Impact of Income Tax Policy on Tax-Saving Investment Behavior: Evidence from Salaried Individuals

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ABSTRACT
This study presents a behavioral analysis of the relationship between income tax policy and tax-saving investment options among salaried individuals. In India, salaried individuals use various investment instruments such as Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS) to reduce their tax liability. The research examines that investment decisions are not based solely on tax benefits but are also influenced by factors such as risk perception, financial literacy, income level, and psychological biases. The study uses both primary and secondary data to analyze how the new and old tax regimes affect investment behavior. The findings indicate that behavioral factors play a significant role, which in turn impacts the effectiveness of tax policy.

Keywords: Income Tax Policy, Salaried Class, Tax-Saving Investments, Investment Behavior, Financial Literacy

1. INTRODUCTION:

In the present economic scenario, income tax policy is a crucial pillar of a country's fiscal structure, as it not only ensures government revenue but also directly influences the saving and investment behavior of citizens. In India, the salaried class represents a major group of taxpayers, characterized by relatively stable and transparent income structures, which makes them more sensitive to tax obligations. As a result, this group actively selects various tax-saving investment options to reduce its tax burden. Among the provisions offered by the government, instruments such as Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS) are particularly popular, as they provide tax benefits under Section 80C and other provisions. However, the selection of these investment options is not limited to obtaining tax benefits alone; it is also influenced by factors such as risk appetite, expected returns, income level, financial literacy, and psychological tendencies. According to behavioral finance, investment decisions are not always entirely rational but are driven by cognitive biases such as overconfidence, herd behavior, and loss aversion. Furthermore, the introduction of new and old tax regimes in recent years has made the decision-making process more complex for salaried individuals, making it challenging to balance tax planning and investment strategies. In this context, the present study analyzes the interrelationship between income tax policy and tax-saving investment options and attempts to understand how salaried individuals make investment decisions under the influence of behavioral and economic factors. The study not only highlights actual investment behavior patterns but also provides useful insights for policymakers in designing effective tax policies.

Over time, the income tax system in India has become more structured and transparent, with the salaried class emerging as a key taxpayer segment. Due to their regular and source-based income, taxation has a direct impact on this group, making them more aware of tax

planning. The government encourages savings through various tax-saving provisions and investment options such as PPF, EPF, ELSS, and NPS. However, investment decisions are influenced not only by tax benefits but also by individuals' risk tolerance, income levels, financial knowledge, and psychological tendencies. The coexistence of the new and old tax regimes has further complicated investment decision-making, thereby creating a need for in-depth study on this subject.

2. Significance Of the Study

This study makes a significant contribution to understanding the relationship between income tax policy and tax-saving investment options in the context of salaried individuals. In the current scenario, where tax structures are continuously evolving, it becomes essential to analyze how tax policies influence individuals' investment decisions. The research not only evaluates the usage and effectiveness of tax-saving instruments such as Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS), but also highlights the critical role of behavioral factors—such as risk perception, financial awareness, and psychological biases—in shaping investment decisions.

The findings of this study can assist policymakers in designing more effective and behaviorally informed tax policies, while also providing guidance to investors for making better financial decisions. Therefore, this research holds substantial value from academic, practical, and policy-oriented perspectives.

3. Theoretical Framework of Income Tax Policy

The theoretical foundation of income tax policy is rooted in public finance and taxation principles, which aim to generate government revenue, ensure income redistribution, and maintain economic stability. Traditionally, income tax policy is based on principles such as equity, justice, certainty, and convenience, which hold a prominent place in Adam Smith's canons of taxation. According to the principle of equity, the tax burden is determined based on the income of taxpayers, whereby higher-income groups pay more taxes while lower-income groups receive relief.

In addition, the principles of ability to pay and benefit also form important bases of income tax policy, ensuring that the taxation system remains fair and balanced. In modern times, income tax policy is no longer confined to revenue collection alone; it has also become a significant tool for influencing economic behavior. Governments encourage savings and investments through various tax exemptions and incentives, such as Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS). Thus, income tax policy not only serves as a mechanism for redistributing economic resources but also plays a crucial role in shaping investment behavior, savings patterns, and overall economic development.

