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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 significantly influences the standard of living of the middle classes in India in three primary ways: (i) through direct taxes on income (including personal income tax, surcharge, cess, and payroll-based compliance requirements); (ii) through indirect taxes (particularly the Goods and Services Tax (GST) and excise duties); and (iii) through the interaction between tax design and broader economic factors such as inflation, housing costs, and household consumption baskets. This paper synthesises recent policy changes and empirical literature to assess the impact of Indian tax policies on disposable income, consumption, savings, and perceived fairness among middle-class families. It examines key mechanisms and documents distributional implications using secondary evidence from the Income Tax Department's Budget FAQs and tax slabs, reports by PRS Legislative Research, GST Council rate rationalisation documents, and household consumption fact sheets published by the Ministry of Statistics and Programme Implementation (MoSPI). The findings suggest that recent income-tax relief measures, particularly the increase in the tax-free threshold through the Section 87A rebate and the enhancement of the standard deduction under the new tax regime, have increased post-tax income and may stimulate consumption among lower and lower-upper middle-income segments. At the same time, these changes reduce the relative advantage of deduction-intensive tax planning under the old regime. Indirect tax reforms that reduce rates on mass-consumption goods and certain aspirational durables can lower the cost of living. However, consumption taxes are structurally regressive when measured against annual income, particularly where essential goods constitute a larger share of household budgets. Administrative complexity and compliance costs also play a significant role. Evidence indicates that compliance burdens are not trivial, and simplification of procedures can

generate welfare gains beyond the effect of tax rate changes alone. The paper concludes by proposing policy alternatives, such as improved indexation to inflation, better targeting of GST relief, and a reduction in compliance costs, that can enhance the welfare of middle-class households without compromising revenue adequacy.

Keywords: Indian tax policy, middle-class welfare, direct taxation, income tax reform, Union Budget 2025–26, Section 87A rebate, standard deduction, tax-free threshold, tax incidence, disposable income, GST rationalisation, indirect taxation, cost of living, household consumption, HCES 2022–23, compliance costs, tax administration, progressivity, fiscal policy, public finance, India

1. Introduction

Middle-class families in India play a strategic role in the country's fiscal as well as political economy. They account for an increasingly significant proportion of reported personal income tax collections, drive urban consumer demand, and are often perceived as “swing voters” in public debates surrounding tax relief and fiscal populism. However, the middle class is not a homogeneous income category. It includes single-earner salaried households, dual-income families, professionals, small proprietors, and newly urban migrant households. Each of these groups faces varying levels of exposure to direct taxes, GST-inclusive prices, housing costs, education expenditure, health shocks, and credit obligations.

In theory, the influence of tax policy on the middle class must be assessed not only through statutory tax rates, but through effective disposable income after accounting for: (a) direct taxes and payroll-based charges; (b) indirect taxes embedded in consumer prices; and (c) compliance and transaction costs. A comprehensive welfare analysis must therefore integrate tax incidence, cost-of-living effects, and administrative burdens.

This question has become particularly topical in light of recent reforms. In the Union Budget 2025–26, the Government of India announced that no income tax would be payable on income up to ₹12 lakh under the new tax regime through an enhanced rebate mechanism. Salaried taxpayers could effectively remain tax-free up to ₹12.75 lakh after accounting for the standard deduction. The maximum rebate of ₹60,000 in the case of ₹12 lakh income was clarified in

subsequent official documentation¹. These changes were positioned as middle-income relief measures aimed at boosting consumption and supporting aggregate demand.

On the indirect tax front, significant GST rate rationalisation was announced at the 56th meeting of the GST Council in September 2025. A wide range of common consumption items were shifted to the 5 per cent or nil rate slab, while certain durable goods were placed under the 18 per cent slab. For middle-class families, such reforms may directly affect the cost of living—particularly with respect to packaged foods, personal care products, household goods, and selected appliances. However, the distributional impact depends on household-specific consumption baskets.²

Accordingly, this paper asks: What is the impact of Indian tax policies on the welfare of middle-class families in terms of expendable income, consumer prices, and compliance burdens? It offers a structured synthesis of policy mechanisms, maps the available evidence, and examines practical implications for middle-income households.

