TAX PLANNING AND MANAGEMENT

M Com (Finance)

IV Semester

2015 Admission

UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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CALICUT UNIVERSITY
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Study Material

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TAX PLANNING AND MANAGEMENT

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Settings & Lay Out By:

SDE,Computer Cell

SYLLABUS
TAX PLANNING AND MANAGEMENT

Objectives:

- To acquaint the students with theoretical and practical knowledge of taxplanning and management techniques.
- To familiarize the students with major and latest provisions of the India tax laws and related judicial pronouncements pertaining to various assesses with a view to derive maximum possible tax benefits admissible under the law.

Module 1: Introduction to tax planning and management: Concept of tax planningand management – Tax evasions and tax avoidance-Need and significance of taxplanning and management-Tax Planning in respect of residential status.

Module 2: Assessment of companies: Residential status and incidence of tax-Special provisions applicable to assessment of total income of companies–Deductionsavailable to corporate assesses – Computation of taxable income ofcompanies and determination of corporate tax liability – Minimum Alternate Tax–Taxon distributed profit of domestic companies- Tax on income distributed to unitholders-Security Transaction Tax – Tonnage Tax.

Module 3: Tax Planning: Individuals – Tax Planning with reference to all fiveheads of income for individuals – Salary, House Property, Profit from business andprofession, Capital Gains and Income from other sources – Tax planning withrespect to deductions, exemptions, Rebate, Relief, Concession and incentives(Problems focused on tax planning).

Module 4: Tax planning and managerial decisions: Tax planning in respect ofmake or buy, own or lease, repair or replace, export or domestic sales, shut down orcontinue, expand or contract, amalgamate or demerger, invest or disinvest – FinancialManagement decisions, Capital Structure, dividend policy and bonusshares.

Module 5: Tax planning under various circumstances: Tax planning while settingup of a business-with reference to location, nature and form of organizations-Taxplanning related to Special Economic Zones (SEZ), Export Processing Zones (EPZ) and Export Oriented Units (EOUs) – Infrastructure sector and background areas –Tax incentives for exporters.

(50% theory and 50% problem)

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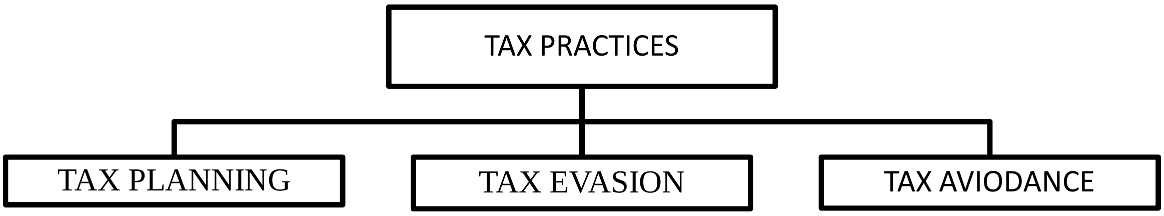
UNIT – I
INTRODUCTION TO TAX PLANNING AND MANAGEMENT

Taxes are the compulsory contribution by the citizens of a country for meeting different government expenditures. There are three stages in the imposition of tax by the government. First step is the declaration of the liability by the Government i.e. what are all the incomes chargeable to tax, second one is the assessment and tax payment by persons and the last one is the method of recovery of tax if tax was not paid on time. Tax planning and management focuses efficient administration of tax procedures and minimization of tax liability through eligible schemes. Through this chapter we can discuss about the basic concepts of Tax Planning, Tax Management, Tax Evasion and Tax Avoidance.



TAX PLANNING

Tax Planning is an exercise undertaken to minimize tax liability through the best use of all available exemptions, deductions, rebates and reliefs to reduce income. Tax planning can be defined as an arrangement of one’s financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances, reliefs and rebates so that tax liability reduces to minimum. In other words, all arrangements by which the tax is saved by ways and means which comply with the legal obligations and requirements and are not colourable devices or tactics to meet the letters of law but not the spirit behind these, would constitute tax planning.

The Hon’ble Supreme Court in McDowell & Co. v. CTO (1985) 154 ITR 148 has observed that “tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods.”

Actually the allowances, deductions, exemptions, rebates and reliefs were given as per legal regulations to achieve social and economic goals. For instance deductions as per 80C for individuals and HUF aim to encourage saving and investment habits for the economic prosperity of the country.

Example of tax planning: where a person buys machinery instead of hiring it, he is availing the benefit of depreciation. It is his exclusive right either to buy or lease it. In the same manner to choice the form of organization, capital structure, buys or make products are the assessee's exclusive right. One may look for various incentives in the above said transactions provided in Income Tax Act, for reduction of tax liability. All this transactions involves tax planning.

TAX EVASION

It refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the income or by inflating the expenditure showing the income lower than the actual income and resorting to various types of deliberate manipulations. An assessee guilty of tax evasion is punishable under the relevant laws. Under direct tax laws provisions have been made for imposition of heavy penalty and institution of prosecution proceeding against tax evaders.

The tax evaders reduce his taxable income by one or more of the following steps:

(a) Non-disclosure of capital gains on sale of asset.
(b) Non-disclosure of income from 'Binami transactions'.
(c) Willfully unrecording or partial recording of incomes. Eg: sales, rent, fees, etc.
(d) Charging personal expenses as business expenses. Eg: car expenses, telephone expenses, medical expenses incurred for self or family recorded in business books.
(e) Submission of bogus receipts for charitable donations under section 80 G.

TAX AVOIDANCE

Tax avoidance is a method reducing tax incidence by availing of certain loopholes in the law. The Royal Commission on Taxation for Canada has explained the concept of tax avoidance as under: For our purposes 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 provisions or lack of provisions of law. It excludes fraud, concealment or other illegal measures.

The line of demarcation between tax planning and tax avoidance is very thin and blurred. Any planning which, though done strictly according to legal requirements, defeats the basic intention of the Legislature behind the statute could be termed as instance of tax avoidance. It is usually done by taking full advantage of loopholes adjusting the affairs in such a manner that there is no infringement of taxation laws and least taxes are attracted.

Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. In the judgment of the Supreme Court in McDowell's case 1985 (154 ITR 148) SC, tax avoidance has been considered as heinous as tax evasion and a crime against society. Most of the amendments are now aimed at curbing practice of tax avoidance.

