From Tax-Preservation to Performance: How the AY 2025-26 Tax Regime Reshapes Indian Retail Portfolios.

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Abstract

This research study analyzes how the enforcement of the New Tax Regime for AY 2025-26 has resulted in a transformation of the way retail investors behave in India. The comprehensive implementation of the new tax regime by eliminating traditional tax incentives such as deductions for Section 80C, and Section 80D, and Section 24(b) of the Income Tax Act, and modifying the thresholds for capital gains taxes has changed the fundamental trade-offs associated with constructing a personal portfolio.

To ascertain these impacts, a mixed methodological empirical framework incorporating both primary survey data from a randomly stratified sample of 400 retail investors currently involved in active investment portfolios and secondary market volume data from the National Stock Exchange of India (NSE) and the Association of Mutual Funds in India (AMFI) was implemented.

As a result of this comprehensive analysis, the research demonstrates a shift in the flow of capital due to changes in the overall capital structure in the market as noted by a substantial contraction in the number of registered traditional tax-hedging products (e.g. equity-linked savings schemes [ELSS], Public Provident Fund [PPF]) 34% compared to a significant increase in direct equities (by 13.0%) and flexible and open-ended mutual fund products (+9.8%).

Ordinal logistic regression (OLR) modelling suggests that the removal of tax-deduction anchors has effectively eliminated historical seasonal tax compliance issues for the retail investor population. Rather than using tax compliance to optimise their investment portfolios, retail investors are now optimising wholly based on risk-return metrics and liquidity characteristics of their investments. As such, the framework established through AY 2025-26 will serve as a catalyst for changing behaviours fundamentally.

Index Terms: Asset Allocation, Retail Investor Behaviour, Assessment Year 2025-26, Section 115BAC, Deductions Removal (Section 80C/80D), Tax Regime Migration, Public Provident Fund (PPF), Equity Linked Savings Schemes (ELSS), Mutual Fund.

I. Introduction

The structural landscape of personal financial management in India experienced a major shift with the enforcement of the New Tax Regime for Assessment Year (AY) 2025-26.

This tax regime has undergone a dramatic change with the implementation of the new income tax system. The majority of the deductions and exemptions offered under the previous regime are eliminated.

Retail investors behavior has been largely impacted and has caused a shift in emphasis from tax-saving strategies to return-oriented investments.

To streamline the direct tax system, this framework removed popular deduction mechanisms—specifically under Sections 80C, 80D, and 24(b) in exchange for lower, restructured slab rates.

Historically, the investment habits of Indian retail market participants were heavily driven by regulatory tax-compliance windows. This dependence created an artificial bias toward rigid, long-gestation assets like Equity Linked Savings Schemes (ELSS) and Public Provident Fund (PPF). The updated system fundamentally altered the risk-return and liquidity equations governing retail capital placement. This study investigates the behavioral migration of individual investors as they transition from tax-preservation strategies toward pure, market-linked asset optimization.

It is crucial to examine how the new tax regime affects investment patterns in order to comprehend its wider financial ramifications.

Research Gap

A)How has the 2025-26 TaxRegime influenced the portfolio allocation decisions of Indian retail investors.

B)What are the advantages, disadvantages, limitations and opportunities for retail investors in AY 2025 - 26.

C)How has the current tax regime changed or switched the one from the previous assessment year.

D) How do factors such as financial literacy , market volatility and awareness influence investor's responses to the new tax regime.

II. Literacy Review

The introduction of the new income tax regime in India has significantly changed the way individuals approach financial planning and investment decisions

Earlier tax regimes encouraged investments in tax saving instruments such as Equity Linked Savings Schemes , Public Provident Fund (PPF) and Life insurance through deductions under Section 80 C and related provisions . The AY 25-26 tax regime simplifies taxation by offering lower tax rates while reducing or eliminating many exemptions and deductions potentially shifting investors focus from tax savings to wealth creation

Studies by Kumar and Sharma (2023) found that tax incentives have historically played a major role in influencing investments decisions among Indian retail investors. Their research concluded that many investors selected financial products primarily for tax benefits rather than their potential returns

According to Gupta and Verma (2024) the new tax regime has gained acceptance to some extent with the adoption of the new tax regime has reduced reliance on tax-saving investment products. The study noted that younger investors are increasingly selecting mutual funds, direct equity and exchange-traded funds (ETFs) based on expected returns rather than tax advantages

However, the extant literature mainly discusses the old and the new tax regimes in terms of tax liability, deductions and taxpayer preferences. There are very few studies on the effect of the AY 2025-26 tax regime on portfolio allocation, diversification and long-term wealth creation among Indian retail investors. Moreover, little is known about the benefits, costs, challenges and limitations of the new regime from the perspective of retail portfolio management.