2. Literature Review

2.1 Direct Tax Design, Progressivity, and Middle-Class Incidence

Classical public finance literature demonstrates that the welfare effects of direct taxation are determined by progressivity, behavioural responses, and administrative costs³. Even progressive tax schedules may produce limited redistribution when the tax base is narrow, enforcement capacity is uneven, and exemptions dilute effective progressivity. In emerging economies, tax morale, third-party reporting mechanisms, and administrative simplicity significantly influence both revenue collection and perceived equity.

India-specific evidence suggests that while income taxation does have redistributive effects, its overall impact on inequality may be modest relative to structural disparities. Studies such as Datt et al. (2022) highlight the importance of progressivity but also point to constraints arising from a limited taxpayer base and broader fiscal design. Long-run income tax data analysed by

¹ Ministry of Finance, Government of India, *Union Budget 2025–26* (Budget Speech and Budget Documents, 2025).

² Goods and Services Tax Council, *Recommendations of the 56th GST Council Meeting* (Press Release, September 2025).

³ Emmanuel Saez, 'Using Elasticities to Derive Optimal Income Tax Rates' (2001) 68(1) *Review of Economic Studies* 205.

Banerjee and Piketty (2005) document the dynamics of top incomes in India, explaining why debates on progressivity often focus on the top tail rather than the middle-income segment.

The choice between the old and new tax regimes has important distributional implications. The old regime incentivised deductions—such as investments in savings instruments, insurance premiums, and housing loan interest—thereby favouring households with stable formal incomes and the ability to lock funds into eligible instruments. In contrast, the new regime minimises deductions and offers lower rates with wider tax-free brackets. This structure may benefit individuals without significant deductible expenditures but with steady wage income—typically a broad segment of middle-income earners. The Union Budget 2025–26 policy documents explicitly highlight revised slabs and enhanced rebate provisions under the new regime, underscoring its redistributive intent within the middle-income band.

2.2 Indirect Taxes (GST) and Cost-of-Living Effects

International literature on consumption taxation generally finds that such taxes are regressive when measured relative to annual income, as lower-income households spend a larger proportion of their income on consumption (Keen and Lockwood, 2010; Blasco et al., 2023). However, lifetime incidence may vary depending on savings patterns and intertemporal consumption. Cross-country evidence suggests that consumption taxes can partially offset redistribution achieved through direct taxes and transfers, making the design of GST crucial for middle-income welfare.

In India, the implementation of GST has been examined in terms of price pass-through, efficiency gains, compliance costs, and distributional implications. Empirical studies analysing GST pass-through across Indian states report mixed short-term inflationary impacts, depending on identification strategies (Das, 2018). Other research finds that GST efficiency varies across states, reflecting differences in administrative capacity and implementation quality (Mukherjee, 2020). These findings suggest that the welfare effects of GST are mediated not only by rate structures but also by institutional performance.

The 2025 GST rationalisation announced by the GST Council—which moved many mass-consumption goods to lower slabs—strengthens the cost-of-living dimension of tax policy. Official documentation indicates substantial rate reductions on household goods and food products. For middle-class households, such changes may reduce expenditure burdens;

however, the net effect depends on the relative weight of essentials versus discretionary goods in household consumption baskets.

2.3 Compliance Costs, Complexity, and “Hidden Taxes”

Beyond statutory liabilities, taxpayers incur compliance costs in the form of time spent on filing, payments to intermediaries, record-keeping obligations, and uncertainty. These burdens create welfare losses that function as implicit or “hidden” taxes. Indian evidence suggests that compliance costs associated with personal income taxation can be significant and disproportionately salient for smaller taxpayers navigating complex rules and documentation requirements (Singh, 2010)⁴.

International syntheses demonstrate that simplification can generate efficiency gains without altering statutory rates (Eichfelder and Vaillancourt, 2014)⁵. Public finance scholarship increasingly recognises that administration and enforcement are integral to optimal tax design rather than afterthoughts (Slemrod and Yitzhaki, 2002)⁶. For middle-class households, therefore, the welfare impact of taxation extends beyond rates and rebates to include the administrative architecture through which taxes are implemented.