DISTINCTION BETWEEN TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

Basis	Tax Planning	Tax Avoidance	Tax Evasion
Meaning	Way of minimizing tax liability by availing full advantages of the Act through exemptions, deductions, rebates and relief.	The assesse legally takes advantage of loopholes in the tax laws	Illegal way reducing tax liability by deliberately suppressing incomes or hiking expenditures.
Aim of Practice	Saving of tax	Hedging of tax	Concealment of tax
Nature	Moral in nature	Immoral in nature and bends the law without breaking it	Illegal and objectionable.
Result	Advantages arise in the long run	Advantages arise in the short run.	Penalty and Prosecution
Legal implications	Uses benefits of the law	Loopholes in the law	Overrules the law

TAX MANAGEMENT

Tax management refers to compliance with the income tax rules and regulations. Tax management covers matters relating to

(a) Taking steps to avail various tax incentives
(b) Compliance with tax rules and regulations (including timely filing of return)
(c) Protecting from consequences of non-compliance of tax rules and regulations. i.e. penalties, prosecution etc.
(d) Review of departments orders and if need apply for rectification of mistake, filing appeal, tax revision or settlement of tax cases.

AREAS OF TAX MANAGEMENT

Important areas of tax management are discussed below:

1. **TDS (Tax Deducted at Source)**: Persons responsible for deducting tax at source should deduct from the income and that should be paid to the central government on time. Moreover he should issue deduction certificate to the deductee’s and file it in the income tax website.
2. **Collection of tax at source:** In some special cases, some persons responsible for collecting the tax at source from the buyers (sec 206C). They should comply with those formalities.
3. **Payment of tax:** It includes

(a) Payment of advance tax

(b) Payment of tax on self-assessment.
(c) Payment of tax on demand (payment after receiving notice from authorities)

4. **Maintenance of books of accounts:** Every businessman or a professional must maintain books of accounts and other relevant documents so that the tax can be computed accurately and verified by the Assessing Officer. Maintenance of account books, vouchers, bills, correspondence and agreements, etc. is a part of tax management.
5. **Audit of books of accounts:** If the turnover of the business for the previous year 2015-16 exceeds one crore rupees, the audit of books of accounts is compulsory as per income tax rules. (w.e.f P.Y 2016-17 – 50 lakh). In case of profession audit is compulsory if the gross receipts more than 25 lakhs.
6. **Furnishing the return of income**: The tax manager must ensure that the return of income is furnished on time otherwise the assesse will lose the right to carry forward and set off the losses and become liable to pay interest, penalty, prosecution or fine or both.
7. **Documentation and maintenance of tax records:** An assessee should keep complete and updated tax files so that the documentary evidences can be made available in case of all queries. Tax files include filed returns, Form 16, documentary evidence in support of deductions, rebate and relief, court orders, etc.
8. **Review of orders of Income Tax Department:** Review the assessment orders and other orders received from the tax department is an important function of tax management. If there is any mistake in the order, application for rectification can be made. If the order is prejudicial to the interest of the assessee he can file an appeal, revision or an application for settlement of case can be made.

DIFFERENCE BETWEEN TAX MANAGEMENT AND TAX PLANNING

TAX PLANNING	TAX MANAGEMENT
It is a wider term than tax management	It is the first step towards tax planning.
Aim of tax planning is to minimize tax burden.	Aim of tax management is compliance with legal formalities.
It is a guide in decision making	It is a regular activity
It is not essential for every assesse.	It is essential for every individual.
It looks at future benefits out of present actions	It relates to the past, present and future.

PROBLEM 1.1

Specify whether the following acts can be considered as an act of (a) tax management; or (b) tax planning; or (c) tax evasion.

(a) Mr. A invests in Public Provident Fund so as to reduce tax payable.

(b) ABC Ltd maintains TDS register at the company to enable timely compliance.
(c) X Ltd installed an air conditioner at the residence of a director as per terms of his appointment; but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

Solution:

(a) Investment in PPF is a part of tax planning.
(b) ABC Ltd maintains TDS register in the company as part of legal compliance. So it is tax management.
(c) Air conditioner is installed in the director's residence. But by fraud the company claiming depreciation of Air conditioner in the company's books to reduce tax burden. So it is tax evasion.

UNIT- II
TAX PLANNING

Tax planning is the analysis of one's financial situation from a tax efficiency point of view so as to plan one's finances in the most optimized manner. Tax planning allows a taxpayer to make the best use of the various tax exemptions, deductions and benefits to minimize their tax liability over a financial year. This process varies from person to person and depends, among many factors, taxable income, time schedule for investments, risk bearing inclination, existing investment pattern, expected returns etc. Over the years, tax planning scenario has become more dynamic and complicated, due to constant changes in the tax laws and falling interest rates. Further tax planning cannot be done in isolation; it should be a part of overall Financial Planning.

NEED AND SIGNIFICANCE OF TAX PLANNING

Tax Planning is the honest and rightful activity to minimize tax burden of various persons. Needs and significances of tax planning were discussed below.

(a) **Reduction of tax liability:** The basic need of tax planning is to reduce tax liability by arranging his affairs in accordance with the requirements of law, as contained in the fiscal statutes. In many a cases, a taxpayer may suffer heavy taxation not on account of the dosage of tax administered by the Act, but, because of his lack of awareness of the legal requirements

(b) **Minimization of litigation:** There is always tug-of-war between taxpayers and tax administrators. Tax payers try to pay least tax and the tax administrators attempt to levy higher amount of tax. Where a proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation is minimized

(c) **Productive investment:** Channelization, of taxable income to the various investment schemes is one of the prime purpose of tax planning as it is aimed to attain twin-objectives of: (i) harnessing the resources for socially productive projects, and, (ii) relieving the tax payer from the burden of taxation, converting the earnings into means of further earnings.

(d) **Reduction in cost:** The reduction of tax by tax planning reduces the overall cost. It results in more sales, more profit and more tax revenue.

(e) **Healthy growth of economy:** The growth of a nation's economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both. Tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. On the other hand tax evasion results generation of black money, the evils of which are obvious. Tax planning thus assumes a great significance in this context.

(f) Economic stability: Tax planning results in economic stability by way of: (i) availing of avenues for productive investments by the tax payers and, (ii) harnessing of resources for national projects aimed at general prosperity of the national economy and (iii)reaping of benefits even by those not liable to pay tax on their incomes.

