

# An Evaluation of Rationality of Employees of Kerala While Spending Money on the Purview of Income Tax Planning Tools

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**Abstract:** This study is about the logic of preferences of employees of Kerala when they are spending money on tax planning measures in general and especially on the allowable deductions. The study found out that mainly there are three motives for employees for spending money on income tax planning tools. They are wealth creation motive, social and self development motive and risk coverage motive. The study concludes that only 52 percent of the employees are spending their money logically for the tax planning tools. The remaining 48 percent employees are irrational in relation with the spending on income tax planning tools.

**Key words:** *Income tax planning, Irrational employees, Rational employees, Risk coverage motive, Social and self development motive, Wealth creation motive.*

## I. INTRODUCTION

"Income tax is an important source of finance for the government. In India, the government has used income tax as an instrument to achieve various socioeconomic objectives also. The power to tax and property is an essential attribute of sovereignty"[1]. From the above definition it is clear that income tax is a right of the state. More than that it is an instrument in the hands of government to achieve various socioeconomic objectives like proper distribution of wealth among the people of the country by taking money from the rich as tax and distribute it among the people as various welfare measures.

Irrespective of our wealth all the people like to enjoy various welfare measures done by the government .But in many circumstances people do not like to pay a portion of income as income tax to the government and may try to evade tax. As a result the government may not be able to undertake various developmental activities.. In such a situation the government needed to raise money from the people and at the same time it should not affect the people adversely. At this point the best tool in the hands of government is to provide some tax planning opportunities to the people, so that, they can intelligently plan and reduce the payable tax and thus they can enjoy more from the fruits of their hard work. At the same time government can carry on with their developmental activities using the money it collected from the public by providing some exemptions and deduction in the taxation law[2].

The term tax planning may be defined as, 'logical analysis of a financial situation or plan from a tax perspective, to align financial goals with tax efficiency planning' [3]. The

purpose of tax planning is to discover how to accomplish all of the other elements of a financial plan in the most tax-efficient manner possible. Tax planning thus allows the other elements of a financial plan to interact more effectively by minimizing tax liability. In other words it is an arrangement of one's financial affairs in such a way that without violating in any way the legal provisions of an act, full advantage is taken of all exemptions, deductions , rebates and reliefs permitted under the act, so that the burden of the taxation on an assessee, as far as possible, the least.

From the view point of a person income tax planning is the careful management of his incomes in order to minimize his tax incidence by availing full advantage of exemptions, deductions and rebates provided in the law. And from the view point of government, they provide tax planning opportunities to its people as a tool of its financial management.

## II. STATEMENT OF THE PROBLEM

Indian income tax act 1961 divides income of a person into five different heads such as income from salary, income from business or profession, income from house property, capital gains, and income from other sources[4]. It also provides various deductions, exemptions and rebates to the people with respect to each of these heads of income. Some people have more knowledge about the provisions of the income tax act and some may not be that much aware of the provisions of the act. Despite their knowledge one thing is obvious - everyone needed desperately to reduce their tax burden. Every tax payers are eagerly searching for a

solution that will reduce their taxes even when their income shows an upward trend.

The only legitimate solution for the problem of larger tax burden is tax planning. It is the Logical analysis of a financial situation or plan from a tax perspective, to align financial goals with tax efficiency planning[5]. The purpose of tax planning is to discover how to accomplish all of the elements of a financial plan in the most tax-efficient manner possible[6]. Tax planning thus allows the elements of a financial plan to interact more effectively by minimizing tax liability.

A precondition for planning in any field is a thorough knowledge about the premises of planning and the right perception about it. In the case of tax planning it is the knowledge about rules and regulation that are connected with the income tax law. Hence, this study is all about the perception of the people about investing their money in the light of provisions of the income tax that helps to reduce their tax burden. And the question that will be addressed in this study is:-

- 1) What is the perception of employees about the investments that will help to reduce income tax?

## OBJECTIVES OF THE STUDY

The objectives of the study includes the following

- 1) To study various motives of people while investing or spending money.
- 2) To study the rationality among employees while investing or spending for tax planning..

## IMPORTANCE OF THE STUDY

There is nothing which hurts more than payment of taxes. One question that goes through every tax payer's mind is "how can I reduce my tax liability?" Reducing tax liability is not always a bad or illegal exercise. There are legitimate ways to reduce taxes through proper tax planning and such methods are always encouraged. But unfortunately, there is also a tendency to reduce tax through illegal methods. They are not accepted practice and can invite problems. Hence it is the need of the hour to popularize the legitimate ways to reduce taxes. It will always be helpful to the people and to the government.

