

E-Content (M.Com sem 4)

Accounts Group Paper II - Tax Planning & Management

By -

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Tax Planning

This content will include -

- 1) meaning of tax and tax evasion
- 2) Reasons of tax evasion
- 3) meaning of tax avoidance
- 4) Difference and characteristics of tax planning
- 5) meaning and objectives of tax planning
- 6) Importance and significance of tax planning.
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Meaning of Tax

Under dictionary meaning, the word 'tax' means 'a rate or sum of money levied on persons property for the benefit of the State'. Section 2(43) of the Income Tax Act, 1961, defines 'tax'. Tax means income tax chargeable under the provisions of this Act.

TAX EVASION

When a person reduces his total income by making false claims or by withholding the information regarding his real income, so that his tax liability is reduced, is known as tax evasion. Tax evasion is not only illegal but it is also immoral, anti-social and anti-national practice. Therefore, under the direct tax laws provisions have been made for the imposition of heavy penalty and the institution of prosecution proceedings against tax evaders.

The tax evader reduces his taxable income by one or more of the following steps :

- (1) Unrecorded sales.
 - (2) Claiming bogus expenses, bad debts and losses.
 - (3) Charging personal expenses as business expenses, e.g., car expenses, telephone expenses, travelling expenses, medical expenses incurred for self or family may be shown in the account books as business expenses.
 - (4) Submission of bogus receipts for charitable donations for deduction u/s 80G.
 - (5) Non-disclosure of capital gains on the asset.
 - (6) Non-disclosure of income from 'Benami transactions'.
 - (7) By showing excessive or bogus salary payments to near relatives.
 - (8) By not showing taxable incomes in return of income.
- In a brief to evade tax, he suppresses or omits receipts, inflates expenses and claims bogus deductions.

Now the question is why a person evades tax? The main reasons of tax evasion are :

1. Deterioration of moral values.
2. In society, tax evader is not a bad person. If he is rich, he is a respectable person in society.
3. Declaration of voluntary disclosure schemes by the Government from time to time. The tax evader knows that in such a scheme he can pay tax at a lower rate and save interest and penalty.
4. The tax management is not accountable for the increase in tax evasion.
5. The tax management and tax experts help in tax evasion.
6. Misutilisation of public fund by the Government and its employees.
7. Imparting no education regarding the advantages of tax payment and disadvantages of tax evasion to the people.

TAX AVOIDANCE

Tax avoidance is an art of dodging tax without actually breaking the law. It is a method of reducing tax incidence by availing of certain loopholes in the law. The Royal Commission on Taxation for Canada has explained the concept of 'avoidance of tax' as under :

The expression 'Tax Avoidance' will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provision or lack of provision in the law. It excludes fraud, concealment or other illegal measures. In other words, 'tax avoidance' is a device which technically satisfies the requirement of the law but in fact, it is not in accordance with the legislative intent.

Per Jagadisan J. [*in Aruna Group of Estates vs. State of Madras* (1965) 55 ITR 642 (Mad.)], "Avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law and; certainly, not bad morality, for anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum."

However, now the Supreme Court is of the view that the colourable devices to avoid tax should not be encouraged and this is the duty of the court to expose the persons who avoid tax and refuse to approve such practice because the social evils of tax avoidance are manifold, and may be summarised as under :

- (a) substantial loss of much needed public revenue, particularly in a welfare state like ours;
- (b) serious disturbance caused to the economy of the country by piling up of mountains of black money directly causing inflation;
- (c) large hidden loss to the community by some of the best brains in the country being involved in the perpetual war waged between tax avoider and his expert team of advisers, lawyers and accountants on one side, and Tax Officer and perhaps not so skilful advisers on the other side;
- (d) sense of injustice and inequality which tax avoidance arouses in the breasts of those who are unwilling or unable to profit by it;
- (e) ethics (or lack of it) of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of artful dodgers.

[McDowell & Co. Ltd. vs. Commercial Tax Officer (1985) 154 ITR 148]

The legislature has inserted the provisions in direct tax laws for checking tax avoidance. But so long there are loopholes in the laws, tax avoidance cannot be checked by the Courts. The function of the judiciary in India is clearly not legislative, its role lies in interpreting the law made by the legislature.