4. Tax Structure of The Salaried Class

In India, the tax structure of the salaried class is governed by the provisions of the Income Tax Act, 1961, under which their income is classified as "Income from Salary" and taxed according to prescribed tax rates. For this group, tax assessment is relatively simple and transparent, as tax is deducted at source (TDS) by the employer.

At present, salaried individuals have the option to choose between the new and the old tax regimes. Under the old regime, various exemptions and deductions are available

under sections such as 80C and 80D, whereas the new regime offers lower tax rates with limited exemptions. To reduce their tax liability, salaried individuals utilize several tax-saving instruments such as Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS), which provide tax benefits up to specified limits.

Additionally, provisions like standard deduction, interest deduction on home loans, and medical insurance premiums also help in reducing the tax burden. Thus, the tax structure of the salaried class serves not only as a mechanism for revenue collection but also as an effective tool for encouraging savings and investment, playing a significant role in personal financial planning and economic stability.

5. Overview Of Tax-Saving Investment Options

In India, tax-saving investment options are instruments through which taxpayers can reduce their taxable income while ensuring long-term financial security and wealth creation. Under various provisions of the Income Tax Act, 1961—particularly Sections 80C, 80CCD, and 80D—the government offers multiple investment avenues that not only provide tax benefits but also encourage a habit of savings.

Major tax-saving instruments include Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS), each offering different risk-return profiles. Options like PPF and EPF are relatively safe and provide stable returns, whereas ELSS, being market-linked, offers the potential for higher returns along with higher risk. NPS, on the other hand, promotes long-term investment as a retirement planning tool.

Additionally, life insurance premiums, health insurance (under Section 80D), and interest deductions on housing loans are also important tax-saving avenues. The selection of these investment options depends on an individual's income, risk tolerance, investment horizon, and financial goals. Thus, tax-saving investment options not only help reduce tax liability but also play a significant role in strengthening personal financial planning and economic stability.

6. Literature Review

The existing literature clearly indicates a strong interrelationship between income tax policy, investment behavior, and psychological factors, for which the behavioral finance approach has proven highly useful. Akerlof and Shiller (2009) argued that economic decisions are not based solely on rational calculations but are also significantly influenced by human emotions and psychological tendencies. Similarly, Barberis and Thaler (2003) explained through behavioral finance theories that investors often deviate from rational behavior and are influenced by various cognitive biases. De Bondt et al. (2008) further demonstrated that investor behavior evolves over time and affects market dynamics. These studies suggest that understanding the impact of income tax policy requires not only economic models but also the inclusion of behavioral dimensions, particularly in the case of the salaried class, where regular income and limited risk-taking tendencies are prominent.

Several important studies also examine the relationship between financial literacy and investment decisions. Lusardi and Mitchell (2014) established that financial literacy directly influences the quality of investment

decisions, with more financially literate individuals making more effective financial plans. Similarly, Madrian (2014) emphasized the application of behavioral economics in policymaking, showing that appropriate policy interventions can positively influence individuals' investment behavior. Kahneman (2011), through his dual-process theory, explained that human decisions are based on two types of thinking—fast and slow (analytical)—highlighting that investment decisions often involve quick and emotional responses. Thus, financial literacy and psychological processes are critical components in understanding investment behavior.

Studies conducted in the Indian context reveal that tax policy significantly influences the investment decisions of the salaried class. Bhatnagar (2018) found a direct relationship between tax planning and investment behavior among salaried individuals, where investment options are chosen primarily for tax-saving purposes. The provisions of the Income Tax Act, as presented by the Government of India (2022), demonstrate that tax exemptions under various sections encourage savings and investments. Instruments such as Public Provident Fund (PPF), Employees' Provident Fund (EPF), Equity Linked Savings Scheme (ELSS), and National Pension System (NPS) are among the most prominent options. It has also been observed that the salaried class generally prefers safe and tax-saving instruments, while adopting riskier options to a limited extent. This indicates that tax policy not only serves as a means of revenue collection but also acts as a significant tool for guiding investment behavior.

