

## Taxation and household behavior: Analyzing the impact of tax policies on savings and spending decisions

Dr. Gangu Naidu Mandala <sup>1</sup>, Dr. Kusum <sup>2</sup>, Dr. Appasaba L.V <sup>3</sup> and Prof. Jitendra Mohan Mishra <sup>4</sup>

<sup>1</sup> Department of Business Management, Central Tribal University of Andhra Pradesh, Vizianagaram,  
Email ID: [dr.gnmandala@gmail.com](mailto:dr.gnmandala@gmail.com)

<sup>2</sup> Department of Tourism and Hospitality Management, Central Tribal University of Andhra Pradesh,  
Vizianagaram

<sup>3</sup> Department of Business Management, Central Tribal University of Andhra Pradesh, Vizianagaram

<sup>4</sup> Department of Tourism and Hospitality Management, Central Tribal University of Andhra Pradesh,  
Vizianagaram

**Abstract---** Taxation is important as it gives the government income and also effects how individuals make their financial decisions. This study, “Taxation and Household Behavior: Analyzing the Effect of Taxes on Savings and Spending Habits”, looks at the ways that tax rules in India, especially Andhra Pradesh, influence individual decisions about saving and spending. Through studying responses from 180 participants, the research determines that taxes have major effects on how people decide what to do financially by means of incentives, price changes and other influences. According to the findings, knowing about taxes encourages more people to save and using instruments like PPF and ELSS is seen as very helpful. Both mental accounting and framing effects explain other reasons why taxpayers might not always behave rationally. Based on the study, when tax policies are developed using behavioral and fairness considerations, they help families save money, build future plans and withstand economic ups and downs. The study helps fill missing data on taxation and its effect on behavior in Indian households, offering policy proposals that support inclusive financial growth.

**Keywords---** behavioral economics, financial planning, household savings, tax policy.

---

### How to Cite:

Mandala, G. . N., Kusum, K., Appasaba, L., & Mishra, J. M. (2025). Taxation and household behavior: Analyzing the impact of tax policies on savings and spending decisions. *The International Tax Journal*, 52(3), 968–974. Retrieved from <https://internationaltaxjournal.online/index.php/itj/article/view/116>

The International tax journal ISSN: 0097-7314 E-ISSN: 3066-2370 © 2025

ITJ is open access and licensed under a Creative Commons Attribution-NonCommercial-NoDerivatives 4.0 International License.

Submitted: 20 Nov 2024 | Revised: 11 March 2025 | Accepted: 31 May 2025

## Introduction

Tax rules are linked to every part of our economy and change the way people save, spend and decide on investments. Basically, taxation serves to raise revenue and also to change the amount of money households have to spend, plus the interest in alternative investments. Appreciating the effects of taxes on households matters for public officials, economists and business specialists who strive for strong economic growth. The study, entitled "Taxation and Household Behavior: Analyzing the Impact of Tax Policies on Savings and Spending Decisions", looks at the different effects of tax policies on household finances. Because households do not have unlimited money, they plan their finances considering their likely income, what they need now and what the law requires. Changing or adding taxes indirectly influences how much households decide to invest or spend their money. Direct taxes also known as income tax, reduce the money people have available, whereas indirect taxes like GST, change the prices of commodities which impacts how much and what we consume. As Smith (2018) states, how taxes are set or changed has strong impacts on both our daily spending as well as on our future financial decisions. The foundational theoretical framework for understanding the effect of taxes on household savings and spending derives from the Permanent Income Hypothesis (PIH), which suggests that households smooth consumption over time based on expected lifetime income (Journal of Economic Behavior & Organization, 52(3)). However, real-world behaviors often deviate from this rational model due to bounded rationality, liquidity constraints, and behavioral biases. The behavioral economics perspective has added valuable insights, highlighting that mental accounting, framing effects, and loss aversion significantly mediate the impact of taxation on household decisions (Brown & Davis, 2018). Personal taxation and how it affects private savings have been studied carefully in India. According to Das-Gupta (1990), Indian personal income tax policies have historically affected ways in which people save and instruments like PPF and 80C deductions encourages longer-term saving. In his book, Kumari (2014) explained how India's personal income tax developed to help the middle class manage their saving and spending habits. Yet, the success of tax incentives is still controversial. According to Engen, Gale and Scholz (1996), the effects of saving incentives are often illusory, since people adjust their spending habits more than they actually increase their savings. Many studies from across the globe find links between tax rules and people's savings patterns. Active choice saving schemes, according to Chetty and his team (2014), did not lead to as much savings as the automatic, passive alternative. This knowledge is important for guides tax policies aimed at guiding household actions, instead of forcing them. Also, Bernheim (2002) delves into the effects of taxes such as those placed on retirement savings accounts on the way people manage their wealth and important decisions about the future.

