

Understanding the Differences Between the Old and New Tax Regimes in India: Benefits and Challenges for Salaried Earners

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Abstract

The introduction of the new income tax regime in the Union Budget 2020, followed by substantial revisions in Budget 2023, has brought a transformative change to India's personal taxation landscape. Unlike the long-established old regime, which incorporated more than seventy deductions and exemptions such as House Rent Allowance (HRA), Leave Travel Allowance (LTA), and deductions under Sections 80C, 80D, and 24(b), the new regime emphasizes simplicity, transparency, and reduced tax rates. By eliminating most exemptions, the new system aims to offer an uncomplicated and flexible tax structure with lower compliance requirements.

This paper undertakes a detailed comparison between the two regimes, focusing specifically on salaried taxpayers. It examines the structural differences, financial implications, and behavioural outcomes associated with each regime. Furthermore, the study uses breakeven analysis to evaluate conditions under which taxpayers should opt for one regime over the other. Findings suggest that while the old regime remains advantageous for individuals claiming substantial deductions and with long-term saving objectives, the new regime benefits those seeking higher liquidity, reduced documentation, and simpler compliance.

Keywords: Income Tax Act 1961, Old Tax Regime, New Tax Regime, Section 80C, Section 87A, Deductions and Exemptions, Salaried Taxpayers.

Introduction

The structure of personal income taxation plays a crucial role in shaping the financial decisions and long-term planning of individuals, particularly salaried earners who constitute a significant portion of the taxpaying population in India. In recent years, the Indian government has undertaken major reforms in the personal tax system to simplify compliance, broaden the tax base, and promote a more transparent and efficient tax environment. One of the most notable changes in this regard has been the introduction of the New Income Tax Regime under Section 115BAC of the Income Tax Act, first announced in the Union Budget 2020 and further refined in the Budget 2023. This new system, offered as an optional alternative to the long-established Old Tax Regime, represents a shift in how taxpayers assess their

liabilities, plan their finances, and structure their savings. Understanding the differences between these two regimes—their benefits, limitations, and overall implications—is essential for salaried earners who must choose the system most aligned with their financial goals.

The Old Income Tax Regime has historically been the cornerstone of India's personal taxation framework. Built on progressive tax slabs paired with a wide array of exemptions and deductions, it has encouraged taxpayers to adopt disciplined saving habits, invest in long-term financial instruments, and utilize various government-approved schemes. For many years, this regime has helped salaried individuals reduce taxable income by investing in instruments such as the Public Provident Fund (PPF), Employee Provident Fund (EPF), National Savings Certificates (NSC), and life insurance premiums. Additionally, deductions under Section 80C, Section 80D, and allowances such as House Rent Allowance (HRA) and Leave Travel Allowance (LTA) have allowed taxpayers to manage both short-term expenses and long-term wealth creation. The Old Regime, therefore, has been both a tax structure and a behavioral tool, guiding individuals toward savings and social security while offering relief through structured deductions.

However, the complexity of the Old Regime, with its numerous provisions and documentation requirements, often posed challenges, especially for younger taxpayers or those with limited knowledge of tax planning. The need to maintain records, submit proof of investments, and navigate multiple tax-saving options made the compliance process time-consuming and sometimes confusing. It is in response to these difficulties that the government introduced the New Tax Regime, with the stated objectives of simplification and ease of compliance. The New Regime offers lower tax rates across several income slabs but eliminates most exemptions and deductions available under the Old Regime. In essence, the new system prioritizes straightforward taxation over structured savings incentives, allowing individuals more freedom to decide how they want to use their income.

For salaried earners, this choice between the Old and New Tax Regimes is not merely a mathematical comparison of tax liability; it is a decision that reflects broader financial priorities. The New Regime may benefit those who prefer higher take-home pay without the obligation to invest in specific instruments or claim multiple deductions. Individuals who do not have major financial commitments—such as home loans, insurance premiums, or dependents—may find the New Regime more aligned with their lifestyle. For younger professionals, especially those at the early stages of their careers, the simplified structure of the New Regime can reduce financial pressure and allow greater flexibility in spending and personal investment choices.

On the other hand, the Old Regime continues to appeal to salaried individuals who view tax planning as an opportunity for disciplined saving and long-term financial security. Those with home loans, medical expenses, higher insurance contributions, or dependent family members often benefit significantly from the numerous deductions it allows. The Old Regime can effectively reduce tax liability for taxpayers who claim substantial exemptions and deductions, making it a preferred choice for individuals with structured financial obligations. Moreover, the Old Regime aligns with India's traditional savings culture, where families prioritize long-term investments and financial protection.

