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Mental Accounting and Tax Refund: Evidence From Employees

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Abstract

In the day to day life, people receive different kinds of windfalls such as coupons, premiums, cash back offers, etc. such windfalls have noticeable effect on purchase decisions and are influenced by the mental accounting practices. Tax refund is a kind of windfall among tax payers, which they receive unexpectedly on account of inaccurate assessment, amended policies, filing o incomplete records etc. But, how this refund effects purchase decisions is an unanswered question. A number of studies had conducted to determine the influence different types of windfalls except tax refund. Hence this study has conducted among taxpaying employees to determine the influence of mental accounting in purchase decisions, to identify whether employees are concerned about the basic elements of mental accounting and to analyse the purchase behavior on account of tax refund. The study also tries to determine whether the proportion of tax refund is associated with the income of employees.

Key words: mental accounting, windfalls and tax refund.

INTRODUCTION

In the present competitive world, marketers try to attract their customers by offering coupons, cash back, bonus, etc. These kinds of small windfalls may have influence on purchasing decisions of customers. According to life cycle theory of consumption or to the theory of standard permanent income (Friedman, 1957; Modigliani and Brumberg, 1954) these kinds of small windfalls have no significant effect on purchase decision as such kinds of windfalls do not bring changes in life time wealth. However the persons receiving these kinds of windfalls put this unexpected cash to buy items might not have otherwise purchased. This kind of behavior can be interpreted as the basis for mental accounting (Thaler and Shefrin, 1981)

According to Richard H Thaler, the first to describe the phenomenon, mental accounting is the set of cognitive operations used by individuals and households to organize, evaluate, and keep track of financial activities. And the theory states that, rather than grouping all decisions together and optimizing consumption choices by the people over a life-long horizon, they categorize their activities into "mental accounts" and make decisions within the context of these limited spending and saving categories.

An implication of the theory that individuals create mental accounts to manage their purchase decisions is that they will respond to small, unexpected windfalls by spending them immediately and buying items that they would not buy without expanding their budget significantly.