(g) Employment generation: Tax planning creates employment opportunities in different ways. Firstly, efficient tax planning requires some sort of expertise that creates job opportunities in the form of advisory services. Secondly, amount saved through tax planning is generally invested in commencement of new business or the expansion of existing business. This creates new employment opportunities.

PRECAUTIONS IN TAX PLANNING

Successful tax planning techniques should have following attributes:

(a) It should be based on up to date knowledge of tax laws. Assessees must have an up to date knowledge of the statute he must also be aware of judgments of the courts, the circulars, notifications, clarifications and Administrative instructions issued by the CBDT from time to time.

(b) The disclosure of all material information and furnishing the same to the income-tax department is an absolute pre-requisite of tax planning the concealment in any form would attract the penalty often ranging from 100 to 300% of the amount of tax sought to be evaded. Section 271(1)(c) read together with explanations there to.

(c) Foresight is the essence of a business and the tax planning should also reflect this essence. Tax regimeis flexible in nature and tax planning model must also be flexible so that it could be scrutinized in relative situations.

(d) Tax planning should not be based on tax avoidance.

(e) Tax planning cannot be attempted in isolation. While doing tax planning we have to consider the violation of other laws.

TYPES OF TAX PLANNING

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are:

(a) Short-range and long-range tax planning.

(b) Permissive tax planning.

(c) Purposive tax planning.

(a) Short-range planning & Long-range planning: Short-range planning refers to year to year planning to achieve some specific or limited objective. For example, an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive ax relief. By investing in such a way, he is not making permanent commitment but is substantially saving in the tax. It is one of the examples of short-range planning.

Long-range planning on the other hand, involves entering into activities, which may not pay-off immediately. For example, when an assessee transfers his equity shares to his minor son he knows that the Income from the shares will be clubbed with his own income. But clubbing would also cease after minor attains majority.

(b) Permissive tax planning: Permissive tax planning is tax planning under the expressed provisions of tax laws. Tax laws of our country offer many exemptions and incentives.

(c) Purposive tax planning: Purposive tax planning is based on the measures which circumvent the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. For example, under Sections 60 to 65 of the Income-tax Act, 1961 the income of the other persons is clubbed in the income of the assessee. If the assessee is in a position to plan in such a way that these provisions do not get attracted, such a plan would work in favour of the tax payer because it would increase his disposable resources. Such a tax plan could be termed as 'Purposive Tax Planning'.

TAX PLANNING IN RESPECT OF RESIDENTIAL STATUS

The income tax will be applicable or not on an income source depends on the residential status of the assessee. The persons which are outside India for a major of time during the year and preceding year can keep some points in mind so that if they are capable of adjust their schedule they can save a lot of tax.

I. Individuals who are visiting India on a business trip or in some other connection should not stay in India for more than 181 days in the year and no more than 364 days in preceding four years to enjoy non-resident status.

II. If individual is in India for more than 364 days during the preceding four years then he should avoid staying in India for more than 59 days in a year. If he wants to stay more than 59 days then he may come in such manner that not more than 59 days comes in a previous year. For example, he may come after 2ndFebruary and leave before 29 May. So that not more than 59 days period is covered in both previous years.

III. Similarly Indian citizen or person of Indian origin should plan their trip such that not more than 181 days will fall in one year.

IV. A non-resident should not receive any income directly in India even if the business is controlled directly from India. He should first receive income outside India and then remit it to India, by such way no tax is leviable on such income.

V. Similarly a not ordinarily resident should receive his income outside India which is earned outside India and from a business controlled outside India.

UNIT – III

MINIMUM ALTERNATIVE TAX (MAT)

At times it may happen that a taxpayer, being a company, may have generated income during the year, but by taking the advantage of various provisions of Income-tax Law (like exemptions, deductions, depreciation, etc.), it may have reduced its tax liability or may not have paid any tax at all. Due to increase in the number of zero tax paying companies, MAT was introduced by the Finance Act, 1987 with effect from assessment year 1988-89. Later on, it was withdrawn by the Finance Act, 1990 and then reintroduced by Finance (No. 2) Act, 1996, w.e.f1-4-1997.The objective of introduction of MAT is to bring into the tax net "zero tax companies" which inspite of having earned substantial book profits and having paid handsome dividends, do not pay any tax due to various tax concessions and incentives provided under the Income-tax Law.Since the introduction of MAT, several changes have been introduced in the provisions of MAT and today it is levied on companies as per the provisions of section 115JB.

Basic provisions of MAT

As per the concept of MAT, the tax liability of a company will be higher of the following:

(a) Tax liability of the company computed as per the normal provisions of the Income-tax Law, i.e., tax computed on the taxable income of the company by applying the tax rate applicable to the company. Tax computed in above manner can be termed as normal tax iability.

(b) Tax computed @ 18.5% (plus surcharge and cess as applicable) on book profit (manner of computation of book profit is discussed in later part). The tax computed by applying18.5% (plus surcharge and cess as applicable) on book profit is called MAT.

Applicability and non-applicability of MAT

As per section 115JB, every taxpayer being a company is liable to pay MAT, if the Income tax (includingsurcharge and cess) payable on the total income, computed as per the provisions of the Income-tax Act in respect of any year is less than 18.50% of its book-profit + surcharge (SC)+ education cess (EC) + secondary and higher education cess.

From the above it can be observed that the provisions of MAT are applicable to every company whether public or private and whether Indian or foreign. However, as per section 115JB(5A)MAT shall not apply to any income accruing or arising to a company from life insurance business referred to in section 115B. Further, as per provisions of Section 115V-O the provisions of MAT will not apply to a shipping income liable to tonnage taxation, i.e., tonnage taxation scheme as provided in section 115V to 115VZC.

As per Explanation 4 to section 115JB as amended by Finance Act, 2016 with retrospective effect from 1/4/2001, it is clarified that the MAT provisions shall not be applicable and shall be deemed never to have been applicable to an assessee, being a foreign company, if

- the assessee is a resident of a country or a specified territory with which India has an agreement referred to in sub-section (1) of section 90 or the Central Government has adopted any agreement under sub-section (1) of section 90A and the assessee does not have a permanent establishment in India in accordance with the provisions of such agreement; or
- the assessee is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) and the assessee is not required to seek registration under any law for the time being in force relating to companies.