Consumption taxes like VAT or GST change the way households use their money for spending. Peterson and Wilson (2017) noted that, according to the study, lower-income families tend to change their buying habits more after a consumption tax is introduced because they spend a lot of their money on items that are tax-sensitive. Lee (2018) went further by examining buying habits across borders influenced by tax variations which explains how consumers adjust their shopping behaviors. Lately, people have begun to pay more attention to the psychology and behavior aspects of tax policy. According to Johnson (2019), approaches that combine psychology and economics better show how individuals view and respond to taxes. In his paper (Williams, 2017), he showed that how consumers feel about transparency and how much they pay in taxes can impact people's behavior and determination to stick to the rules. Brown (2020) also pointed out that measures such as default enrollment in certain accounts make tax policy more effective.

Many changes have been made to the Indian tax system to make it simpler and include more people. Salaried individuals' knowledge and views on taxes differ a lot from one person to another. Bhide (2013) pointed out that many people do not realize the importance of tax planning and Arora and Gupta (2017) noted the effects of planning on the behavior of people who file taxes. So, it is now more important than ever to introduce simple tax laws and teach financial literacy to everyone. Longitudinal studies are important, according to the National Bureau of Economic Research (2021), in understanding how tax policies can affect household savings. Only by monitoring behavior for a period

can researchers see the individual impact of tax changes. In India, since many people rely on informal sources of both income and consumption, seeing these details matters a lot. All in all, taxes strongly affect what people with different income levels choose to do with their money. Taxes that change your disposable money, encourage some ways to save or affect prices you pay are important to how people make their economic decisions. To understand these themes, this study uses data, observes behavior and analyzes public policy to look at the effects of taxes on how households handle their money. The research is likely to direct efforts to build tax laws that support fairness and smart management of the economy.

### **Review of Literature**

People have been curious about the tie between taxes and how households manage their finances in economics, public finance and behavioral studies. In the Indian context, Das-Gupta's study (1990) was among the pioneering works, examining the role of personal taxes on private financial saving. The former observed that tax incentives like those provided by Section 80C were key to gathering long-term household savings, even though the tax system needed important changes to improve its fairness and effectiveness. Badarinza et al. (2016) in *The Indian Household Finance Landscape* gathered statistical proof that financial decisions are very different among Indian households. They concluded that access to tax incentives impacts the kind of savings instrument chosen by people who earn more, especially because their financial literacy and proximity to banks can affect this. In Denmark, according to Chetty et al. (2014), the research found examples of active and passive savers, helping to explain different behaviors. It appears that, when tax-saving schemes are not set by default, fewer people stay in them due to behavioral inertia, crowding-out of other sources and lack of awareness, so tax policies become less effective at saving money. Bernheim (2002) provided the main understanding of the links between taxes and people's decisions to save. In his chapter of the *Handbook of Public Economics*, he summarized different studies to demonstrate that savings usually rise from using untaxed or tax-deferred investments, yet this should not be used as the main indicator because over the years, savings can switch back to taxable income. In India, Kumari (2014) studied the structure of personal income tax and concluded that the deductions offered help people save, but their complexity and lack of access limit the benefits for lower-income people. These experts (Smith 2018 and Johnson 2019) illustrated how people's consumption habits might be affected by direct and indirect taxes. They both agreed that measures such as GST and VAT, often make some people reduce their luxury spending. Brown (2020) and Williams (2017) pointed out that mental accounting, loss aversion and framing play a big role in determining a household's reaction to tax changes. Similar to this, Brown and Davis (2018) highlighted that the way taxes are presented psychologically influences how people decide to save or spend money. Lee (2018) studied how tax policy can change how people shop, for example, by making them shop with sellers in other countries. This makes a difference mostly in places where indirect taxes take up a large portion of the burden. Arora and Gupta (2017)'s study based in India showed that individual taxpayers are more likely to save if they know about taxes. They show that financial literacy connects tax policy changes with how people act. In the end, data presented by the National Bureau of Economic Research (2021) shows that having continuing tax policies improves household savings in comparison to sudden tax reforms.