Overall, the literature suggests that income tax policy, financial literacy, and behavioral factors jointly determine investment decisions. However, most studies focus either on tax policy or behavioral finance, with limited research addressing their interrelationship, particularly in the context of the Indian salaried class. Moreover, there is insufficient behavioral analysis regarding the impact of the new and old tax regimes. Therefore, the present study attempts to fill this research gap by providing a behavioral analysis of the relationship between income tax policy and tax-saving investment options. This study not only enriches theoretical understanding but also offers practical insights for policymakers and investors, enabling the formulation of more effective tax policies and improved investment decisions.

7. Analysis Of Income Tax Policy And Tax-Saving Investment Options

1. Overview of the Current Income Tax Policy in India:

India's income tax policy is based on a progressive taxation system, in which tax rates are determined according to the level of income. Its objective is not only to ensure revenue collection but also to promote equitable distribution of income and maintain economic balance. In recent years, the government has introduced several reforms to make the tax system simpler and more transparent, among which the introduction of the new tax regime is a major development.

2. Tax Provisions for the Salaried Class:

For the salaried class, tax assessment is relatively simple, as tax is deducted at source (TDS). This group benefits from provisions such as standard deduction, interest deduction on home loans, and investment-based deductions under various sections, which help reduce their overall tax burden.

3. Major Tax-Saving Investment Options:

To encourage tax savings, the government provides various investment instruments that

not only offer tax benefits but also ensure long-term financial security:

- **Public Provident Fund (PPF):** A safe, long-term investment option offering fixed returns along with tax benefits.
- **Employees' Provident Fund (EPF):** A mandatory savings scheme for salaried employees that provides financial security after retirement.
- **Equity Linked Savings Scheme (ELSS):** An equity-based investment option with the potential for higher returns, but associated with higher risk.
- **National Pension System (NPS):** A long-term pension scheme that helps ensure a regular income after retirement.
- **Life Insurance Plans:** These provide a combination of protection and investment benefits along with tax exemptions.

4. Comparison between the New and Old Tax Regimes:

The old tax regime offers tax-saving opportunities through various exemptions and deductions, whereas the new tax regime provides lower tax rates with limited exemptions. The choice between the two depends on an individual's income level, investment capacity, and financial goals.

Thus, income tax policy and tax-saving investment options together not only influence tax liability but also shape investment behavior and broader economic decision-making.

8. Behavioral Analysis Of The Salaried Class

1. Investment Behavior Patterns:

The investment behavior of the salaried class is largely influenced by regular income, a tendency toward limited risk-taking, and the need for long-term security. Most individuals prefer safe and tax-saving options, while some investors are also attracted to market-based instruments in pursuit of higher returns.

2. Perception of Risk and Return:

The balance between risk and return is a key factor in investment decisions. Salaried individuals generally prefer low to moderate-risk investments, as their income is fixed and they prioritize capital protection. However, younger investors tend to exhibit a greater willingness to take higher risks in order to achieve higher returns.

3. Awareness of Tax Saving:

Awareness of tax-saving options is increasing among the salaried class, but it is not uniform across all income groups. Individuals in higher income brackets tend to have greater awareness of tax planning, whereas lower and middle-income groups often lack sufficient information, leading to underutilization of available tax benefits.

4. Impact of Financial Literacy:

Financial literacy has a direct impact on investment behavior. Individuals with a better understanding of financial products and tax provisions tend to make more rational and beneficial investment decisions. In contrast, those with lower financial literacy are often limited to a narrow set of traditional options.

5. Behavioral Biases (e.g., Overconfidence, Herd Behavior):

According to behavioral finance, investment decisions are not purely based on logical analysis but are also influenced by psychological factors. Overconfidence may lead investors to overestimate their abilities, while herd behavior causes them to follow others' decisions. Additionally, loss aversion influences individuals to prefer safer options.

Thus, the investment behavior of the salaried class is shaped by a combination of economic

and psychological factors, which ultimately determine the selection of tax-saving strategies and investment options.

9. Research Methodology

This study adopts a descriptive and analytical research design to examine the behavioral relationship between income tax policy and tax-saving investment options among salaried individuals. Both primary and secondary data have been utilized in the research. Primary data were collected through a structured questionnaire, which included questions related to investment behavior, tax-saving preferences, and awareness levels of salaried individuals. Secondary data were obtained from various research papers, government reports, financial publications, and reliable online sources.

