. These are the conclusions that can be proved by evidence based on both regional level indicators and household level data analyses. Prakash (2019)¹⁰ The literature reviewed is focused mainly on the macroeconomic effects of demonetization in India, with a focus on the GDP changes, liquidity restrictions, and financial inclusion advancement. It, however, does not directly evaluate the impact of the 12 lakh income tax threshold on middle-class disposable income, which shows a definite gap in the research on household post-policy consumption and savings behaviors. Karmakar and Narayanan (2019)¹¹ According to existing information, Karmakar and Narayanan suggest that in the short term, demonetization had a negative effect on household income and consumption. The lack of access to formal banking in households witnessed greater reductions in spending, which are indicative of liquidity restrictions. This was seen to increase the dependence on borrowing in the recovery phase which has heterogeneous impacts on disposable income among households with various economic and financial inclusion levels. Deodhar (2016)¹² The source has a low relevance to the literature (ROL) since it does not test the effect of the 12 lakh tax-free limit on the disposable income of the middle-class. This limitation limits its level of analysis since disposable income is a direct determinant of consumption, savings behavior, and general economic welfare, which are key dimensions in determining whether tax policy reforms are successful or not. Lahiri (2020)¹³ Demonetization was not that successful in expanding the tax base of India since the formalization gains were small, and unevenly distributed in sectors. Simultaneously the policy created temporary losses of output, especially in cash intensive sectors, which negatively influenced employment, and decreased middle-income

disposable income, limiting household consumption and total economic impetus. Deshpande (2017)¹⁴ Within the framework of a literature review, this source is valuable as it discusses the economic and societal implications of demonetization why taken as a whole. Nevertheless, it does not directly examine how 12 lakh tax-free limit can impact on the disposable income of the middle-income group. This underscores a literature gap, which means that some specific research is necessary on the topic of alterations in tax policy and its direct effects to household financial well-being. Gale et al. (2018c)¹⁵ The Tax Cuts and Jobs Act will generate a temporary effect of increasing the economic activity, and its long-term effect on GDP is predicted to be marginal. The law will decrease the federal incomes and increase income disparity. These impacts could offset short term benefits, which could reduce spending power of the middle-income earners and leave majority of the households poorer at the end of the long run.

III. RESEARCH METHODOLOGY

3.1 RESEARCH DESIGN

The authors shall employ a descriptive and analytical research design to examine the impact of the implementation of a 12 lakh tax-free income threshold under the new system of income tax as part of the Union Budget 2025 to the disposable income of middle-class taxpayers in India in this research. The research will involve both a review of the legal factors of the proposed tax act, and the economic factor of the act on the economy of the country. The current paper is based entirely on secondary sources. The authors used Government of India publications, Government of India income tax act, publications devoted to the Union Budget and the related economic literature to gather all the secondary data. The authors applied comparative analysis methodology to conclude how much taxpayers are going to save due to having their tax cut and the amount of disposable income that will be left after the tax under the existing tax system and under the new tax regime. Additional comparisons will be applied to quantify the degree of tax cut to be offered to people living in middle-income groups and its expected impact on their savings and consumerism. The type of study is cross-sectional and is aimed at assisting to estimate the short-term effects of the tax reform work of 2025. Despite the lack of primary data,

the study design will offer a systematic structure to the assessment of the effectiveness of the new taxation policy, and the research of its distributional impact.

New tax regime with a 12 lakh tax, free threshold in the Union Budget 2025 was to increase the disposable income of the middle-class. Nevertheless, there is no intensive and thorough research on this measure in the existing literature. The bulk of the past work has been on significant tax reforms, GST, or demonetization, or macroeconomic outcomes, like GDP growth and tax base buildup. Even though there are studies that theorize the disposable income, they do not specifically take into account the modified income tax threshold and the initial, hand impacts of the same on the middle, class taxpayers.

In addition, some of the papers also highlight the ambiguity of the budget records regarding the specification and achievement of the 12 lakhs tax, free threshold, thereby making it more difficult to measure the distributional benefits in relation to the various income groups. Although there is no empirical comparison of taxes before and after the threshold change, particularly at the new tax system regime choice, there is obviously a gap in research. Therefore, there is need to conduct a legal and economic research on how the 12 lakhs taxation threshold would influence the disposable income, consumption and saving behaviour of the Indian middle-income group. It is a descriptive and analytical research, which relies on secondary data to furnish the content of the paper. It has come up with a research design that will enable it to examine both the legal framework and the economic implications of the tax, free threshold of 12 lakh that was announced in the Union Budget 2025. The secondary data has been generated through documentation of the official budgets, income tax laws, government publications, and relevant economic studies.