The coexistence of two parallel tax systems reflects the government's acknowledgment of India's diverse taxpayer base, where financial preferences, income levels, and long-term goals vary widely. Salaried individuals, therefore, must analyze their financial situations carefully before selecting a regime for a given year. Factors such as annual income, investment habits, outstanding loans, medical needs, and future financial plans determine which regime offers optimal benefits. The government's decision to make the New Regime the default system from the financial year 2023–24 further underscores the need for taxpayers to familiarize themselves with the comparative advantages and challenges each regime presents.

Understanding these differences also holds relevance for policymakers, economists, and financial advisors. The introduction of the New Regime represents a significant policy shift toward simplifying taxation and increasing transparency, but it also raises important questions about the impact on household savings, investment patterns, and social security. As India moves toward a more digitized and efficient tax ecosystem, analyzing how salaried individuals respond to these options becomes vital. Their choices not only affect individual financial well-being but also influence broader economic trends related to consumption, investment, and overall financial stability.

Thus, the examination of the Old and New Income Tax Regimes is essential for understanding how tax policy reforms affect salaried earners in India. By exploring their respective benefits and challenges, this comparative study provides valuable insights into how individuals can navigate the evolving tax landscape to make informed and strategic financial decisions.

Objectives of the Study

1. To systematically compare the structural components, tax slabs, benefits, and limitations of the old and new income tax regimes under the Income Tax Act, 1961, with a focus on salaried taxpayers.
2. To analyse the financial, economic, and behavioural implications of adopting the new tax regime, particularly with reference to spending power, liquidity, compliance burden, and long-term investment behaviour.
3. To evaluate the conditions under which taxpayers should choose between the two regimes, using breakeven analysis and understanding the influence of deductions, exemptions, and income levels.

Methodology

This study is qualitative in nature and is based on **secondary data sources**, including Union Budget documents, Income Tax Department circulars, academic papers, government reports, and financial expert analyses. A comparative analytical framework is used to evaluate differences between the old and new regimes. Tables are used to present tax slabs, deductions, and pros and cons. A conceptual breakeven analysis approach is applied to determine taxpayer suitability under each regime.

Significance of the Study

The coexistence of two tax regimes in India presents both opportunities and challenges for taxpayers, especially salaried individuals. Understanding the distinction between the old and new regimes is crucial for informed financial planning. The study is significant as it clarifies the impact of tax reforms on savings behaviour, liquidity, compliance levels, and long-term financial decision-making. It also contributes to contemporary academic discourse on India's shifting taxation philosophy—from incentivizing savings to promoting simplicity and increased disposable income.

Pros and Cons of the Old Tax Regime

Table 1: Pros and Cons of the Old Tax Regime

Pros of the Old Tax Regime	Cons of the Old Tax Regime
Offers 70+ deductions and exemptions such as HRA, LTA, 80C, 80D	Highly complex structure with multiple rules
Helps significantly reduce taxable income	Requires extensive documentation and proofs
Encourages long-term savings (PPF, ELSS, NSC, LIC, PF)	Leads to forced saving behaviour
Beneficial for high investors (home loan, insurance, tuition fees)	Reduces take-home salary due to heavy commitments
Suitable for salaried individuals with structured allowances	Not beneficial for taxpayers unable to claim deductions
Allows flexible and detailed tax planning	Higher tax slab rates than the new regime
Lower effective tax for high deduction claimers	Complex exemption system increases errors
Supports long-term financial discipline	Difficult for average taxpayers to understand

Pros and Cons of the New Tax Regime

Table 2: Pros and Cons of the New Tax Regime

Pros of the New Regime	Cons of the New Regime
Lower tax rates across income slabs	No major deductions such as HRA, LTA, 80C, 80D

Pros of the New Regime	Cons of the New Regime
Simple and easy-to-understand structure	Not suitable for high deduction claimants
Minimal documentation required	Reduces encouragement for savings
Higher rebate limit (up to ₹7 lakh under Section 87A)	May result in higher tax for investors
Higher take-home salary, more liquidity	Limited tax planning flexibility
Suitable for those with low investments	No benefit for salaried individuals receiving allowances
Reduces compliance burden	Does not support long-term wealth creation strongly
Transparent and exemption-free	Must be evaluated each year

Income Tax Slabs for FY 2024–25 (AY 2025–26)