Meaning of book profit

As per Explanation 1 to section 115JB(2) "book profit" for the purposes of section 115JB means net profit as shown in the P & L Account prepared in accordance with Schedule VI of the Companies Act [now Schedule III to the Companies Act, 2013] as increased and decreased by certain items prescribed in this regard. The items to be increased and decreased are as follows:

Computation of book profit	
Particulars	Amount
Net profit as per Profit & Loss A/c prepared in accordance with Schedule VI to the Companies Act[now Schedule III to the Companies Act, 2013]	XXXXX
Add : Following items (if they are debited to the P & L A/c)	
Income-tax paid/payable and the provision thereof *	XXXXX
Amounts carried to any reserves by whatever name called (Other than reserve specified under Section 33AC)	XXXXX
Provisions for unascertained liabilities	XXXXX
Provisions for losses of subsidiary companies	XXXXX
Dividends paid/proposed	XXXXX
Expenditure related to incomes which are exempt under section 10 [other than section 10(38)] section 11 and section 12	XXXXX
The amount or amounts of expenditure relatable to, income, being share of the taxpayer in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86.	XXXXX

The amount or amounts of expenditure relatable to income accruing or arising to a taxpayer being a foreign company, from : (a) the capital gains arising on transactions in securities; or (b) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII if the income-tax payable on above income is less than the rate of MAT	XXXXX
The amount representing notional loss on transfer of a capital asset, being share or a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47 or the amount representing notional loss resulting from any change in carrying amount of said units or the amount of loss on transfer of units referred to in clause (xvii) of section 47	XXXXX
Expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF	XXXXX
Amount of depreciation debited to P & L A/c	XXXXX
Deferred tax and the provision thereof	XXXXX
Provision for diminution in the value of any asset	XXXXX
The amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such an asset if not credited to profit and loss account	XXXXX
The amount of gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be;	XXXXX
Less : Following items (if they are credited to the P & L A/c)	
Amount withdrawn from any reserve or provision if credited to P&L account	XXXXX
Incomes which are exempt under section 10 [other than section 10(38)] section 11 and section 12	XXXXX
Amount of depreciation debited to P&L account (excluding the depreciation on revaluation of assets)	XXXXX
Amount withdrawn from revaluation reserve and credited to P&L account to the extent it does not exceed the amount of depreciation on revaluation of assets	XXXXX

The amount of income, being the share of the taxpayer in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any such amount is credited to the profit and loss account	XXXXX
The amount of income accruing or arising to a taxpayer being a foreign company, from : (a) the capital gains arising on transactions in securities; or (b) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII if such income is credited to the profit and loss account and the incometax payable on above income is less than the rate of MAT.	XXXXX
The amount (if any, credited to the profit and loss account) representing (a) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47; or (b) notional gain resulting from any change in carrying amount of said units; or (c) gain on transfer of units referred to in clause (xvii) of section 47, The amount representation notional gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be;	XXXXX
Income by way of royalty in respect of patent chargeable to tax under section 115BBF	XXXXX
Amount of brought forward loss or unabsorbed depreciation, whichever is less as per books of account	XXXXX
Profits of a sick industrial company till its net worth becomes zero/positive	XXXXX
Deferred tax, if credited to P&L account	XXXXX
Book profit to be used to compute MAT	**XXXXX**

(*) The amount of Income-tax shall include:

1. Any tax on distributed profits under section 115-O (dividend distribution tax - i.e., DDT)or tax on distributed income under section 115R;
2. Any interest charged under this Act;
3. Surcharge, if any, as levied by the Central Acts from time-to-time;
4. Education Cess on Income-tax, if any, as levied by the Central Acts from time-to-time; and

5. Secondary and Higher Education Cess on Income-tax, if any, as levied by the Central Acts from time-to-time.

MAT credit

As discussed in earlier part, a company has to pay higher of normal tax liability or liability as per MAT provisions. If in any year the company pays liability as per MAT, then it is entitled to claim credit of MAT paid over and above the normal tax liability in the subsequent year(s).The provisions relating to carry forward and adjustment of MAT credit are given in section 115JAA.

Period for which MAT credit can be carried forward

As discussed earlier, the company can carry forward the MAT credit for adjustment in subsequent year(s), however, the MAT credit can be carried forward only for a period of 10years after which it will lapse. In other words, if MAT credit cannot be utilised by the company within a period of 10 years (immediately succeeding the assessment year in which such credit was generated), then such credit will lapse. No interest is paid to the taxpayer in respect of such credit.

Problem 3.1

The net profit of PQ Ltd as per profit and loss account for the previous year 2015-2016 is Rs 2,56,80,770 after debiting/crediting the following items:-

1. Provisions for income tax: Rs 20,00,800
2. Provisions for deferred tax: Rs 14,45,300
3. Proposed Dividend: Rs 5,48,200
4. Depreciation debited to profit and loss account is Rs 12,00,650. This includes depreciation on revaluation of asset to the tune of Rs 4,00,000.
5. Profit from unit established in Special Economic Zone: Rs 12,00,470
6. Provisions for permanent diminution in value of investment: Rs 2,00,000

Brought forward losses and unabsorbed depreciation as per books of the company are as follows:-

Previous Year	Brought Forward Loss	Unabsorbed Depreciation
2012-13	Rs 1,50,000	Rs 2,00,000
2013-14	Rs 1,20,000	Rs 1,75,000
2014-15	Rs 2,50,000	Rs 2,25,000

Compute book profit and tax payable on book profit of the company under section 115JB for the Assessment Year 2016-17.