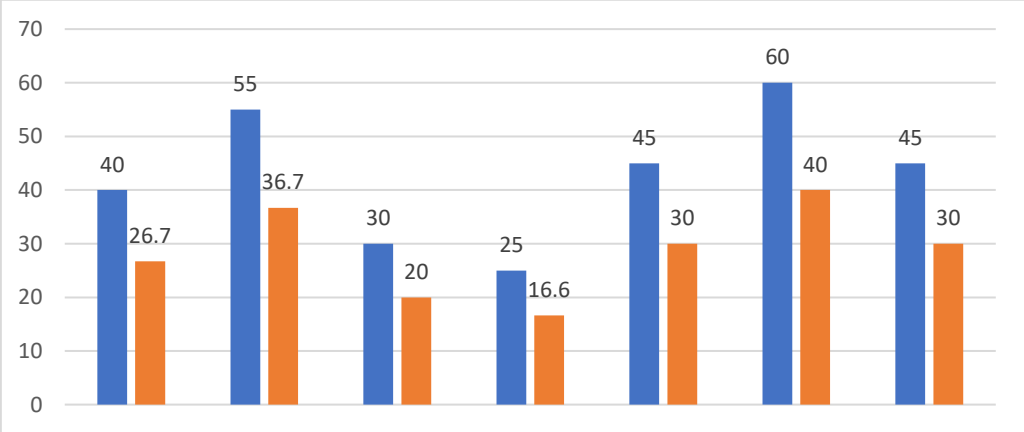
A convenience sampling technique was employed to select a sample of 150 respondents. For data analysis, statistical techniques such as descriptive statistics, ANOVA, and regression analysis were applied to examine relationships among different variables. Additionally, standardized measures were followed to ensure the reliability and validity of the study.

Thus, the adopted methodology effectively supports the achievement of research objectives and the derivation of accurate conclusions.

10. Results And Discussion

Table 1: Demographic Profile of Respondents

Variable	Category	Frequency	Percentage (%)
Age	20–30 years	40	26.7
	31–40 years	55	36.7
	41–50 years	30	20.0
	50+ years	25	16.6
Income Level	₹2–5 lakh	45	30.0
	₹5–10 lakh	60	40.0
	Above ₹10 lakh	45	30.0



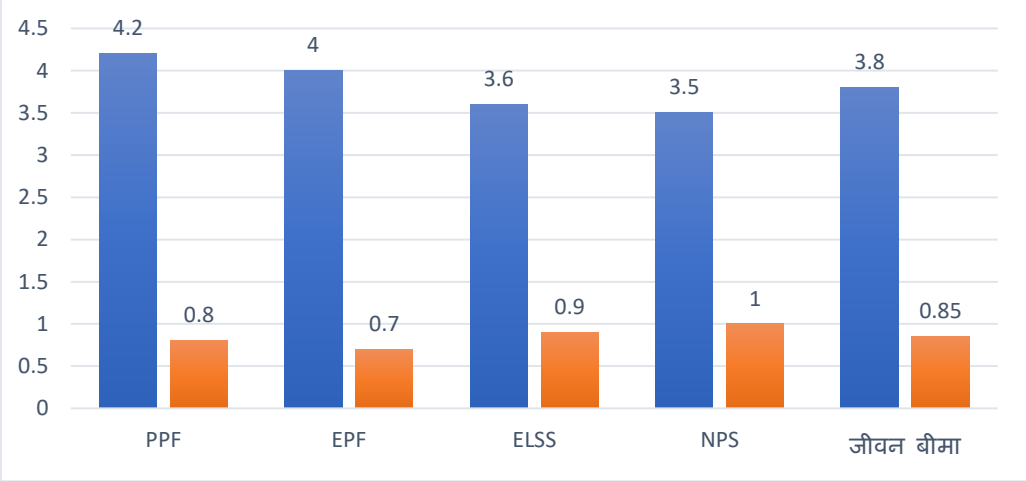
Interpretation:

The table illustrates the distribution of respondents based on age and income level. The results indicate that the majority of respondents belong to the 31–40 years age group, which represents an actively earning segment and is more involved in investment decisions. In terms of income distribution, the ₹5–10 lakh category shows the highest representation, highlighting the dominance of the middle-income group. This segment typically strives to maintain a balance between tax-saving and investment objectives.