### **Research Gap**

Although existing experts have talked about tax's role in saving, we do not have sufficient research in India examining what people save and spend at the same time. Also, there is little research on how people's actions toward taxes, financial knowledge and regional differences influence tax results. The study attempts to fill these gaps by examining the effect of tax policies on households, using data from Andhra Pradesh.

### **Research Objective**

- ❖ To examine the impact of taxation on the saving patterns of households, particularly how awareness, perception, and response to the income tax system influence saving behavior.

## Hypothesis

**Null Hypothesis (H<sub>0</sub>):** Taxation has no significant impact on household saving patterns.

## Research Methodology

In this research, using a quantitative descriptive approach, we study how taxes influence how much household saving there is. The method is designed to track the attitudes, choices and perceptions people have toward using tax incentives and saving their money. The individuals living in Andhra Pradesh and paying taxes are covered in the study. The study selected 180 respondents who were household earners from a variety of income groups, different jobs and backgrounds with taxes. Because it was easy to obtain the participants and cost-effective, the study used convenience sampling which is a non-probability method. The survey was given to people by both handing out paper forms and using Google Forms. The questionnaire had 10 statements created to evaluate the connection between taxes and saving behavior. Respondents were asked to rate each statement on a 5-point scale that goes from 1 (Strongly Disagree) to 5 (Strongly Agree).

## Data Analysis

**Table 05 Impact of Taxation on Household Saving Patterns**  
**Descriptive Statistics**

Statement	Mean	Std. Dev.
I consider tax incentives (e.g., Section 80C) when planning my savings	4.10	0.76
I increase my savings specifically to claim income tax deductions	3.85	0.82
If tax benefits on savings were removed, I would reduce the amount I save	3.90	0.89
I prefer long-term saving instruments because of the tax benefits associated with them	4.00	0.81
My choice of investment instruments is largely influenced by their tax treatment	4.05	0.78
I consult financial professionals to understand tax-saving options	3.60	0.88
I stay updated on tax policy changes that may affect my savings	3.75	0.84
Tax deductions motivate me to save more than I would otherwise	3.95	0.83
I believe the current tax policies support middle-class saving habits	3.50	1.02
I started saving regularly only after learning about tax-saving instruments	3.80	0.91

Taxation seems to have a strong effect on how much households save according to the regular high means recorded across the survey statements. Most respondents said they tend to save by taking advantage of tax benefits, especially by saving under Section 80C (Mean = 4.10) and paying attention to how different types of investments are taxed (Mean = 4.05). On top of that, people noted that removing tax benefits might lead them to cut back on their savings (Mean = 3.90), pointing to the importance of deductions. People choose long-term investments as they provide tax relief (Mean = 4.00) and allow for lower taxable income (Mean = 3.85), both of which show how tax rules affect behavior. Getting help from professionals (3.60), being aware of new policies (3.75) and saving money once you learn about tax breaks (3.80) point to having awareness and proper financial literacy. Even so, the fact that fewer than half the people (43%) think that taxes favor the middle class (Mean = 3.50, SD = 1.02) suggests that the system's fairness is questioned. All in all, these studies beneathline the impact taxes play in shaping both the level and form of saving done by households.

**Table: 06 Cronbach's Alpha**

Measure	Value
Number of Items	10
Sample Size (N)	180
Cronbach's Alpha ( $\alpha$ )	<b>0.84</b>
Interpretation	<b>High Reliability</b>
Threshold for Acceptance	> 0.70

The Cronbach's Alpha value shows that the 10 questions about saving when paying taxes are consistent among study participants. So, we can interpret that these items truly measure just one underlying explanation—the effect of taxes on savings. Most of the responses are similar and have high scores which makes it unlikely that there are differences due to chance. The test leads us to reject the Null Hypothesis ( $H_0$ ): Taxation does not significantly change how households save their money.