3. Methodology

3.1 Research Design

This study adopts a policy-synthesis and secondary-data analytical research design. The approach integrates multiple strands of evidence in order to evaluate the welfare impact of tax policy on middle-class households. Specifically, the study combines:

1. **Direct tax policy parameters**, including revised slabs, rebate limits, standard deductions, and cess provisions, as set out in official Budget FAQs and analyses of the Union Budget 2025–26;⁷

⁴ Manmohan Singh, ‘Compliance Costs of Personal Income Tax in India’ (2010) National Institute of Public Finance and Policy Working Paper.

⁵ Sebastian Eichfelder and François Vaillancourt, ‘Tax Compliance Costs: A Review of Cost Burdens and Cost Structures’ (2014) 20(2) *International Tax and Public Finance* 183.

⁶ Joel Slemrod and Shlomo Yitzhaki, ‘Tax Avoidance, Evasion, and Administration’ in Alan J Auerbach and Martin Feldstein (eds), *Handbook of Public Economics*, vol 3 (Elsevier 2002).

⁷ Ministry of Finance, Government of India, *Budget 2026 FAQs on New Income Tax Regime and Rebate under Section 87A* (Press Release, 2026).

2. **Indirect tax changes**, particularly GST rate rationalisation measures communicated through press releases and recommendations of the GST Council;
3. **Household consumption patterns**, derived from the Household Consumption Expenditure Survey (HCES) fact sheets published by the Ministry of Statistics and Programme Implementation (MoSPI), in order to relate tax changes to typical middle-class expenditure baskets⁸; and
4. **Empirical literature** on tax incidence and compliance costs, drawn from peer-reviewed academic research, to interpret distributional and behavioural implications.

By synthesising policy documents with empirical evidence, the study aims to move beyond statutory rate analysis and assess effective welfare outcomes.

3.2 Data Sources

The analysis relies exclusively on secondary sources, including:

- **Income-tax policy documents:** Budget 2026 FAQs (particularly regarding rebate caps and income thresholds); press releases accompanying the Union Budget 2025–26 detailing revised slabs and standard deduction provisions; and analytical tables prepared by PRS Legislative Research summarising changes in tax structure.⁹
- **GST policy materials:** Press releases and official recommendations issued following the 56th meeting of the GST Council, including details on rate rationalisation, simplification measures, and effective dates of implementation.
- **Consumption data:** Household Consumption Expenditure Survey (HCES) 2022–23 fact sheets published by the Ministry of Statistics and Programme Implementation, used to map expenditure patterns across income groups.

These sources enable a structured comparison between policy intent and likely economic incidence.

3.3 Analytical Framework

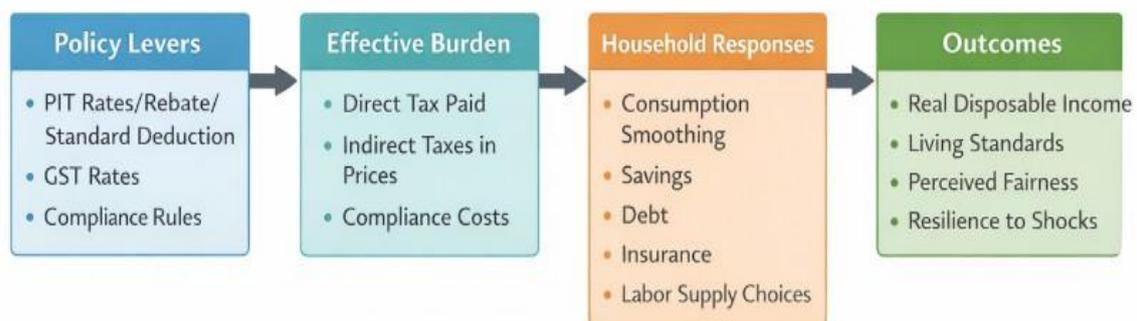
⁸ Ministry of Statistics and Programme Implementation (MoSPI), Government of India, *Household Consumption Expenditure Survey (HCES) 2022–23: Fact Sheets* (2023).