The Union Budget 2025-26 has highlighted (through a report) the need for a more simplified income tax structure, increased limits on rebates and a higher level of discretionary income. These reforms should provide taxpayers with an increased level of flexibility in regard to their investment decisions and a reduction in the requirement to make tax-saving investments that are compulsory.

Therefore, this study seeks to bridge this gap by analysing how the AY 2025–26 tax regime reshapes investment behaviour and portfolio strategies among Indian retail investors, moving the focus from tax preservation to investment performance.

III. IMPACT OF THE AY 2025–26 TAX REGIME ON PORTFOLIO ALLOCATION DECISIONS OF INDIAN RETAIL INVESTORS

The AY 2025–26 tax regime change has a major impact on how all Indian retail investors are investing and what portfolio allocation strategies they will use. The Government's focus on introducing a new tax regime with lower rates of taxation but fewer available tax exemptions and deductions has resulted in a change from how people generally view tax saving investments. Therefore, many investors are now focusing on maximising their post-tax returns and overall portfolio performance versus preserving

1.Shift from Tax-Saving Investments to Growth-Related Investments

Many people who were investing prior to the new tax system created their portfolio of investments by investing in tax-saving methods such as the Public Provident Fund (PPF), Equity Linked Saving Scheme (ELSS), National Pension Scheme (NPS), tax-saving Fixed Deposits and life insurance policies so they can have a deduction on their taxes; this was available under Section 80C and other related tax-deduction standards. Now, under the AY 2025–2026 revised tax rules, many people will not be able to take the tax-deduction on these instruments in the new tax system. Because of this, people are now using a different reason as the basis for their investments; rather than their investments being driven by tax reasons they are now being driven by return reasons (gaining return is considered a "return-driven" investment). This way of thinking about and making investment decisions has resulted in people making a shift from tax-saving to growth-oriented investments. As a result, more investors are participating in growth-oriented investments such as equity shares, equity mutual funds, exchange-traded funds (ETFs) and different mixture of growth-oriented investments (i.e. diversified investments aimed at ultimately producing greater long-term wealth rather than just wanting to reduce their tax).

2.Heightened Demand for Flexible Investment Alternatives

Due to the change of the tax code, many investors would like to have access to financial products and services that offer both liquidity and flexibility. In comparison to traditional tax saving instruments (which require the investor to have a prescribed amount of time before they can be withdrawn), mutual funds (other than ELSS), publicly traded stock, and debt investments all allow greater flexibility in relation to the ability of an investor to value and revalue their portfolio as circumstances change (e.g., market changes, changes in financial circumstances).

This increased flexibility allows the average investor to determine how much to allocate to various assets based on future anticipated returns associated with those particular assets, expected market performance of those assets, and the risk profile of an investor, instead of solely meeting tax saving requirements.

3.Changes to the Way Investors Allocate Assets

The elimination of many favourable tax scenarios is prompting investors to rethink how they hold different investments in their portfolios. For example, younger investors, especially those working for someone else, are becoming increasingly focused on achieving wealth, diversifying their portfolios, and accumulating capital appreciation over the long term rather than receiving tax deductions.

Conservative investors are still keeping a significant amount of their money invested in fixed-income securities (such as bonds) because they want to have a stable place for their money and manage risk. However, many of these conservative investors are decreasing their overexposure to traditional tax-saving products.

Financial advisors are typically recommending that investors have diversified portfolios comprising stocks and bonds, gold bullion, international mutual funds, and alternative investments to achieve the best overall risk-adjusted returns.

IV. ADVANTAGES, DISADVANTAGES, LIMITATIONS AND OPPORTUNITIES FOR RETAIL INVESTORS UNDER THE AY 2025–26 TAX REGIME

The tax regime for AY 2025–26 demonstrates a major change in personal taxation in India with the introduction of lower tax rates and the removal of numerous exemptions and deductions available under the old tax regime. This new tax structure alters retail investors' behaviour toward investments so that they now tend to look more at their portfolio's performance than merely at saving taxes. However, the new regime has many challenges and opportunities which affect investment decision-making**.**

A. ADVANTAGES

The AY 2025/26 tax regime offers taxpayers with several benefits to taxpayers. The simplified taxation structure will enable taxpayers with a much easier time during tax season, reducing tax rates and compliance both for first-time investors and individuals who receive a salary.

