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A Study on the Effects of Tax Benefits and Exemptions on Mutual Fund Investment Decisions

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ABSTRACT: This study investigates the impact of tax benefits and exemptions on mutual fund investment decisions among retail investors in Karnataka, India. Set against the backdrop of India's mutual fund industry surpassing ₹70 trillion and the sweeping capital gains tax reforms of Union Budget 2024 which raised STCG from 15% to 20% and LTCG from 10% to 12.5%. The research asks: do fiscal incentives materially shape individual investment behaviour? Using an OLS regression model on primary survey data (N = 100), the study finds that tax exemption level ($\beta = 0.833 - 1.794$, $p < 0.001$), financial awareness ($\beta = 0.211$, $p < 0.001$), and risk appetite ($\beta = 0.430$, $p < 0.001$) are statistically significant positive determinants of investment decisions. The model explains 91.4% of variation in investment decisions ($R^2 = 0.914$). Age group and investment frequency are not significant, and income is marginally significant only at the highest bracket. The findings call for coordinated tax policy and investor education initiatives to promote broad-based retail mutual fund participation.

KEYWORDS: Tax Benefits, Mutual Funds, Investment Decisions, Capital Gains Tax, Risk Appetite, Financial Awareness, OLS Regression, India, ELSS

I. INTRODUCTION

India's mutual fund industry has undergone a structural transformation over the past decade. Assets Under Management (AUM) crossed ₹70 trillion as of March 2025, a 22.25% year-on-year increase and a near-tripling over five years (CAGR ~21.9%). Monthly SIP inflows remained consistently above ₹200 billion throughout FY 2025, with over 100 million SIP accounts, reflecting the financialization of household savings at an unprecedented scale (AMFI, 2025; CRISIL/ICICI Prudential, 2025).

Central to this growth is the tax policy environment. Mutual funds benefit from specific fiscal incentives — including deferred and reduced taxes on capital gains, ELSS deductions under Section 80C of the Income Tax Act 1961, and the LTCG annual exemption threshold (now ₹1.25 lakh per the Finance Act 2024). However, the 2024 Union Budget introduced the most consequential capital gains tax revision in recent memory: STCG on equity funds rose from 15% to 20%, LTCG from 10% to 12.5%, indexation benefits were removed for most asset classes, and the definition of 'Specified Mutual Fund' was narrowed to cover primarily debt-oriented schemes from FY 2025-26.

These changes raise a critical research question: to what extent do tax benefits and exemptions influence individual mutual fund investment decisions — and how do financial awareness, risk appetite, and income moderate this relationship? This paper addresses that question empirically using primary survey data from Karnataka, contributing to a largely underexplored dimension of retail investor behaviour in the Indian context.

II. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Theoretical Underpinnings

Three theoretical frameworks ground this study. Expected Utility Theory (Von Neumann & Morgenstern, 1947) establishes that rational investors maximise post-tax expected utility — tax exemptions directly lower the effective cost of investing and raise expected returns, creating a clear incentive to invest. The Life-Cycle Hypothesis (Modigliani & Brumberg, 1954) extends this by situating investment decisions within a long-term wealth accumulation context, where tax-advantaged instruments such as ELSS reconfigure the cost-benefit calculus over the investor's lifetime. Finally, the Information Asymmetry Framework (Akerlof, 1970; Stiglitz & Weiss, 1981) explains why investor awareness emerges



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as a critical predictor: those with superior knowledge of provisions — Section 80C, Section 54EC, the ₹1.25 lakh LTCG threshold — can optimise their portfolios, while uninformed investors systematically forgo tax benefits.

2.2 Empirical Evidence

Table 1 summarises the key empirical literature informing this study's design, variables, and hypotheses.

Author(s) & Year	Focus	Key Contribution to This Study
Bergstresser & Poterba (2002)	After-tax returns & fund inflows (USA)	High-income investors most tax-sensitive; tax reforms drive fund flows
Bailey, Kumar & Ng (2011)	Behavioural biases in MF investment	Herding, overconfidence & loss aversion distort tax-responsive behaviour
Ivkovic & Weisbenner (2009)	Individual investor MF flows	Sentiment, past performance & fees mediate tax impact on decisions
Kowhakul (2018)	Thai MF investor decision-making	Age, income & risk tolerance are significant demographic moderators
Dhar, Salema & Saha (2017)	MF investor behaviour, Bangladesh	Education & income positively linked to MF participation
Klapper, Sull & Vittas (2004)	Global MF industry development	Regulatory quality & financial literacy drive MF adoption
Oztek & Yilmaz (2012)	Disposition effect in MF trades	Tax framing influences timing of fund redemptions
Twesige & Gasheja (2019)	Tax incentives & SME growth, Rwanda	Tax incentives significantly stimulate productive investment
Sung & Hanna (1998)	Spouse effect on retirement funds	Joint decision-making improves tax-advantaged fund utilisation
Keswani & Stolin (2008)	Individual vs institutional MF flows	Institutional investors more tax-efficient; retail investors reactive