Solution

Computation of book profit of PQ Ltd under section 115JB for the Assessment Year 2016-17

Net profit as per profit and loss account		2,56,80,770
Add: Provisions for Income Tax	20,00,800	
Provisions for deffered tax	14,45,300	
Proposed dividend	5,48,200	
Depreciation	12,00,650	
Provision for dimunation in value of Investment	2,00,000	31,075,720
Less: Depreciation (excluding depreciation on revaluation)	8,00,650	
Aggregate of brought forward loss or unabsorbed depreciation, as per books of Past years whichever is less	5,20,000	13,20,650
Book Profit		**29,755,070**

Tax on book profit

18.5% of book profit (29,755,070 * 18.5/100) = 55,04,688

Add : surcharge (55,04,688 * 12/100) = 6,60,563

Add : Education cess = 1,84,958

Tax on book profit 63,50,209

UNIT – IV
DEDUCTIONS AVAILABLE TO CORPORATE ASSESSEES

In case of corporate assessees, firstly we have to compute Gross Total Income (GTI) by combining four heads of income. i.e. Income from House Property, Profit and Gains from Business, Capital Gains and Income from Other Sources. From the above GTI various deductions u/s 80G, 80GGA, 80GGB, 80IA, 80IAB, 80IB, 80IC, 80ID, 80IE, 80JJA, 80JJAA & 80LA are available to corporate assessees.

DEDUCTION IN RESPECT OF DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. [SEC. 80G]

Conditions for claiming deduction:-

(i) The donation should be of a sum of money and not in kind.

(ii) The donation should be to specified funds/institutions.

(iii) Amount paid by any mode of payment other than cash and if paid in cash the amount should not exceed Rs10,000.

Eligible Donation	Qualifying Deduction	Permissible Amount
PM's National Relief Fund; PM's Armenia Earthquake Relief Fund; The Africa (Public Contributions India) Fund; The National Foundation for Communal Harmony; A university or any educational institution of national eminence as may be approved; The National Illness Assistance Fund; Any ZilaSakshartaSamiti for improvement of primary education in villages and towns and for literacy activities; National Blood Transfusion Council or to any State Blood Transfusion Council; Any fund set up by the State Government for medical relief to the poor; The Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Air force Central Welfare Fund established by the armed forces of the Union for the	From item Nos. 1 to 23 there is no maximum limit (i.e. 100% of the amount will qualify for deduction)	Quantum of deduction for item Nos. 1 to 18,20, 24, 30, 31, 32 & 33 =100% of the qualifying amount. For other items, quantum of deductions = 50% of the qualifying amount.

welfare of the past and present members of the such forces or their dependants; The Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund in respect of any State or Union Territory, as the case may be; The National Sports Fund to be set up by the Central Government; The National Cultural Fund set up by the Central Government; The Fund for Technology Department and Application setup by the Central Government; The National Defence Fund; Any fund setup by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat; Any sum paid during the period beginning with 26.1.2001 and ending on 30.9.2001 toany trust, institutions or fund recognized under Section 80G for providing relief to the victims of earthquake in Gujarat; National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple disabilities constituted under the relevant Act of 1999; PM's Drought Relief Fund; The National Children's Fund; Jawaharlal Nehru Memorial Fund; Indira Gandhi Memorial Trust; Rajiv Gandhi Foundation; Contribution by a company as donations to the Indian Olympic Association or to any other Association notified by the Central Government u/s. 10(23); Any approved fund or institution established for charitable purposes;	From SI Nos. 24 to 30 qualifying amount shall be restricted to 10% of Adjusted Total Income (i.e. G.T.I. as reduced by deductions u/s.	

Government or local authority to be used for charitable purpose; Any authority set up for providing housing accommodation or town planning; Any corporation established by Government for promoting interest of schedules caste/ scheduled tribe/backward class; Renovation of notified temple mosque, church, or gurudwara or any other notified place of national importance Government or local authority or approved institution/association for promotion of family planning; The Swachh Bharat Kosh, set up by the Central Government, other than the sum spent by the assessee in pursuance of Corporate Social Responsibility under subsection(5) of section 135 of the Companies Act, 2013 [w.e.f. A.Y. 2015-16]; The Clean Ganga Fund, set up by theCentral Government, where such assessee is a resident and such sum is other than thesum spent by the assessee in pursuance of Corporate Social Responsibility under subsection(5) of section 135 of the Companies Act, 2013 [w.e.f. A.Y. 2015-16]; The National Fund for Control of Drug Abuse constituted under section 7A of the Narcotic Drugs and Psychotropic Substances Act,1985 [w.e.f. A.Y. 2016-17].	80CCC to 80U other than 80G and other income on which no tax is payable and other incomes on which deductions under Chapter VIA are not allowed)	

IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT [SEC. 80GGA]

In computing the Total Income of accompany whose Gross Total Income does not include income from “Profits and Gains of Business or Profession”, deduction shall be allowed of an amount paid by him to—

(a) an approved scientific research association or University or College or other institution to be used for scientific research, research in social science or statistical research.
(b) an approved association or institution to be used for carrying out any approved programme or rural development,
(c) an approved institution or association which has the object of training of persons for implementing programmes of rural development [Sec. 35CCA]
(d) public sector company or local authority or an approved association or institution for carrying out any eligible project or scheme u/s 35AC.
(e) association/institution/fund which has the object of carrying out any programme of conservation of natural resources or afforestation [Sec. 35CCB]
(f) National Urban Poverty Eradication Fund (NUPEF).

Section 80GGA (2A) provides that no deduction shall be allowed under section 80GGA in respect of any sum exceeding Rs 10,000 unless such sum is paid by any mode other than cash.

DEDUCTIONS BY COMPANIES TO POLITICAL PARTIES [SEC. 80GGB]

Condition: Amount should be contributed by a company any mode other than cash. Amount of Deduction:100% of sum contributed during a Previous Year to any political party, registered u/s 29A of Representation of the People Act, 1951.

DEDUCTIONS IN RESPECT OF PROFITS & GAINS FROM INDUSTRIAL UNDERTAKINGS OR ENTERPRISES ENGAGED IN INFRASTRUCTURE DEVELOPMENT [SEC. 80IA]

The deduction under this Section is applicable to all assessees whose Gross Total Income includes any profits and gains derived from any business of an industrial undertaking or an enterprise.