⁹ PRS Legislative Research, *Union Budget 2025–26: Analysis of Direct Tax Proposals* (PRS Legislative Research 2025)

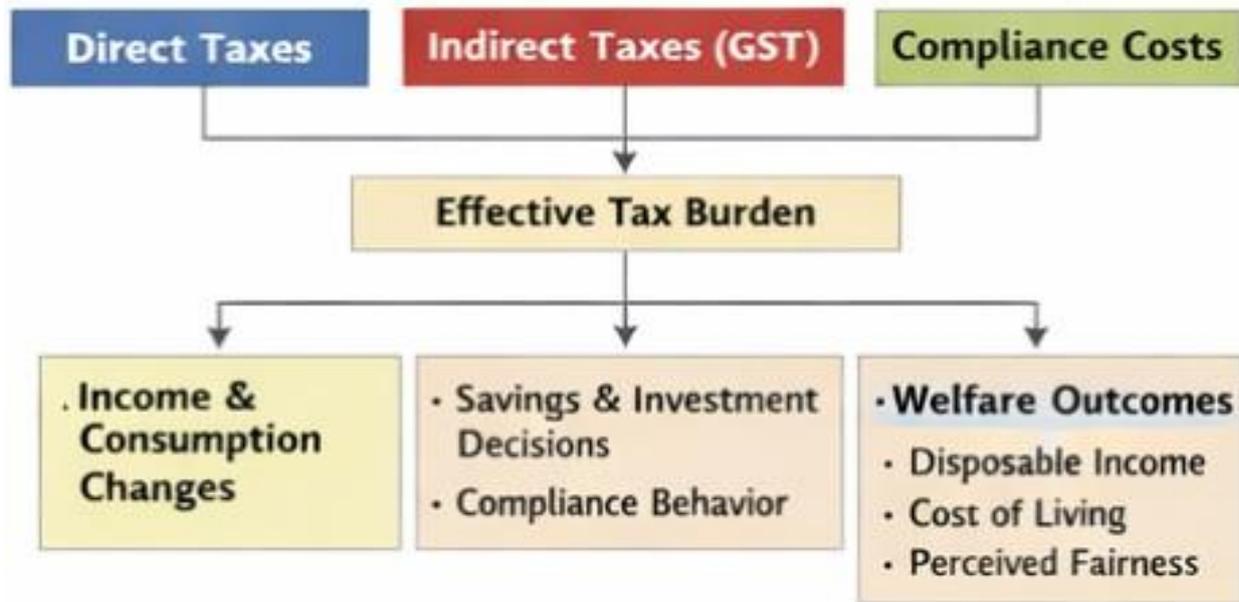
The study applies a three-channel tax incidence framework (Figure 1) linking tax policy to middle-class welfare outcomes:

- **Channel A (Direct Tax Channel):** Changes in effective income-tax liability affect disposable income, which in turn influences savings and consumption decisions. Relief measures—such as enhanced rebates or expanded tax-free brackets—operate through this channel.
- **Channel B (Indirect Tax Channel):** GST and excise duties embedded in consumer prices influence real purchasing power. Rate rationalisation affects the cost of living, particularly for goods that constitute a significant share of middle-class consumption baskets.¹⁰
- **Channel C (Administrative and Compliance Channel):** Administrative complexity, compliance costs, and uncertainty translate into monetary and time burdens. These “hidden costs” affect welfare and taxpayer trust, independent of statutory tax rates.

Together, these three channels provide an integrated framework for assessing how tax design translates into tangible economic outcomes for middle-class households.



¹⁰ AB Atkinson and JE Stiglitz, ‘The Design of Tax Structure: Direct versus Indirect Taxation’ (1976) 6(1) *Journal of Public Economics* 55.