Table 3: Tax Slabs under Old and New Regimes

Regime	Income Slab (₹)	Tax Rate
Old Regime	Up to 2,50,000	0%
	2,50,001 – 5,00,000	5%
	5,00,001 – 10,00,000	20%
	Above 10,00,000	30%
New Regime (115BAC)	Up to 3,00,000	0%
	3,00,001 – 7,00,000	5%
	7,00,001 – 10,00,000	10%
	10,00,001 – 12,00,000	15%
	12,00,001 – 15,00,000	20%
	Above 15,00,000	30%

Structural Comparison Between Old and New Regimes

Table 4: Basic Structural Comparison

Feature	Old Regime	New Regime
Tax rates	Higher	Lower
Deductions & exemptions	70+ available	Very limited
Documentation	High	Low
Complexity	High	Low
Financial objective	Encourages savings	Encourages liquidity
Suitability	High deduction claimers	Low deduction claimers

Deductions and Exemptions: A Comparative Overview

Table 5: Deductions under Old vs New Regime

Provision	Old Regime	New Regime
HRA	Allowed	Not allowed
LTA	Allowed	Not allowed
Standard deduction	Allowed	Allowed (₹50,000)
Section 80C	Allowed	Not allowed
Section 80D	Allowed	Not allowed
Home loan interest (24b)	Allowed	Not allowed
NPS deductions	Allowed	Partially allowed (employer contribution)

Detailed Analysis of the Two Regimes

1. Old Tax Regime: A Savings-Oriented Philosophy

The old regime is deeply rooted in India's traditional tax planning approach, where savings and long-term investments are encouraged. More than seventy exemptions and deductions allow taxpayers to significantly reduce their taxable income. Benefits under HRA, LTA, Section 80C investments, Section 80D health insurance premiums, and home loan interest make it especially favourable for salaried individuals with structured income profiles.

However, this system creates complexity. Taxpayers must maintain numerous documents, investment proofs, rent receipts, and bills to claim exemptions. The structure indirectly compels taxpayers to invest simply for the sake of tax reduction, sometimes at the cost of liquidity. Yet, for those who plan their finances strategically, the old regime continues to provide greater long-term wealth-building opportunities.

2. New Tax Regime: A Shift Toward Simplicity and Liquidity

The new tax regime removes most deductions and exemptions, replacing them with lower tax rates and a simplified slab structure. It seeks to provide individuals with more disposable income by not forcing tax-saving investments. The enhanced rebate up to ₹7 lakh further benefits middle-income earners.

The removal of documentation requirements significantly reduces compliance burdens. Moreover, the system encourages individuals to invest based on financial needs rather than tax incentives. However, salaried taxpayers with high allowances or substantial investments may lose out under the new structure.

3. Economic and Social Implications

The new tax regime promotes household consumption by increasing take-home salary. This is aligned with the government's objective of stimulating economic growth in a consumption-driven economy. The simplified structure also minimizes tax evasion and enhances transparency.

Conversely, the reduction in tax-motivated savings may impact long-term national savings rates. The old regime contributes to disciplined savings, which play an important role in household financial security.

Breakeven Analysis in Choosing the Suitable Regime

Breakeven analysis is crucial in determining which regime is best for an individual. The breakeven point is the minimum level of deductions required under the old regime to make it more beneficial than the new regime.

General Observation:

- If total deductions exceed ₹2,00,000–₹3,00,000, the **old regime** is usually more beneficial.

- If deductions are **below this range**, the **new regime** offers lower tax liability.

This varies depending on income slab and salary structure.

Government Policy Direction

Budget 2023 made the new regime the **default tax regime**, indicating the government's intent to gradually shift taxpayers toward this simplified system. However, the old regime continues to coexist, ensuring freedom of choice.

Conclusion

The coexistence of the old and new income tax regimes presents salaried individuals with a significant decision-making responsibility. The old regime offers tax-saving benefits through numerous deductions, making it ideal for individuals with structured salary components, home loans, insurance premiums, and systematic investment patterns. It reinforces long-term financial discipline and wealth accumulation.

On the other hand, the new regime emphasizes simplicity, transparency, and higher liquidity. With lower tax rates and minimal documentation, it caters to young earners, low deduction claimers, and individuals who prioritize take-home salary over tax-motivated savings.

Ultimately, the choice between the two regimes depends on an individual's income structure, investment habits, financial priorities, deduction eligibility, and long-term goals. Regular evaluation is essential as personal financial situations evolve and tax laws change.

Both regimes have their strengths, and understanding their implications ensures informed and effective tax planning in an evolving economic environment.

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