Table 1: Summary of Key Prior Studies and Their Contribution to the Present Research

Collectively, the literature establishes that: (i) tax sensitivity is concentrated among high-income and more informed investors; (ii) behavioural biases can attenuate the rational tax-optimisation impulse; and (iii) demographic moderators — particularly income, education, and risk tolerance — significantly shape the magnitude of the tax-investment relationship. A gap persists in the Indian retail context, particularly post the 2024 reforms.

2.3 Research Gap

Despite a robust international body of evidence, no study to date has examined the effect of the specific 2024 Indian capital gains tax reforms on individual mutual fund investor behaviour using primary survey data from India. Further, the moderating roles of financial awareness and risk appetite in the tax–investment relationship remain underexplored among Indian retail investors. This study directly addresses both gaps.

III. RESEARCH METHODOLOGY

3.1 Research Objectives and Hypotheses

The study pursues four objectives: (1) examine the impact of tax exemptions on mutual fund investment decisions; (2) analyse the role of financial awareness; (3) assess income and risk appetite as determinants; and (4) provide policy recommendations. Three directional hypotheses are tested:



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- H1: Tax benefits and exemptions have a significant positive effect on mutual fund investment decisions.
- H2: Higher financial awareness of tax provisions significantly increases the likelihood of investment.
- H3: Higher risk appetite significantly increases the likelihood of mutual fund investment.

3.2 Research Design and Data Collection

A quantitative, cross-sectional survey design was adopted. Primary data were collected via a structured Google Form questionnaire comprising 11 closed-ended items, distributed across online platforms and kept open for approximately one month. A convenient sampling approach targeted current and past mutual fund investors in Karnataka. After screening for completeness, 100 valid responses were retained (N = 99 for statistical analysis post-listwise deletion). The questionnaire captured: demographic information (age group, annual income), investment behaviour (frequency, primary objective), tax benefit awareness and perceived impact, risk appetite, and likelihood of investing in tax-efficient funds. Data were processed in MS-Excel and analysed using IBM SPSS (OLS regression, descriptive statistics, Pearson correlations). Significance threshold: $p < 0.05$ (marginal significance noted at $p < 0.10$).

3.3 Variables of the Study

Table 2: Variable Classification and Operationalisation

Variable	Type	Operationalisation
Mutual Fund Investment Decision	Dependent	Likelihood to invest (1–3 ordinal scale)
Tax Exemption Level	Independent	Perceived tax benefit level (1–4 scale; dummy-coded)
Financial Awareness	Independent	Awareness of tax provisions (Yes/No; dummy-coded)
Annual Income	Independent	Income bracket (5 categories; dummy-coded)
Risk Appetite	Independent	Risk tolerance: Averse / Neutral / Taker (dummy-coded)
Investment Frequency	Control	Monthly / Quarterly / Bi-annual / Annual
Age Group	Control	18–25 / 26–35 / 36–45

3.4 Regression Model

$$Y = \alpha + \beta_1(\text{Tax Exemption}) + \beta_2(\text{Awareness}) + \beta_3(\text{Income}) + \beta_4(\text{Risk Appetite}) + \beta_5(\text{Age}) + \beta_6(\text{Invest. Freq.}) + \varepsilon$$

Where Y = mutual fund investment decision score; α = constant; β_1 – β_6 = coefficients; ε = error term. All categorical independent variables were dummy-coded relative to the base categories specified in Table 4 footnotes.

IV. DESCRIPTIVE STATISTICS

Table 3 presents descriptive statistics for the three core scale variables (N = 99). The investment likelihood variable (mean = 2.03, SD = 0.76) is slightly negatively skewed (–0.05) and platykurtic (–1.26), indicating moderate clustering around the midpoint with no extreme outliers. The tax impact variable (mean = 2.12, SD = 0.98) shows moderate variability and slight positive skew, reflecting a proportion of respondents perceiving limited impact. The risk appetite variable (mean = 2.15, SD = 0.61) clusters around the risk-neutral midpoint.