Additionally, a significant number of respondents belong to the higher income group, who tend to utilize more diversified investment options. Overall, the table reflects a balanced representation of different age and income groups in the study, thereby enhancing the reliability and validity of the findings.

Table 2: Preference for Tax-Saving Investment Options

Investment Option	Mean Score	Standard Deviation (SD)	Rank
PPF	4.2	0.8	1
EPF	4.0	0.7	2
ELSS	3.6	0.9	3
NPS	3.5	1.0	4
Life Insurance	3.8	0.85	3



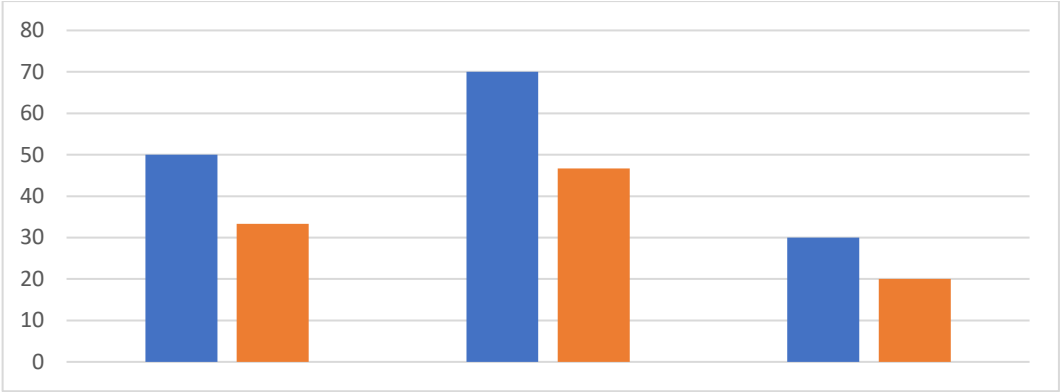
Interpretation:

The table presents respondents' preferences for various tax-saving investment options. The results clearly indicate that safe investment instruments such as PPF and EPF are given the highest priority, reflecting the security-oriented mindset of the salaried class. In contrast, options like ELSS and NPS receive comparatively lower preference due to their exposure to market risk.

Life insurance occupies a moderate position, as it serves both protection and tax-saving purposes. The mean scores and standard deviations suggest that although there is some variation in investor preferences, there is an overall inclination toward safer investment instruments.

Table 3: Level of Awareness of Tax Saving

Awareness Level	Frequency	Percentage (%)
High	50	33.3
Moderate	70	46.7
Low	30	20.0



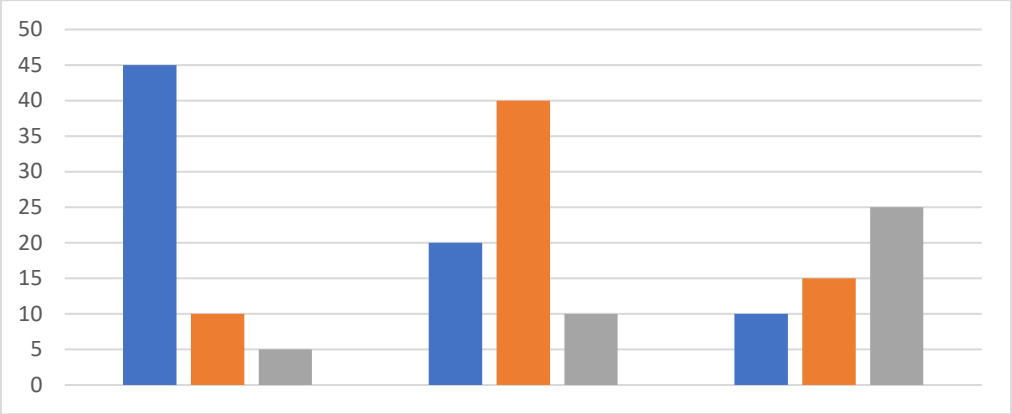
Interpretation:

The table shows the level of awareness regarding tax-saving among respondents. The results indicate that the majority of respondents possess a moderate level of awareness, while a significant proportion also demonstrates a high level of awareness. However, a notable segment still falls under the low awareness category, suggesting that not all individuals have complete knowledge of tax planning and available investment options.