Classification of Industries	Period of commencement	Deduction
(i) Any enterprise carrying on the business of developing or maintaining and operating or developing, maintaining and operation any infrastructure facility	On or after 1.4.1995	100% for 10 consecutive Assessment Years.
(ii) Any undertaking providing telecommunication services whether basic or cellular including radio paging, domestic satellite service or network of trunking and electronic data interchange services.	From 1.4.95 to 31.3.2005	100% for first 5 years & 30% for the next 5 years.
(iii) Any undertaking which develops or develops and operates or maintains and operates an industrial park notified by the Central Government.	From 1.4.97 to 31.3.2011	100% for 10 consecutive Assessment Years.
(iv) An Industrial undertaking set up in any part of India for the generation or generation and distribution of power.	From 1.4.93 to 31.3.2017	100% for 10 consecutive Assessment Years.
(v) An industrial undertaking which starts transmission or distribution of power by laying a network of new transmission or distribution lines.	From 1.4.99 to 31.3.2017	100% for 10 consecutive Assessment Years.
(vi) An industrial undertaking starts business of substantial renovation and modernization of existing transmission / distribution lines in Power Sector.	From 1.4.2004 to 31.3.2017	100% for 10 consecutive Assessment Years.
(vii) Undertaking established for reconstruction / revival of Power Generation Plant Established before	30.11.2005 to 31.3.2011	100% for 10 consecutive Assessment Years.

The deduction under this Section is available at the option of the assessee for any 10 consecutive Assessment Years out of 15 years beginning from the year in which the undertaking or enterprise develops and begins to operate any infrastructure facility or starts providing telecommunication services or develops an industrial part or generates power or commences transmission or distribution of power. However, in case of an infrastructure facility being a high way project including housing or other activities being an integral part of a high way project, the assessee can claim deduction for any10 consecutive Assessment Years out of 20 years beginning from the year of operation.

DEDUCTIONS IN RESPECT OF PROFITS AND GAINS BY AN UNDERTAKING OR ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE [SEC. 80IAB].

Where the Gross Total Income of an assessee, being a Developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a Special Economic Zone, notified on or after the 1st day of April, 2005 under the Special Economic Zones Act, 2005, there shall, in accordance with and subject to the provisions of this Section, be allowed, in computing the Total Income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for ten consecutive Assessment Years. The deduction specified in sub-section (1) may, at the option of the assessee, be claimed by him for any ten consecutive Assessment Years out of fifteen years beginning from the year in which a Special Economic Zone has been notified by the Central Government.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FOR CERTAIN INDUSTRIAL UNDERTAKING OTHER THAN INFRASTRUCTURE DEVELOPMENT UNDERTAKINGS [SEC. 80IB]

Categories of deduction	Date of commencement	Tax exemption	
		Period	Quantum
Scientific and industrial research and development for a company registered in India.	Approved after 31/03/2000 but before 01/04/2007	10 initial A.Ys.	100% of profits
Commercial production of mineral oil	After 31/03/1997 but before 01/04/2017	7 initial A.Ys.	100% of profits
Refining of mineral oil	After 30/09/1998 but before 01/04/2012. After 31/03/2009 but before 01/04/2017	7 initial A.Ys.	100% of profits
Commercial production of natural gas under NELP VIII etc.	After 31/03/2009 but before 01/04/2017	7 initial A.Ys.	100% of profits

Housing project	Approved after 30/09/1998 but before 31/03/2008	---	100% of profits
Integrated business of handling, storage and transportation of food-grains.	After 31/03/2001	5 initial AYs	100% of profits
		Next 5 AYs	30% of profits
Processing, preservation and packaging of fruits or vegetables	w.e.f AY 2005-06	5 initial AYs	100% of profits
		Next 5 AYs	30% of profits
Processing, preservation and packaging of meat, meat products or poultry or marine or dairy products	After 31/03/2009	5 initial AYs	100% of profits
		Next 5 AYs	30% of profits
Hospital	01/04/2008 to 31/03/2013	5 initial AYs	100% of profits

SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS OR ENTERPRISES IN CERTAIN SPECIALCATEGORY STATES [SEC. 80-IC]

1) Where the Gross Total Income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (2), there shall, in accordance with and subject to the provisions of this Section, be allowed, in computing the Total Income of the assessee, a deduction from such profits and gains, as specified in sub-section (3).
2) This Section applies to any undertaking or enterprise,—

a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, or which manufactures or produces any article or thing, not being any article or thing specified in the Thirteenth Schedule and undertakes substantial expansion during the period beginning—

i. on the 23rd day of December, 2002 and ending before the 1st day of April, 2007 in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Sikkim; or
ii. on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software

Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Himachal Pradesh or the State of Uttaranchal; or

iii. on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in any of the North-Eastern States;

b) which has begun or begins to manufacture or produce any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule, or which manufactures or produces any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule and undertakes substantial expansion during the period beginning—

i. on the 23rd day of December, 2002 and ending before the 1st day of April, 2007, in the State of Sikkim; or

ii. on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal; or

iii. on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the North-Eastern States.

3) The deduction referred to in sub-Section (1) shall be—

i. in the case of any undertaking or enterprise referred to in sub-clauses (i) and (iii) of clause (a)or sub-clauses (i) and (iii) of clause (b), of sub-section (2), one hundred per cent of such profits and gains for ten Assessment Years commencing with the initial Assessment Year;

ii. in the case of any undertaking or enterprise referred to in sub-clause (ii) of clause (a) or sub clause(ii) of clause (b), of sub-section (2), one hundred per cent of such profits and gains for five Assessment Years commencing with the initial Assessment Year and thereafter, thirty per cent of the profits and gains.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM BUSINESS OF HOTELS IN SPECIFIED AREA (80-ID)

An undertaking engaged in the business of hotel (two-star, three-star or four-star category) located in the specified district having a World Heritage site, if such hotel is constructed and has started or starts functioning between 01/04/2009 and 31/03/2013.

A deduction of 100% of the profits and gains derived from such business for five consecutive assessment years.

SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS IN NORTH-EASTERN STATES [SEC. 80IE]

(1) Where the Gross Total Income of an assessee includes any profits and gains derived by an undertaking, to which this Section applies, from any business referred to in sub-section (2), there shall be allowed, in computing the Total Income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for ten consecutive Assessment Years commencing with the initial Assessment Year.

(2) This Section applies to any undertaking which has, during the period beginning on the 1st day of April, 2007 and ending before the 1st day of April, 2017, begun or begins, in any of the North-Eastern States,

1. to manufacture or produce any eligible article or thing;
2. to undertake substantial expansion to manufacture or produce any eligible article or thing;
3. to carry on any eligible business.

"Substantial Expansion" means increase in the investment in the Plant and Machinery by at east 25% of the book value of Plant and Machinery as on the 1st day of the Previous Year in which substantial expansion is undertaken.