Prior to the new tax regime, comparative analytical approach was applied in assessing the modification in the tax liability due to revised threshold. The legal provisions on the new tax regime were research on in order to establish the statutory basis of the reform, and primarily the economic analysis focused on differences in the post, tax income. It is the only way to conduct an in-depth analysis regarding how the changes in the tax structure affect the middle, class taxpayers without having to use primary survey data.

3.2 DATA ANALYSIS

The Data analysis was performed by comparing the quantity of income tax to be paid under the old taxation regime with the case of a new tax regime and having a tax, free limit of 12 lakh. According to the findings of the study, the medium, class taxpayers with eligibility gain a sizeable cut in their tax liability, thus their net income is increased. The growth in the available income after tax increases the financial situation of the households and they can now save more and consume more goods and services.

The study results in general reflect that the tax reform is a move to consumption, led economic growth by increasing the purchasing power of their middle, income earning groups. The benefits are however not equally applicable to all, but rather they are dependent on the level of income and even on the preference of either the old or new tax regime.

In the same study, the winding of the road ahead is revealed, which involves matters like the ability of the government to finance its spending in the long term, the possibility of overheating the economy and equitably distributing the taxpayers in the various groups.

These findings indicate that although the policy provides a short-term relief, its overall economic outcome is conditional upon a number of structural and fiscal features.

IV. DISCUSSIONS

Salary range earners making less than ₹12,00,000 will now be able to keep all of that income and no longer pay taxes on it with the new ₹12 lakh tax-free threshold. This means the new tax structure removes over ₹1,79,400 (including the health & education cess) off your taxable income if your annual salary was \$\$. You would have paid in taxes under the old tax structure. Since this means you will have 17.6% more disposable income than before; it should greatly affect how you spend your extra money as a mid-income earner. In turn, this increased disposable income will result in increased spend in most critical consumer categories, including, but not limited to: education; health care; housing; durable goods (e.g., appliances, furniture, electronics).

The findings show that 12 lakhs tax-free rate is a significant move towards easing taxes and supporting the middle-income citizens. This reform would

increase the disposable income, which would in turn be accompanied by the objective of the government to boost domestic consumption and reinforce the aggregate demand. This is in line with the economic theory that decrease in direct taxation will positively influence consumption and saving behaviour by an individual or a household particularly in regard to low or middle incomes.

There are however serious concerns to the distribution of the benefits as this brings concerns of equity and inclusion. The simplified tax compliance will offer fewer tax incentives on individuals and families to save up their long-term savings since most of the tax breaks will be eliminated. The associated trade-off will probably impact negatively on the financial planning of most of the middle-income families.

The augmented disposable income can exert augmenting fiscal strains on government revenues in the long term; this can impact the capability of the government to proceed supplying its people with some expenditures or welfare programs. Consequently, the success of this policy will be determined by the further increase of the economy and the increase of the tax base significantly. On the whole, despite the short-term advantages of this reform implementation, the success of such policy in the long-term will be preconditioned by the close fiscal balancing and constant assessment of this policy.

V. CONCLUSION

The introduction of new income tax system as announced in the Union Budget will lead to a dramatic effect on individual taxation in India. The new income tax regime with the introduction of the tax free level of 12 lakh will be of great help to tax payers in the middle-income group that in turn will give a boost to further develop the economy in consumption based way. This reform will enable taxpayers to have less tax liability and more disposable income to spend in any manner they choose to (i.e. as spending money). This change in the law will enable households to spend and save more of their increased disposable income. Based on the analysis conducted, it has been established that the lowering of the tax bill will enable the generation of additional disposable earnings, and using the tax reform, will enhance government initiatives towards simplification of tax and higher compliance.

The positive sides of the tax reform would be on the part of offering taxpayers with tax relief due to the increased taxable income, though it should be mentioned that the tax relief which is granted to tax payers by the higher threshold level would not be equally distributed among the tax payers. The amount of tax relief will be specific to the situation of this or that taxpayer and will largely be predetermined by the fact whether the taxpayer chooses to exploit the new tax regime or the current taxation system on income. The new tax regime will eliminate exemptions and deductions to taxpayers that used to enjoy, which will become a potential setback to taxpayers who used to greatly benefit off the exemptions and deductions. One of the issues that taxpayers may be concerned with is equity and inclusiveness as it applies to this new system in as much as they had been using the old exemptions and deductions, and were enjoying the benefits.

The government should also know how long-term fiscal problems can affect the amount of money spent by people in case there is no compensating rise in consumption, compliance and rise of the tax base as discussed above. In this regard, the loss of the potential revenue will affect the government negatively and will have to consider possible cuts in the social services to the middle classes due to a higher tax load.

The 12 lakh (12,00,000 tax-free) limit is a good move towards the creation of the middle class and a very good stimulus to the economy in terms of higher disposable income although to achieve maximum success in the long run, the government needs to exercise sound fiscal management and revisit the policies laid down in the regard to this change with later enhancement and fair results.

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