4. Results

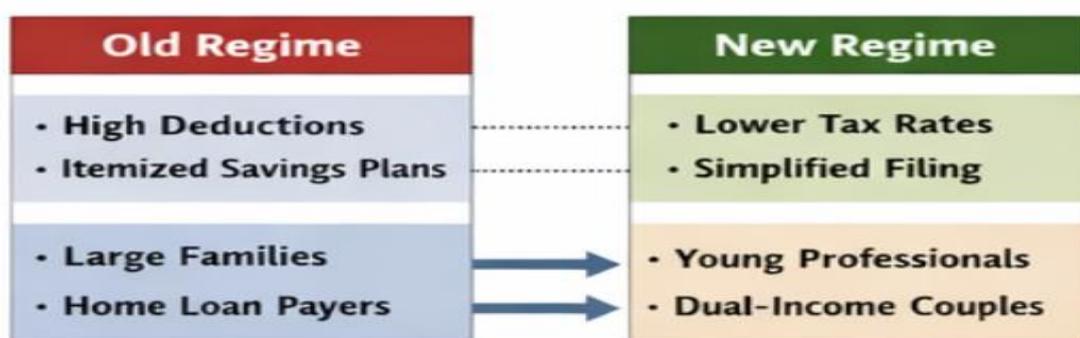
4.1 Direct Tax Relief: Higher Tax-Free Thresholds and Middle-Class Disposable Income

According to the official outlines of the Union Budget 2025–26, no income tax is payable under the new regime on income up to ₹12 lakh due to the enhanced rebate mechanism. For salaried taxpayers, the availability of a standard deduction of ₹75,000 effectively raises the tax-free income threshold to ₹12.75 lakh. The Budget 2026 FAQs further clarify that a maximum rebate of ₹60,000 is available to a taxpayer earning ₹12 lakh under the new regime slabs, along with marginal relief provisions to smoothen liability at the threshold.

From a middle-class perspective, the primary welfare impact is concentrated among households just above the earlier tax-liability threshold—particularly those whose net tax liability is reduced to zero due to the enhanced rebate. For many salaried families, this reform effectively eliminates a positive tax payment, thereby increasing take-home income and improving short-term liquidity. The additional disposable income may translate into higher consumption expenditure or precautionary savings, depending on household preferences and financial obligations.

However, the benefits are not uniform across the middle class. Households with significant housing loan interest deductions, substantial investments under Section 80C, or other deductible expenditures may still find the old regime more advantageous. In contrast, individuals without large deductible expenses—especially salaried earners with stable incomes—may benefit more from the simplified new regime with its higher rebate and wider tax-free brackets.

Thus, the distributional effect of direct tax relief depends not only on income level but also on household financial structure, debt exposure, and investment patterns.



Provision	What Changed / What Matters	Expected Middle-Class Effect
Section 87A Rebate (New Regime)	Maximum rebate of ₹60,000; effective “no tax” up to ₹12 lakh under new regime	Raises disposable income for lower- and middle-income segments near threshold; improves liquidity
Standard Deduction (Salaried)	₹75,000 highlighted in Budget 2025–26	Expands tax-free income band for salaried households; favours formal middle-class earners
Rate / Slab Restructuring (New Regime)	Revised slabs summarised by PRS Legislative Research (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 at 4% on computed income tax	Moderately increases effective rates uniformly; small but salient addition

4.2 Indirect Tax Reforms: GST Rationalisation and Cost-of-Living Pressures

The recommendations of the 56th meeting of the GST Council included significant GST rate rationalisation. Many common consumption goods—including personal care items and household products—were reduced from 12% or 18% to 5%. Several packaged food items were also brought under the 5% slab, and certain goods were zero-rated. Additionally, some durable goods were moved from higher slabs (e.g., 28%) to 18%, with implementation effective from 22 September 2025.

For middle-class families, the welfare channel operates through real purchasing power. When high-frequency goods shift from 18% to 5%, the price effect can be substantial—particularly for households whose expenditure baskets include packaged foods, toiletries, and household consumables. However, realised gains depend on tax pass-through. If supply chains and market structures absorb part of the tax reduction, retail prices may not fall proportionately. Empirical evidence on GST pass-through across Indian states suggests heterogeneity and dampened short-term inflationary effects (Das, 2018), indicating that statutory rate changes do not automatically translate into equivalent consumer price reductions.

Using the Household Consumption Expenditure Survey (HCES) fact sheets published by the Ministry of Statistics and Programme Implementation, it is evident that food, housing, transport, and health/education constitute significant portions of middle-class expenditure. GST reductions on frequently purchased goods can therefore alleviate cost-of-living pressures—even for households outside the income-tax net but affected by rising prices. For tax-paying middle-class households, GST relief combined with direct tax reductions may produce a cumulative welfare gain.