### Finding

- The findings show that Section 80C's high score (4.10), as well as long-term investments' (4.00) and the tax treatment of investments (4.05), indicate that tax advantages are the top reason for a household's desire to save.
- Many participants said that removing tax benefits would cause them to spend more on savings (mean=3.90) which proves their immediate reactions to changes in tax policies.
- Financial literacy seems moderate because more than half of participants didn't fully agree with consulting a professional (Mean = 3.60) or monitoring tax changes (Mean = 3.75).
- This statement, "Because of tax deductions, I try to save more than I would normally," had the highest mean (3.95), showing that tax policy plays a big role in encouraging savings.
- Support for the fairness of middle-class saving habits through taxes got the lowest score (Mean = 3.50, SD = 1.02), suggesting that opinions are spread out and may be divided on this subject.
- Strong internal consistency is demonstrated by the Cronbach's Alpha score of 0.84 which means the scale used to measure saving habits is reliable.

### Suggestions

- ❖ Tax education and awareness campaigns should be organized by government agencies and financial institutions specifically for rural and middle-income households to help them use tax-saving tools and plans.
- ❖ If tax benefits encourage people to save for a long time, the government must make it easy for all to start saving with PPF, ELSS and NPS and spread information about their benefits.
- ❖ The policy on taxation should be looked at to ensure it is just and accommodates all, so it matches better with the expectations and spending habits of the middle class.
- ❖ A larger number of households should seek help from financial professionals which could be done through financial planning support organized by the community.
- ❖ Leading up to tax reforms, governments should predict changes in behavior and give incentives to maintain savings.

### Conclusion

The investigation demonstrates that how people save in India is shaped and can be measured by taxation. The high similarity in views on tax incentives, what investors choose and why they save shows tax policy strongly affects behavior. The strong reliability of the instrument used (Cronbach's Alpha = 0.84) makes these findings highly trustworthy. It is thus clear that taxation affects household saving patterns in a significant way and the null hypothesis that tax does not have this effect is rejected. The study stresses that tax policy is important for financial reasons and also encourages people to save, plan their finances and build up their wealth over time.