"Eligible Article or Thing" means the article or thing other than tobacco, manufactured tobacco substitute, plastic carry bag (Less than 20 Microns), and goods produced by petroleum oil or gas refineries.

"Eligible Business" includes –

i. Hotel (Not Below 2 Star Category),
ii. Adventure & Leisure Sports including Ropeways,
iii. Nursing Homes (Minimum 25 Beds),
iv. Old-age Home,
v. Information Technology related Training Centre,
vi. Manufacturing Information Technology related Hardware,
vii. Vocational Training Institute for Hotel Management, Food Craft, Entrepreneurship Development, Nursing & Para Medical, Civil Aviation & Fashion Design & Industrial Training.
viii. Bio-technology

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM THE BUSINESS OF COLLECTING AND PROCESSING BIO-DEGRADABLE WASTE (80-JJA)

The section provide that where the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas, making pellets or briquette for fuel or organic manure. A deduction of an amount equal to the whole of such profit and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN [SEC 80JJAA]

All assessee having manufacturing units is allowed for deduction provided the following conditions are satisfied:

i. The Gross Total Income of the assessee includes profits and gains derived from the manufacture of goods in a factory.
ii. The factory is not hived off or transferred from another existing undertaking or amalgamation with another industrial undertaking or as a result of any business re-organization.
iii. The assessee employs new regular workmen in the Previous Year in such factory.
iv. The assessee furnishes the report of a Chartered Accountant in Form No. 10DA [Rule 19AB]Deduction is available for 3 Previous Years commencing from the Previous Year in which such employment is provided.

Amount of deduction:

a. New industrial undertaking: 30% of the wages paid to new regular workmen in excess of 50 regular workmen employed during the year.
b. Existing undertaking: 30% of the wages paid to new regular workmen provided these is at least10% increase in number of regular workmen over the existing member of workmen employed in such undertaking, as on the last day of the preceding year.

DEDUCTIONS IN RESPECT OF CERTAIN INCOMES OF OFFSHORE BANKING UNITS AND INTERNATIONAL FINANCIAL SERVICES CENTRE [SEC. 80LA]

This deduction applicable to a scheduled bank, or any bank incorporated by or under the laws of a country outside India owning an offshore banking unit in a special economic zone. Quantum of deduction:

a. 100% of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission was obtained.
b. 50% of such income for next five consecutive assessment years.

UNIT – V
ASSESSMENT OF COMPANIES

Income tax being direct tax is a major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head: (a) Corporation Tax (Tax on the income of the companies) and (b) Income Tax (Tax on income of the non-corporate assesses).A company is required to pay corporation tax on every rupee of its total income at a flat rate. First of all we should have an understanding about the provisions in the Income Tax Act about the company.

MEANING OF COMPANY UNDER SECTION 2(17) OF THE INCOME-TAX ACT

(a) any Indian company, or
(b) any body corporate incorporated by or under the laws of a country outside India, or
(c) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or
(d) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the CBDT to be a company.

Liquidating Company

A Company in liquidation is also a "company" and the Income tax authorities are entitled to call upon the liquidator to make a return of the company's income. Likewise, penalty proceedings can also be initiated against a company in liquidation for a default committed prior to liquidation. Thus, the expression Company as defined in the Income Tax Act has a much wider connotation than what is normally understood by a 'Company' under the Companies Act.

Companies established under section 25 of the Companies Act, 1956

In order to be regarded as a taxable entity under the Income Tax Act, 1961, it is not essential that the company must always have a share capital and must have been formed with a profit motive. Even companies having no share capital and those, which are limited by guarantee, are assessable as companies for income-tax purposes even if such companies may have been formed without any profit motive and registered under Section 25 of the Companies Act 1956 (e.g. Chambers of Commerce etc.). Under Section 28 (iii) of the Income tax Act, 1961, trade, professional or similar associations are liable to tax in respect of the income they derive from rendering ofspecific services to their members. Accordingly, in respect of specific services to their members, such entities, even if they are non-profit making, would become liable to tax under the Income tax Act as a company in respect of their income from business although they may not have been specifically formed to carry on any business with a view to make profit. A statutory corporation established under the Act of Parliament, Government companies and the State Government companies who carry on a trade or business would also be treated as a company forall purposes of income tax.

Discontinuance of Business

A company or for that matter, any assessee who discontinued their business are statutorily required to intimate to the Assessing Officer within 15 days (Section 176 of the Income Tax Act, 1961).

TYPES OF COMPANIES

Companies are classified in to five according to the taxation point of view

1. Indian Company
2. Domestic company
3. Foreign company
4. Widely held company
5. Closely held company

Indian Company

Section 2(26) of the Income Tax Act, 1961 defines the expression 'Indian Company' as a company formed and registered under the Companies Act, 1956 and includes:

(a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir, and the Union Territories specified in (e) below);
(b) any corporation established by or under a Central, State or Provincial Act;
(c) any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income Tax Act, 1961;
(d) in the case of State of Jammu & Kashmir, any company formed and registered under any law for the time being in force in that State; and
(e) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;

Domestic Company

Section 2(22A) of the Income Tax Act, 1961, defines domestic company as an Indian company or any other company which, in respect of its income liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.

Foreign Company

Section 2(23A) of the Income tax Act defines foreign company as a company, which, is not a domestic company. However, all non-Indian companies are not necessarily foreign companies. If a non-Indian company has made the prescribed arrangements for declaration and payments of dividends within India, such a non-Indian company must be treated as a "domestic company" and not as a "foreign company".

Company in which public are substantially interested (a widely-held company)

Section 2(18) of the Income Tax, Act defines the expression "company in which the public are substantially interested".

i. If it is a company owned by the Government or the Reserve Bank of India or in which not less than 40 per cent of the shares, whether singly or taken together, are held by the Government or the Reserve Bank of India or a corporation owned by the Reserve Bank of India; or
ii. If it is a company which is registered under Section 25 of the Companies Act, 1956; or
iii. If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Board (CBDT) to be a company in which the public are substantially interested. However, such a company shall be deemed to be one in which the public are substantially interested only for the assessment year(s) as may be specified in the declaration; or
iv. If it is a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 620A of the Companies Act, 1956 to be a Nidhi or Mutual Benefit Society; or
v. If it is a company in which shares carrying not less than 50 per cent of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or
vi. If it is a company which is not a private company as defined in Section 3 of the Companies Act, 1956 and equity shares of the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, i.e. preference shares) were, as on the last day of the relevant previous year, listed in a recognized stock exchange in India;
vii. If it is a company which is not a private company within the meaning of the Companies Act, 1956, andthe shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50 per cent (40 per cent in case of an industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant accounting year beneficially held by (a) the Government, or (b) a corporation established by a Central or State

or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company.