This situation highlights the need for enhanced financial education and awareness programs. Investors with higher awareness tend to adopt more effective tax planning strategies, whereas those with lower awareness are often unable to fully utilize the available tax benefits.

Table 4: Risk vs Investment Choice

Risk Level	Safe Investments	Moderate Risk	High Risk
Low Risk	45	10	5
Medium Risk	20	40	10
High Risk	10	15	25



Interpretation:

The table explains the relationship between risk levels and investment choices. The results indicate that investors with a low risk appetite strongly prefer safe investment options. In contrast, high-risk investors tend to choose investment avenues that offer higher returns despite greater uncertainty. The medium-risk group follows a balanced investment strategy, combining both safe and risky instruments. This distribution clearly demonstrates that risk perception plays a crucial role in shaping investment decisions. Furthermore, it highlights that the salaried class generally exhibits a risk-averse behavior, prioritizing capital protection over higher returns.

Table 5: ANOVA Analysis (Income Level vs Investment Choice)

Source	Sum of Squares	df	Mean Square	F-value	Significance (p-value)
Between Groups	12.45	2	6.225	5.32	0.006
Within Groups	98.30	147	0.668		
Total	110.75	149			

Interpretation:

The table presents the statistical test of the relationship between income level and investment choice using ANOVA. The relatively high F-value and the p-value being less than 0.05 indicate that there is a statistically significant difference between income levels and investment choices. This implies that investment behavior varies significantly across different income groups. Individuals in higher income brackets tend to select more diversified and risk-oriented investment options, whereas lower-income groups prefer safer investment instruments. Thus, the results establish income level as a key determinant of investment decisions.

Table 6: Impact of Behavioral Factors

Independent Variable	Beta Coefficient	t-value	Significance
Financial Literacy	0.45	4.12	0.000
Risk Perception	0.32	3.05	0.003
Tax Awareness	0.28	2.76	0.007
Behavioral Biases	-0.21	-2.10	0.037

Interpretation:

The table illustrates the impact of various behavioral factors on investment decisions. The results clearly show that financial literacy, risk perception, and tax awareness have a positive and statistically significant influence on investment decisions. Among these, financial literacy has the strongest impact, indicating that individuals with better knowledge tend to make more informed and effective investment choices.

On the other hand, behavioral biases have a negative effect, suggesting that psychological factors can hinder rational decision-making. Overall, the findings highlight the crucial role of behavioral finance in shaping investment behavior.

11. Conclusion

The study clearly demonstrates that income tax policy has a significant and multidimensional impact on the investment decisions of the salaried class, particularly when tax-saving provisions are directly linked with investment options. The findings reveal that most salaried individuals prefer safe and traditional investment instruments such as Public Provident Fund (PPF) and Employees' Provident Fund (EPF) to reduce their tax liability, while comparatively fewer investors are inclined toward market-based options like Equity Linked Savings Scheme (ELSS) and National Pension System (NPS).

The study further highlights that investment decisions are not based solely on tax benefits but are also influenced by behavioral factors such as risk perception, income level, financial literacy, and psychological biases. Individuals with higher financial literacy tend to adopt more balanced and diversified investment strategies, whereas those with lower awareness remain confined to limited and traditional options.

Additionally, the availability of both new and old tax regimes has made the investment decision-making process more complex, emphasizing the need to balance tax planning with investment strategy. Overall, the study concludes that an effective income tax policy is not only a tool for revenue generation but also a crucial mechanism for guiding investment behavior. Therefore, policymakers should develop tax policies that are simple, transparent, and investment-friendly, while also strengthening financial literacy programs to enable salaried individuals to make better and more rational financial decisions.

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