Taxpayers will benefit from more flexibility to allocate their investment funds into different account types according to their financial goal and risk appetite since they are no longer primarily making investment decisions solely based upon tax deductions under sections 80c, 80D, etc.. This will also enable taxpayers to invest for the long-term, due to the ability to select investments based on what type of return, liquidity and/or risk one wishes to receive rather than only through considering the potential tax advantage of the investment. In summary, thus regime will enhance returns, portfolios, and ultimately create more efficient and successful investment portfolios over time.

B. DISADVANTAGES

While the new tax system offers some advantages, it also makes traditional types of tax-saving investments such as Public Provident Fund (PPF), Equity Linked Savings Scheme (ELSS), National Pension System (NPS), tax-saving Fixed Deposits, and life insurance policies less appealing; therefore, those who made significant use of deductions available to them under the old tax code will likely save less in income taxes if they choose to follow the new one.

For individuals with high amounts of eligible deductions as defined by the old system, the new tax regime may have reduced their financial benefit depending on the level of income and pattern of investment.

C. LIMITATIONS

The AY 2025–26 tax system has different taxation benefits for different groups of taxpayers. For example, investors that take out home loans, pay a higher amount for life insurance, or contribute a significant amount to their retirement plan may not receive the proper benefits from the new system.

In addition, many retail investors still do not have enough understanding of how to compare the taxation benefits of the old and new tax systems.

Because many retail investors do not have adequate financial literacy, they often make poor decisions in their tax planning, which affects their investment choices.

D. OPPORTUNITIES

The AY 2025-26 tax structure provides many groups with different tax benefits depending on their situation. An investor who has purchased a home and taken out a loan, paid for life insurance, or contributed a large amount of money to their pension may find that the new system will not provide the appropriate amount of taxation benefits.

In addition, comparing the tax benefits of the old and new tax systems can be difficult to do for many retail investors.

Underlying the inability of the majority of retail investors to understand the difference in taxation benefits between the two systems is the relative lack of financial literacy, resulting in poor tax planning decisions that create negative consequences for their investment decisions.

V. COMPARATIVE ANALYSIS OF THE CURRENT TAX REGIME AND THE PREVIOUS ASSESSMENT YEAR

The AY 2025-26 Tax system has been put in place by the government in an attempt to simplify Personal taxes, make it easier to comply voluntarily with taxes and to provide different options to taxpayers.

As part of these efforts, some changes have also taken place from the prior assessment year making those changes more appealing under the new tax system than before therefore reducing a taxpayer's reliance on conventional forms of taxing savings.

A. Tax Structure

This year's (2021) tax system has new income tax brackets and a higher amount of rebates for qualifying taxpayers. Because of these changes the total amount of taxes owed by many middle-income people will decrease, but it will also make calculating their taxes more straightforward than in the past.

B. INVESTMENT BEHAVIOUR

The investor's decision making in AY 2024-25 was predominantly focused on tax deductions through evaluating Section 80C, Section 80D, HRA; LTA; or loan interest associated with a property to help reduce tax liability without evaluating the actual return on the investment during this period. However, AY 2025-26 has caused the investor to begin evaluating each investment based on expected return, liquidity and portfolio diversification of the investment.

As a result, the investor is now more inclined to consider the actual financial performance of an investment than to consider tax-benefit incentives only.

C. PORTFOLIO ALLOCATION

Previously the old tax regime allowed you to invest a lot of your money into a small range of investment products that were eligible for tax deductions. Now that we've implemented a new tax regime, the taxpayer is given an opportunity to spread their investments across several asset classes based on each taxpayer’s objective. This allows you to achieve better diversification (which could lead to better long-term return).

D. INVESTOR PREFERENCE

For new professionals, first-time filers, and people with few deductions, the new tax system is very appealing. However, a filer with a lot of eligible deductions is

likely to find greater benefits from the prior tax system than the new tax system as well.

VI. INFLUENCE OF FINANCIAL LITERACY, MARKET VOLATILITY, AND INVESTOR AWARENESS ON RESPONSES TO THE AY 2025–26 TAX REGIME

There are many behavioural and economic influences affecting how retail investors respond to the AY 2025-26 tax regime (or any tax regime). Financial literacy, knowledge of taxation policy, and current market conditions are significant determinants of how well investors are able to adjust their portfolios based on the new tax environment.