## III. METHODOLOGY AND SAMPLE DESIGN

For the purpose of this study primary data is collected from the employees in Kerala who filed income tax return for the assessment year 2017-18. Questionnaire is used for collecting data. Sample is collected from 200 respondents spread all over Kerala.

## SAMPLING TECHNIQUE AND SIZE

The sampling technique used for the study is convenience sampling. In this method, the sample is one that is available to the researcher by virtue of its accessibility[7]. The data is collected from 200 respondents. Outliers are

traced out by Mahalanobis distance. There were three outliers after eliminating them, the final sample size is 197.

## TOOLS USED FOR THE STUDY

In this study, mean, standard deviation and ranks about the preferences of employees while spending money is calculated to understand the general pulse of employees on spending money. As the next step exploratory factor analysis is used to derive the specific motives while spending money. Then the cluster analysis is used to group the people based on their preferences towards the factors enlisted by the exploratory factor analysis. At last a grouping diagram and 't tests' is used to find weather the grouping is justifiable.

## IV. ANALYSIS OF DATA

The study identified seventeen constructs based on the preferences based on spending money on tax planning. In the table the mean, standard deviation and ranks are calculated to know which construct has the highest mean, highest dispersion.

### Investment preferences of employees.

No		Mean	S.D.	Rank
1	Providing regular income	3.94	0.94	VII
2	Maximize value	4.05	0.91	III
3	Savings should lead to a wealthy future	3.73	1.27	IX
4	Investment should not be depreciated	3.74	1.23	VIII
5	More return than the inflation rate	4.04	1.12	IV
6	protection from physical damage of assets	4.21	1.01	I
7	Ample market to convert investment into cash	4.02	1.07	VI
8	Minimum converting charges to cash should be	4.10	1.32	II
9	No loss while converting investment into cash	4.03	1.23	V
10	I prefer using money on education	3.24	1.37	X
11	I prefer spending money on life insurance	3.01	0.96	XIV
12	I prefer spending money on health insurance	3.16	1.12	XI
13	I prefer spending on building a house	3.10	1.34	XIII
14	I like to donate for various national causes	2.79	1.50	XV
15	I like to donate for charitable purposes	3.11	1.15	XII
16	I like to donate for the culture/arts/science	2.69	1.24	XVI
17	I like to donate to political parties	1.58	0.91	XVII

The above table shows the preferences of employees while investing along with mean, standard deviation, and their respective rankings. From the table, it is clear that the employees prefer most for the security of their assets with mean score of 4.21. the second rank is for the investment

which can be converted into cash with the least conversion charges(4.10).and the third rank is for the investment that maximizes the value of investment(4.05). By examining the table it is clear that people prefer security , liquidity and profitability while investing their funds..

### FACTORIZATION OF THE CONSTRUCTS

The study used seventeen constructs which are preferred by an employee while investing their funds. From this constructs, the study extracted factors using exploratory factor analysis[8], which will help to explain the perception of employees more meaningfully and to reduce the number of factors from seventeen to a more manageable figure for the further analysis.

Before performing factor analysis, the study performed KMO and Bartlett's test.KMO test for sampling adequacy is acceptable when the value is more than 0.60.Bartlett's test of sphericity is acceptable when it is significant at 0.00.

#### KMO and Bartlett's test

KMO measure of sampling adequacy		0.66
Bartlett's test of sphericity	Chi-Square	2643.513
	Df	136
	Sig	0

From the table , it is clear that the KMO value is greater than 0.60 and Bartlett's sphericity test is significant at 0.00.Therefore the data can be used for factor analysis.

### DETERMINATION OF FACTORS

Exploratory factor analysis is used for determining the factor. Eigen values and percentage of variance are used to determine the number of factors that is optimum for the study.

#### Variance explained by factors

Component	Eigen values	% of variance	Cumulative%
ML2	4.903	29	29
ML3	2.895	18	47
ML1	1.645	10	57

Three factors are extracted from seventeen constructs. These three factors have a cumulative variance percentage of 57 which sufficiently explains the preferences of employees while using money.