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Table 3: Descriptive Statistics — Core Scale Variables (N = 99)

Statistic	Invest. Likelihood	Tax Impact	Risk Appetite
Mean	2.03	2.12	2.15
Median	2	2	2
Mode	2	1	2
Std. Deviation	0.76	0.98	0.61
Skewness	-0.05	0.35	-0.09
Kurtosis	-1.26	0.99	-0.38
Min / Max	1 / 3	1 / 4	1 / 3
N	99	99	99

Regarding sample composition: approximately 75% of respondents fall within the 18–25 age bracket (consistent with a student/young professional sample); 62% report annual income below ₹1 lakh; 58% self-identify as risk-averse; 30% as risk-neutral; and 11% as risk-takers. Critically, 71% report awareness of available tax benefits, while 29% are unaware — indicating a significant information gap with direct implications for policy. Investment frequency is approximately evenly distributed across monthly (28%), quarterly (24%), bi-annual (22%), and annual (25%) categories.

V. OLS REGRESSION RESULTS AND HYPOTHESES TESTING

Table 4: OLS Regression Results — Determinants of Mutual Fund Investment Decisions ($R^2 = 0.914$)

Variable	Coeff.	Std. Err.	t-value	p-value	Sig.
Tax Exemption (L2)	0.833	0.068	12.33	0.000	***
Tax Exemption (L3)	1.535	0.073	21.06	0.000	***
Tax Exemption (L4)	1.794	0.105	17.06	0.000	***
Age Group 2	0.208	0.132	1.58	0.118	—
Age Group 3	0.330	0.272	1.21	0.228	—
Invest. Freq. 2	-0.032	0.073	-0.43	0.665	—
Invest. Freq. 3	0.090	0.073	1.24	0.218	—
Invest. Freq. 4	0.061	0.076	0.80	0.429	—
Awareness (L2)	0.211	0.064	3.31	0.001	***
Awareness (L3)	-0.121	0.293	-0.41	0.681	—
Income (L2)	0.051	0.059	0.85	0.398	—
Income (L3)	0.072	0.103	0.70	0.488	—
Income (L5)	0.462	0.259	1.79	0.078	*
Risk Appetite (L2)	0.140	0.078	1.80	0.076	*
Risk Appetite (L3)	0.430	0.088	4.89	0.000	***
Constant	0.862	0.088	9.79	0.000	***



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Note: *** $p < 0.01$; * $p < 0.10$; — Not significant. Base categories: Tax Exemption L1; Age Group 1 (18–25); Invest. Freq. 1 (Monthly); Awareness L1 (Unaware); Income L1 ($< ₹1L$); Risk Appetite L1 (Risk Averse).

The regression model is highly significant overall (F-test $p < 0.001$) and explains 91.4% of variation in investment decisions ($R^2 = 0.914$), confirming strong model fit and validity.

Tax Exemption (H1 — Supported): Tax exemption emerges as the dominant predictor across all tested levels. Relative to the base (minimal benefit), Level 2 yields $\beta = 0.833$ ($p < 0.001$), Level 3 $\beta = 1.535$ ($p < 0.001$), and Level 4 $\beta = 1.794$ ($p < 0.001$). This monotonically increasing dose-response relationship confirms H1 decisively: greater perceived tax benefit produces progressively higher investment propensity, consistent with Expected Utility Theory.

Financial Awareness (H2 — Supported): Awareness Level 2 (aware) yields $\beta = 0.211$ ($p < 0.001$), confirming H2. The insignificant Level 3 coefficient ($\beta = -0.121$, $p = 0.681$) likely reflects a ceiling effect at the highest awareness tier or sample size limitations within that sub-group. With 29% of the sample unaware of tax provisions, the awareness gap represents a direct policy-addressable constraint on investment.

Risk Appetite (H3 — Supported): Risk Taker (Level 3) yields $\beta = 0.430$ ($p < 0.001$) and Risk Neutral (Level 2) $\beta = 0.140$ ($p = 0.076$), both confirming H3. Risk-tolerant investors are more likely to invest in equity-oriented funds, which benefit most from the preferential LTCG treatment under the 2024 regime.

Age and Investment Frequency (Not Significant): Neither age group nor investment frequency produces significant coefficients at conventional levels. This may partly reflect demographic homogeneity in the sample (75% aged 18–25) rather than a genuine absence of age effects in the broader population.

Income (Marginally Significant at Highest Bracket): Only Income Level 5 ($\geq ₹20$ lakh) yields marginal significance ($\beta = 0.462$, $p = 0.078$), consistent with Bergstresser & Poterba (2002): tax sensitivity concentrates among high earners. The predominantly lower-income sample limits income's explanatory power in this study.