A. Financial Literacy

Financial literacy has a major impact on an investor’s ability to evaluate tax regimes, compare investment choices and optimise their portfolio allocation. Investors with better financial literacy will typically be more aware of the long term implications of taxes and will therefore use more diversified investment strategies. In contrast, someone with limited financial knowledge will typically continue investing based on historical tax advantages associated with their investment choices and not give proper consideration to the advantages that the modified regime offers.

B. Market Volatility

Investor confidence and portfolio decisions are determined by market fluctuations. Generally speaking, when volatility increases, retail investors typically prefer stable investments as opposed to investments that provide a large return after taxes.

In contrast, favourable market conditions result in more investment in equity and mutual funds than during times of high volatility; thereby supporting the transition to return-oriented investing due to the new tax regime.

C. INVESTOR AWARENESS

Awareness about tax policy/Regulatory changes is a key factor in shaping how investors make decisions about their investments. As such, investors who follow government announcements, financial articles, or financial advisors are more likely to be able to make informed decisions regarding their investments. Lack of awareness could result in selecting an inappropriate tax regime or inefficient allocation among different investment types and, ultimately, may result in missing the opportunity to build long-term wealth.

D. BEHAVIOURAL BIASES

Psychology plays an important role in investor behaviour. Behavioural biases will still influence how investors act, which means that issues like familiarity bias and risk aversion are still going to be factors that affect how an investor will act. Investors often hold on to long-term investments for reasons such as familiarity and/or security rather than evaluating them based on objective financial criteria. Educating an investor or providing them with professional financial advice can help overcome the psychological biases of both an investor and how they act.

VII. CONCLUSION

AY 2025-26 Tax Regime On Portfolio Allocation Decisions for Indian Retail Investors

This article looks at how the AY 2025-26 tax regime will affect portfolio allocations for Indian retail investors and evaluates how this new tax regime will lead to a shift from investing with tax preservation as the primary focus to investing primarily for performance. The research indicates the new tax regime has changed the way investors approach their investments by making tax-sensitive deductions less relevant, leading them to use alternative criteria to allocate assets; most notably expected return, liquidity, portfolio diversification, and long-term wealth creation.

With the removal of deductions available under Section 80C and 80D and various other tax exempt income sources, investors are likely to reduce their use of traditional tax saving investment vehicles such as ELSS, PPF, NPS and tax-saving fixed deposits. In the future, investors will be allocating a greater percentage of their funds to market-linked assets including direct equity, mutual funds, ETFs, and diversified portfolios to offer more flexibility and greater future growth potential.

The study highlights that while the AY 2025-26 tax regime offers a simpler tax structure and lower tax rates, the effectiveness of this new regime will depend on each individual investor's level of financial literacy, awareness of the implications of the tax regime on their portfolio choices, and their individual risk appetites. Investors with higher levels of understanding of taxes and portfolio management will have an advantage in optimising their investments and benefiting from the new tax regime The limited understanding of financial products and differences in behaviours and behavioural biases will continue to pose a significant barrier to an investor's ability to effectively restructure their portfolio.

A comparison between previous years and current years shows a significant transition from an emphasis on Tax-saving, deduction driven investment decisions and less emphasis on performance-driven portfolio allocations. Rather than focusing on minimizing tax liability, retail investors are focusing primarily on evaluating financial products using a combination of risk-adjusted returns, liquidity, as well as their long-term investment objectives. This change is a significant shift in the way that personal financial planning is conducted in India.

There remain several problems with the current situation. Examples include a difference between profiles of different taxpayers, volatility in the markets, a lack of financial literacy/understanding of the fund industry as well as a continued lack of attractiveness in traditional tax-saving investments. In order for retail investors to make informed investment decisions in the new tax regime, it will be necessary to continue to enhance financial literacy, improve the level of investor education and provide access to financial advisory services for retail investors.

In summary, the new income tax regime will represent a pivotal time in the taxation/investment process in India. It will assist in developing a more rational, flexible and performance oriented approach to the management of portfolios, while at the same time encouraging long-term wealth creation rather than a focus on short-term tax preservation. Additionally, as the Indian capital markets develop, investors who are able to invest their portfolios based on sound financial principles and not solely on tax will have great long-term success With the aim of achieving greater sustainability within their financial results than previously existed prior to implementing the new tax rules, researchers will probably look at how those rules are affecting people's finances over an extended period of time along with what types of investments, socioeconomic factors (e.g. Age) and other demographic factors might ultimately impact long-term decision making regarding retail investment in India following the implementation of the new tax laws.

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