#### Rotated component matrix

No.		Factor Loadings		
		ML2	ML3	ML1
1	Providing regular income	0.493		
2	Maximize value	0.789		
4	Investment should not be depreciated	0.605		
5	more return than the inflation rate	0.834		
6	protection from physical damage of assets	0.833		
7	ample market to convert investment into cash	0.555		
8	minimum converting charges to cash	0.899		

	should be			
9	No loss while converting investment into cash	0.844		
10	I prefer using money on education		0.367	
11	I prefer spending money on life insurance			0.553
12	I prefer spending money on health insurance			0.964
13	I prefer spending on building a house		0.385	
14	I like to donate for various national causes		0.963	
15	I like to donate for charitable purposes		0.828	
16	I like to donate for the culture/arts/science		0.837	

These study originally consists of seventeen constructs. Among those seventeen constructs, two constructs had double loading in the exploratory factor analysis. Hence, for the further analysis those constructs were eliminated and the remaining fifteen constructs are considered.

First factor ML2 is explained by constructs 1,2,4,5,6,7,8, and 9.These constructs are explaining return, security, and liquidity of investment there for the first factor can be named as wealth creation motive

Second factor ML3 is explained by the factors 10,13,14,15, and 16.These constructs are indicating education and social welfare. Hence it can be named as social and self development motive.

The third factor ML1 is formed by constructs 11 and 12. These constructs are about the personal and health insurance. So It can be named as risk coverage motive.

From the exploratory factor analysis it is clear that the three factors driving the preference of employees while spending their money are wealth creation motive, social and self development motive, and risk coverage motive. For the further analysis the study uses these three factors.

### SEGMENTATION OF EMPLOYEES.

The study has derived three factors form the constructs. Segmentation of the employees based on the basis of perception of the employees on these three factors will help to identify how much these factors are influencing the employees.

#### Final clusters and result of T-test

	Clusters		T-Test	
	1	2	T-Value	Significance
Wealth creation motive	3.89 (II)	4.16(I)	- 2.2334	0.02703
Social and self development motive	2.18(II)	3.71(I)	- 15.342	0.000
Risk coverage motive	2.31(II)	3.77(I)	- 17.575	0.000
Average	2.79	3.88		
No. of employees	95	102		
Percentage	48	52		

From the cluster analysis the study found that the employees can be divided into two groups. Group 1 and 2. From the examination of the table it is clear that all the three factors have a greater group mean in the second group . That means the people included in the second group are considering all the three factors more than that of the people in the first group. There for the study identified the first group of people as Irrational group and second group of people are rational group with respect to their preferences while spending their money.

Among the 197employees, 102(52 percentage) employees are belong to the rational group and the remaining 95(48 percentage) people belong to the irrational group..the t test shows that both the group means are significantly different .in the case of each of the three factors

#### Group centroids for investor's preferences



The figure represents each of the two groups and their respective group centroids.It is clear that both the groups are different from each other. First and second groups are irrational and rational group respectively

#### RELIABILITY OF SEGMENTATION-

The reliability of segmentation is determined using discriminate analysis. Three factors are taken as independent variable and clusters classification is taken as grouping variable to find out reliability of cluster classification.

#### Structural matrix

	Function.
Wealth creation motive	-0.14
Social and self development motive	1.10
Risk coverage motive	1.38

The table shows structural matrix. This indicates that one function can be formed for two clusters. This function can be used to describe the population on the basis of cluster membership

The function is-

$$Z = \text{Social and self development motive} \times 1.10 + \text{Risk coverage motive} \times 1.38 - \text{Wealth creation motive} \times 0.14$$

Based on the function, the following classification table can be formed.

#### Classification Results

		Predicted groups		Total
		Rational	Irrational	
Count	Rational	95	0	95
	Irrational	0	102	102
Percentage	Rational	48	0	100
	Irrational	0	52	100

The table show that the predictions based on the discriminate analysis is accurate based on the collected data. Hence the formation of two cluster as rational and irrational is highly reliable.

#### V. FINDINGS AND CONCLUSION

The first objective of the study was to study various motives of people while investing or spending money. This has been studied using exploratory factor analysis and found that there are three motives for spending money in the purview of tax planning they are:-

- 1) Wealth creation motive
- 2) Social and self development motive, and
- 3) Risk coverage motive

Another objective of the study was to study the rationality among employees while investing or spending for tax planning. The cluster analysis reviled that on the basis of the preferences of spending money, the employees can be divided into two groups as rational group(52 percent of the respondents), who are considering the three motives of spending money for tax planning, and the irrational group(48 percent of the respondents ) who are not giving importance to any of the motives of spending.

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