VI. DISCUSSION

The results confirm the central thesis that tax incentives are a powerful and statistically dominant driver of mutual fund investment decisions — but one whose effectiveness is contingent on investor awareness and risk orientation. The graduated response to tax exemption levels aligns with rational utility maximisation theory; however, the 29% awareness gap in the sample illustrates that information asymmetry prevents a significant portion of investors from acting on incentives that formally exist. This is particularly consequential given the complexity introduced by the 2024 reforms — revised LTCG/STCG rates, removal of indexation, and the narrowed definition of Specified Mutual Funds — which have raised the knowledge threshold required to navigate the tax landscape optimally.

The finding that risk appetite significantly moderates the tax–investment relationship has important structural implications. Since equity-oriented funds carry the most favourable long-term tax treatment, tax incentives are most effective for investors already comfortable with equity risk. Conservative investors (58% of this sample) may therefore be systematically less responsive to tax incentives — not because the incentives are inadequate, but because they are channelled primarily through asset classes the investor is unwilling to hold. This suggests a policy design gap: debt-oriented instruments and hybrid funds that appeal to conservative investors carry less favourable post-2024 tax treatment, potentially reducing the reach of fiscal incentives across the risk-averse majority.

The absence of significant age and frequency effects, and the limited income significance, likely reflects sample composition rather than population-level dynamics. A broader, demographically diverse sample would be required to fully characterise these moderators.

VII. IMPLICATIONS

7.1 Policy Implications

The study underscores that the effectiveness of tax incentives as a tool for promoting retail mutual fund investment depends critically on investor financial literacy. The 2024 capital gains tax revisions — while broadly simplifying the



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rate structure — have simultaneously raised the knowledge burden for investors seeking to optimise their post-tax returns. Policymakers at SEBI and the Ministry of Finance should invest in coordinated investor education campaigns, particularly targeting the 18–35 demographic and lower-income groups who exhibit the largest awareness gaps. AMFI's 'Mutual Fund Sahi Hai' campaign could be extended to include a specific 'Know Your Tax Benefit' module.

Additionally, the finding that risk appetite constrains the reach of equity-oriented tax incentives suggests that extending meaningful tax benefits to hybrid and balanced-advantage funds — which appeal to risk-averse investors — could broaden the tax-policy transmission mechanism to the investor majority.

7.2 Managerial Implications

For AMCs and financial advisors, the clear positive relationship between tax benefit perception and investment likelihood underscores the commercial importance of tax-forward product communication. Marketing materials for ELSS, balanced advantage funds, and long-duration equity funds should explicitly quantify post-tax return differentials relative to comparable products. Advisors who demonstrate command of the revised LTCG/STCG framework, SIP taxation (FIFO basis), and Section 50AA treatment of debt funds are better positioned to deepen client commitment and assets under advice.

VIII. LIMITATIONS AND SCOPE FOR FUTURE RESEARCH

This study carries several limitations. The convenient sample ($N = 100$), concentrated in the 18–25 age bracket and lower income categories, limits generalisability to the broader Indian investor population. Cross-sectional design precludes causal inference; longitudinal data tracking the same investors before and after the 2024 tax reforms would enable stronger causal claims. Response bias from self-reported tax awareness and investment likelihood cannot be entirely eliminated.

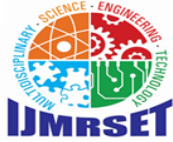
Future research should: (i) deploy larger, demographically stratified samples across multiple Indian states; (ii) use Structural Equation Modelling (SEM) to test mediation (e.g., whether financial literacy mediates income's effect on tax-driven investment); (iii) conduct pre-post panel studies around the 2024 reform; and (iv) examine heterogeneous effects by fund category (ELSS vs. equity index vs. debt hybrid) to map the reach of tax incentives across investor and product types.

IX. CONCLUSION

This study provides robust empirical evidence that tax benefits and exemptions are a significant and graduated positive driver of mutual fund investment decisions among retail investors in Karnataka. An OLS regression model explaining 91.4% of variation in investment decisions identifies tax exemption level, financial awareness, and risk appetite as statistically significant determinants — while age group and investment frequency are not significant, and income is marginally significant only at the highest bracket. These findings, grounded in Expected Utility Theory and the Information Asymmetry Framework, carry direct implications for policymakers, financial advisors, and fund houses navigating India's evolving post-2024 tax landscape. The principal challenge — and opportunity — lies in ensuring that the financial literacy required to convert fiscal incentives into investment action reaches the widest possible range of retail investors, and that tax policy design extends meaningful benefits across the risk-appetite spectrum.

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