> **Difference between 'Tax Planning' and 'Tax Evasion'**

1. Tax planning is an Act within the four corners of the Act to achieve certain social and economic objectives and it is not a colourable device to avoid the tax. Tax evasion is a deliberate attempt on the part of taxpayer by misrepresentation of facts, falsification of accounts including downright fraud.

2. Tax planning is a legal right and social responsibility. By tax planning, certain social and economic objectives are achieved. Tax evasion is a legal offence coupled with penalty and prosecution.

3. Tax planning requires thorough knowledge of the relevant Acts, social, economic and political situation of the country while tax evasion requires boldness to infringe the law.

4. Tax planning helps in the economic development of the country by providing additional funds for investment in desired channels while tax evasion generates black money which is generally utilised for smuggling, bribery, extravagant expenses on luxury.

5. A tax planner enjoys his fruits freely and he does not suffer from high blood pressure, whereas a tax evader remains always in the anxiety of search and seizure.

As our society has become 'money society', whatever the evils of black money may be, it has become a part of the life of most of the people and in near future, there is no hope of putting a check on it.

> **Difference between Tax Planning and Tax Avoidance**

1. In tax planning, the letter and the spirit of the law are followed while in tax avoidance the tax is reduced by taking advantage of the loopholes of the law.

2. Tax planning is permanent while tax avoidance is temporary. However, no penalty can be imposed either in case of tax planning or in case of tax avoidance.

> **Difference between Tax Avoidance and Tax Evasion**

1. Tax avoidance is legal but tax evasion is illegal.

2. In case of tax avoidance, the objects and spirit of the law are not followed while in the case of tax evasion the provisions of the law are flouted.

3. In the case of tax avoidance, no penalty can be imposed while in case of tax evasion the person is liable to penalty and prosecution.

4. In the case of tax avoidance, black money is not generated, hence, it is not very harmful to society. In case of tax evasion, black money is generated which is mostly used for unproductive purposes.

TAX PLANNING

Tax planning may be defined as 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, is the least.

Actually, the exemptions, deductions, rebates and reliefs have been provided by the legislature to achieve certain social and economic goals. For example *section 80IB* of the Income Tax Act, 1961 provides deduction from gross total income in respect of profits from newly established industrial undertakings in industrially backward State or industrially backward district as may be notified in this behalf. The object of the tax concession is clear, i.e. economic development of industrially backward district or State. *Section 80C* provides a deduction from gross total income if an individual or H.U.F. saves the amount and invests or deposits it in the prescribed schemes. The deduction has been provided to encourage savings and investments for economic development of the country.

OBJECTIVES OF TAX PLANNING

Tax liability is reduced by tax planning. In the direct taxes exemptions, deductions, rebates and reliefs have been provided by the legislature to achieve certain social and economic goals. To achieve these objectives people are encouraged to resort to tax planning :

1. Claim deductions from gross total income under sections 80C to 80U.
2. *Reduction in tax liability.* The basic need of tax planning is to reduce the tax liability so that enough surplus out of profits remains with the earner of it for his personal and social needs and also for future investments in his business. This is only possible by planning his tax affairs

OBJECTIVES contd ...

properly and availing the deductions, exemptions and reliefs, etc. which are admissible under the Acts. He can succeed in doing so by updating his knowledge about the various concessions available in the taxation laws and the conditions to be fulfilled to avail them.

3. **Minimisation of litigation.** There is always a tug-of-war between the tax-payers and the tax administrators. The tax-payers try their best to pay the least tax and the tax administrators attempt to extract the maximum. This sometimes results in prolonged litigation. Actually, the main reason of litigation lies in tax avoidance and not in tax planning. Whenever a tax-payer wants to reduce his tax liability by finding a loophole in the Act and the tax administrator does not agree with the interpretation of the assessee under which he is demanding exemption, deduction or relief, it results in litigation. A good tax planning is always based on clear words of the statute or in conformity with the provisions of the taxation laws. In such a case the chances of litigation are minimised.