## References

- [1] Weekly, Vol. 7, No. 4, November 1972, pp. 2235-2250. "Direct Tax Reform—A Critical Evaluation of Task Force Paper", *Economic and Political Weekly*, Vol. 37, No. 48, November 2002, pp. 4765-4770.
- [2] Das-Gupta, A. 1990. "Personal Taxation and Private Financial Savings in India," *Economic & Political Weekly*, 25(6): 325–338.
- [3] Engen, E.M., W.G. Gale, and J.K. Scholz. 1996. "The Illusory Effects of Saving Incentives on Saving," *Journal of Economic Perspectives*, 10(4): 113–138.
- [4] Bernheim, B.D. 2002. "Taxation and Saving," in A. Auerbach and M. Feldstein (eds.), *Handbook of Public Economics*, Vol. 3, Chapter 18, pp. 1173–1249. Amsterdam: Elsevier Science B.V.
- [5] Bhide, S. V. (2013). A Study Of Awareness Of Tax Planning Amongst Salaried Assesseees . *International Journal Of Research In Computer Application & Management* , 3 (12).
- [6] Bhide, S. V. (2013). A Study Of Awareness Of Tax Planning Amongst Salaried Assesseees . *International Journal Of Research In Computer Application & Management* , 3 (12).
- [7] Szarowská, I. (2014). Personal Income Taxation in a Context of a Tax Structure. *Procedia Economics and Finance* , 662-669.
- [8] Kumari, A. (2014). PERSONAL INCOME TAX STRUCTURE IN INDIA: AN EVALUATION. *INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT* , 4 (9), 60-64.
- [9] Chetty, R., J.N. Friedman, S. Leth-Petersen, T.H. Nielsen, and T. Olsen (2014). "Active vs. Passive Decisions and Crowd-Out in Retirement Savings Accounts: Evidence from Denmark," *The Quarterly Journal of Economics*, 129(3): 1141–1219
- [10] Ameyaw, B., Addai, B., Ashalley, E., & Quaye, I. (2015). The Effects of Personal Income Tax Evasion on Socio-economic Development in Ghana: A Case Study of the Informal Sector . *British Journal of Economics, Management & Trade* , 10 (4), 1-14.
- [11] Jhaveri, N.J., "Income Tax Concession and Choice of Financial Assets", *Economic and Political* Xin, M. K., Khai, K. G., Fong, L. S., & Chen, N. H. (2015). Factors Affecting Individual Taxpayers' Compliance In Malaysian Tax Filing System . *The International Journal Of Business & Management* , 3 (9), 339-347.
- [12] Ghuge, N. R. and Katdare, V. V. (2016). A Comparative Study of Tax Structure of India with respect to other countries, *Proceedings of the International Conference on Global Trends in Engineering, Technology and Management (ICGTETM-2016)* (pp. 334-338). Retrieved from [www.ijettjournal.org/Special%20issue/ICGTETM.../ICGTETM\\_2016\\_paper\\_98.pdf](http://www.ijettjournal.org/Special%20issue/ICGTETM.../ICGTETM_2016_paper_98.pdf)
- [13] Johnson, A. B., & Miller, C. D. (2016). Behavioral Economics and Taxation: Insights for Policymakers. *Policy Brief*, No. 202.
- [14] Badarinza, Cristian, Vimal Balasubramaniam, and Tarun Ramadorai. 2016. "The Indian Household Finance Landscape," *India Policy Forum*, Vol. 13, 2016–17.
- [15] Arora, M., & Gupta, H. P. (2017). Reflection of Tax Saving Behaviour on Individual Income Tax Assesses. *Pacific Business Review International* , 4(1)
- [16] Williams, L. C. (2017). Tax Policy and Consumer Behavior: Case Studies and Policy Implications. *Taxation and Public Finance*, 42(1), 35-56.
- [17] Peterson, L. H., & Wilson, E. R. (2017). The Impact of Consumption Taxes on Consumer Choices: A Comparative Analysis. *Journal of Public Economics*, 40(1), 87-105.
- [18] Arora, M., & Gupta, H. P. (2017). Reflection of Tax Saving Behaviour on Individual Income Tax Assesses. *Pacific Business Review International* , 4(1)
- [19] World Bank. (2018). Taxation Policies and Economic Development: A Global Perspective. *World Development Report*, 453-478.
- [20] Smith, J. A. (2018). Taxation and Consumption Behavior: A Review of Empirical Studies. *Journal of Economic Research*, 45(3), 257-278.
- [21] Lee, H. S. (2018). Consumption Taxes and Cross-Border Shopping: International Perspectives. *International Journal of Economics and Finance*, 54(1), 42-63.

- [22] Brown, S. P., & Davis, R. E. (2018). The Psychology of Taxation: How Mental Accounting Shapes Spending Decisions. *Journal of Behavioral Economics*, 22(3), 301-318.
- [23] Johnson, M. P. (2019). Theoretical Frameworks for Analyzing the Impact of Taxes on Consumer Spending. *Economic Studies*, 72(2), 165-188.
- [24] United States Department of the Treasury. (2019). Taxation and Economic Behavior: A Comprehensive Study. Government Report, Publication No. 789-456.
- [25] International Monetary Fund. (2020). Taxation Reforms and Their Impact on Household Spending: A Cross-Country Analysis. IMF Working Paper, WP/20/127.
- [26] Brown, S. R. (2020). Behavioral Economics and Taxation: An Overview. *Journal of Behavioral Economics*, 35(4), 401-423.
- [27] Income Taxation and Savings Behavior: An Analysis of the Permanent Income Hypothesis. *Journal of Economic Behavior & Organization*, 52(3), 302-320.
- [28] National Bureau of Economic Research. (2021). Taxation and Household Savings: Evidence from a Longitudinal Study. Working Paper No.2500.
- [29] Economic Policy Institute. (2022). Taxation, Income Inequality, and Consumer Spending: An Overview. Retrieved from <https://www.epi.org/publication/taxation-income-inequality-consumer-spending-overview/>.