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

Expenditure Category	Typical Middle-Class Salience	Tax-Policy Linkage	Expected Direction
Packaged foods & household consumables	High-frequency purchases	GST rate reductions on packaged foods and household goods	↓ Cost of living (if pass-through occurs)

Expenditure Category	Typical Middle-Class Saliency	Tax-Policy Linkage	Expected Direction
Personal care & hygiene items	Monthly recurring expenses	Many items shifted toward 5% slab	↓ Cost of living
Durable “aspirational” goods (ACs, TVs)	Occasional, high-ticket purchases	Selected durables moved from 28% to 18%	↓ Purchase price; may pull demand forward
Health insurance & related services	High risk exposure	GST treatment affects premium pricing (policy dependent)	Potential ↓ in out-of-pocket risk costs

4.3 Compliance and Administrative Burden: Welfare Effects Beyond the Tax Rate

Compliance burdens affect middle-class households in at least three ways:

1. **Time and administrative stress** associated with filing returns, maintaining documentation, and responding to notices;
2. **Monetary expenditures** on tax consultants or preparers;
3. **Liquidity effects**, including delays in refunds and mismatches in TDS/TCS credits.

Indian evidence suggests that compliance costs for individual taxpayers can be substantial relative to the tax actually paid—particularly for smaller taxpayers—implying that simplification may yield welfare gains even without rate reductions. International research further confirms that tax compliance costs and administrative complexity are economically significant and should be incorporated into policy analysis.

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 or 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

5. Discussion & Conclusion

5.1 Combined Implications for the Indian Middle Class

First, direct tax reforms under the Union Budget 2025–26—particularly enhanced rebates and higher tax-free thresholds—clearly increase disposable income and liquidity for a large segment of salaried middle-income households. The “no tax up to ₹12 lakh” threshold and ₹60,000 rebate limit, as documented in official sources, are especially beneficial for households near the cutoff. However, the impact remains heterogeneous depending on deduction patterns and housing-loan exposure.

Second, GST rationalisation announced by the GST Council in 2025 is likely to ease cost-of-living pressures by targeting high-frequency consumption goods and selected durable items. Nevertheless, as highlighted in the literature, consumption taxes are generally regressive relative to annual income (Blasco et al., 2023). Thus, while GST relief may enhance middle-class welfare, it does not fully resolve broader distributional concerns.

Third, compliance costs and administrative design are central to welfare outcomes. Both Indian and international evidence suggest that reducing compliance burdens can improve effective welfare in ways comparable to statutory tax relief. For middle-class taxpayers, administrative

simplicity, timely refunds, and reduced paperwork are crucial components of perceived fairness and economic well-being.

5.2 Policy Implications (Middle-Class Welfare and Revenue Adequacy)

1. **Index key tax thresholds to inflation** to prevent bracket creep and unintended increases in effective burden.
2. **Target GST relief toward high-budget-share essentials** while limiting spillovers into luxury consumption categories.
3. **Simplify compliance procedures** through expanded pre-filing of returns, improved grievance redressal, and reduced TDS/TCS mismatches.
4. **Broaden the tax base rationally** by improving reporting and reducing distortionary exemptions, thereby maintaining progressivity and revenue adequacy needed to fund public goods such as health, education, and urban infrastructure.

5.3 Conclusion

Indian tax policy influences middle-class households through a combined framework of cash flows (post-tax income), prices (GST-embedded consumption costs), and compliance burdens. Recent direct tax relief under the new regime has the potential to significantly increase disposable income for many salaried middle-class families. Simultaneously, GST rationalisation may reduce cost-of-living pressures, although realised gains depend on pass-through and consumption patterns.

The evidence also underscores that administrative simplicity functions as a substantive welfare lever. Reductions in compliance costs can generate welfare gains comparable to fiscal relief and enhance trust in the tax system. Going forward, inflation-sensitive thresholds, carefully targeted GST policy, and sustained compliance simplification provide a coherent strategy to support middle-class welfare while preserving stable revenue for the Indian state.

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

Policy Lever	Primary Channel	Net Welfare Outcome
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