4. **Productive investment.** A proper tax planning brings fiscal discipline in the functioning of a tax-payer and reduces the transfer of money, from the person who has earned it by hard labour, to the Government for waste and ostentation. The amount so saved enhances the capacity of the tax-payer for expansion and growth, which in turn increases the tax revenue of the Government.

5. **Reduction in cost.** Incidence of tax (direct and indirect) forms a part of the cost of production. The reduction of tax by tax planning reduces the overall cost. It results in more sale, more profit and more tax revenue.

6. **Healthy growth of the economy.** The growth of a nation's economy depends upon the growth of its citizens. Savings through tax planning devices foster the growth of economy while savings through tax evasion lead to the generation of black money, the evils of which are obvious. The tax planning plays an important role in the development of backward districts and backward states and development of infrastructure facilities or in other words, it takes the economy in the intended direction.

7. **Employment generation.** The amount saved by tax planning is generally invested in the commencement of new undertakings or expansion of the business. This creates new employment opportunities in the business. Further, taxation laws are so complicated that by and large tax-payers cannot plan their affairs efficiently. Hence, such persons need services of chartered accountants, financial advisers and lawyers. Such persons join the business concerns either as employees or provide their services as private professionals.

Thus, the tax planning is not only the need of the tax-payers but also of the society as a whole and the Government.

CHARACTERISTICS OF TAX PLANNING

This is the era of planning. As in financial sector finance planning, in management sector management planning is done similarly for taxes tax planning is resorted.

Following are the characteristics of tax planning :

1. **Object.** The main object of tax planning is to reduce tax liability. This object is achieved by claiming deductions, reliefs and rebates allowed under the Act.
2. **Ethical.** Tax planning is ethical because it is an act within the four corners of the Act and it is not a colourable device to avoid the tax.
3. **Basis.** The basis of tax planning is claiming the deductions, rebates and reliefs which have been provided in the Act to achieve certain social and economic goals.
4. **Study and analysis.** Tax planning requires a thorough knowledge of the Act and analysis of its provisions so that tax liability may be reduced by fulfilling the conditions laid down in the Act.

5. **Term.** Tax planning can be a short-term tax planning or a long-term tax planning. When it is resorted to for the current year, it is called short-term tax planning but when it is resorted to availing tax benefits year after year, it is known as long-term tax planning.

6. **Temporary and permanent.** Sometimes the tax liability is reduced in the current year by depositing the money in notified schemes. But when money is withdrawn from the scheme, the depositor has to pay the tax on the amount withdrawn. This is known as temporary tax planning. When the benefit of tax reduction in a year is not withdrawn in the future, it is known as permanent tax planning.

7. **Forms.** There are many forms of tax planning, e.g., savings, investment, selection of place for a new business, a form of organisation, capital structure, construction and use of the house property, transfer of a capital asset, etc.

IMPORTANCE OR SIGNIFICANCE OF TAX PLANNING

Tax planning is not only important for tax-payer but it is beneficial for the development of the country, society, trade, industry, etc.

(1) **For Tax-payer.** By tax planning, the tax-payer reduces his tax liability. For this purpose, he avails the benefit of deductions, reliefs and rebates permissible in the Act. He invests his savings in such schemes from where he gets the maximum tax advantage.

(2) **For the country.** It means the Government. The Government starts development schemes for the progress of the nation. The capital for the schemes is arranged by encouraging people to save and invest. This reduces the pressure on government revenue.

(3) **For society.** By tax planning, the society is also benefitted in many ways. The amount saved is invested in the industry. New industrial units provide an opportunity for employment. This increases demand of goods and services resulting in the better standard of living.

(4) **For industry and trade.** By tax incentive, the Government encourages people for balanced development of different parts of the country. If an industrial undertaking is established in a Backward State or a Backward District, a certain percentage of profit for the specified period is deducted from its income. Similarly to meet the demand of residential houses, tax incentives have been given. This encourages investors to invest in housing projects and the people to purchase houses for themselves.