Closely held company

A Company in which the public is not substantially interested is known as a closely held company. The distinction between a closely held and widely held company is significant from the following viewpoints.

(a) Section 2(22) (e), which deems certain payments as dividend, is applicable only to the shareholders of a closely-held company; and

(b) A closely held company is allowed to carry forward its business losses only if the conditions specified in Section 79 are satisfied.

RESIDENTIAL STATUS AND TAX INCIDENCE UNDER INCOME TAX ACT, 1961

According to Section 6(3) of the Act, a company is said to be resident in India (resident company) in any previous year, if:

I. It is an Indian company; or

II. During that year, the control and management of its affairs is situated wholly in India.

If one of the above two tests is not satisfied the company would be a non-resident in India during that previous year.

According to Section 5(1) of the Act, the total income of a resident company would consist of:

- Income received or deemed to be received in India during the previous year by or on behalf of such company;
- Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year;
- Income which accrues or arises to it outside India during the previous year.

Under Section 5(2) of the Act, the total income of non-resident company would consist of:

- Income received or deemed to be received in India in the previous year by or on behalf of such company;
- Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year.

COMPUTATION OF TOTAL INCOME OF COMPANY

The total income of a company is also computed in the manner in which income of any other assesseeis computed. The first and the foremost step in this direction is to ascertain Gross Total Income. Income computed under four heads (salary head is not applicable), is aggregated. While aggregating the income, section 60 and 61 shall be applicable. Further, effect to set off of losses and adjustment for brought forward losses will also be done. From the Gross Total Income so computed, the deductions u/s 80G, 80GGA, 80GGB, 80IA, 80IAB, 80IB, 80IC, 80ID, 80IE, 80JJA, 80JJAA & 80LA of Chapter VIA should be allowed.

The following are the special provisions under the Income Tax Act which are applicable to a company in which public are not substantially interested i.e. a closely held company:

(A) Carry forward and set off of losses [Section 79].

(B) Deemed dividend u/s 2(22)(e).

(C) Liability of directors [Section 179].

(A) Carry forward and set off of losses in case of certain companies [Section 79]

In the case of closely held companies where a change in shareholding has taken place in a previous year, no loss under any head incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of the previous year in which loss is set off and on the last day of the previous year in which the loss was incurred, the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

In other words, where a change in voting power of more than 49% of the shareholding of a closely held company has taken place between two relevant dates (viz., the last day of previous year in which setoff is claimed and the last date of the previous year in which the loss was incurred), the assessee will not be entitled to claim set off of such losses.

This provision shall not apply to a change in the voting power consequent upon:

i. the death of a shareholder, or **ii.** on account of transfer of shares by way of gifts to any relative of the shareholder making such gift.

Further, section 79 shall not apply to any change in the shareholding of an Indian company which issubsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

Section 79 applies to all losses, including losses under the head Capital Gains. However, over riding provisions of section 79 do not affect the set off of unabsorbed depreciation which is governed by section 32(2). [CIT vs. Concord Industries Ltd. (1979) 119 ITR 458 (Mad)].

(B) Deemed dividend [Section 2(22(e)]

Any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to a shareholder holding not less than 10% voting power or to a concern in which such shareholder is a member or a partner and in which he has substantial interest or any payment by such company on behalf or for the individual benefit of any such shareholder, to the extent to which company in either case possesses accumulated profit shall be treated as deemed dividend.

(C) Liability of directors of private company in liquidation [Section 179]

Where any tax due from a private company in respect of any income of any previous year cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his par tin relation to the affairs of the company.

TAX RATES OF COMPANIES (AY 2016-17)

Company	Rate of income tax (Percentage)
In the case of a domestic company	
Winning u/s 115BB	30
Short term capital gains u/s 111A	15
Long term capital gains u/s 112	10/20
Other income	30
In the case of a foreign company	
Royalty received from Government or an Indian concern in pursuance of an Agreement made by it with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made by it after February 29, 1964 but before April 1, 1976 and where such agreement has, in either case, been approved by the Central Government	50
Winning u/s 115BB	30
Short term capital gains u/s 111A	15
Long term capital gains u/s 112	10/20
Other income	40

SURCHARGE (AY 2016-17)

Company	If net income does not exceeds 1crore	If net income is in the range of 10 crore	If net incomeexceeds10 crore
Domestic company	Nil	7%*	12%**
Foreign company	Nil	2%*	5%**

*Marginal relief - In the case of a company having a net income of exceeding 1 crore, the amount payable as income-tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs 1crore by more than the amount of income that exceeds 1 crore.

**Marginal relief - In the case of a company having a net income of exceeding10 crore the amount payable as income-tax and surcharge shall not exceed the total amount payable as income-tax and surcharge on total income of 10 crore by more than the amount of income that exceeds 10 crore.

Education cess - 2 per cent of income tax and surcharge

Secondary and higher education cess - 1 per cent of income tax and surcharge

Problem 5.1

A domestic company submits the following particulars of its income for the previous year ending on 31/march/2016:

	Rs
1. Profits of business after deduction of donations to approved charitable institution	4,00,000
2. Donation to charitable institution by cheque	50,000
3. Interest on Government securities	20,000
4. Dividend from domestic company (Gross)	60,000
5. Long Term Capital Gain	1,00,000
6. Book Profits u/s 115JB	10,00,000

During the financial year 2015-16 the company deposited Rs 50,000 in IDBI. The company distributed a dividend of Rs 1,00,000 on 06/09/2015.

Compute the taxable income of the company and tax payable by it for AY 2016-17.

Solution

COMPUTATION OF TOTAL INCOME (for the Assessment Year 2016-17)		
Business income		
Business profit	4,00,000	

	Add: Donations	50,000	4,50,000
Capital Gain			
	LTCG		1,00,000
Income from other sources			
	Interest on Govt. securities	20,000	
	Dividend from a domestic company	Exempt	20,000
	Gross Total Income		5,70,000
Less:	Donation u/s 80 G		
	Qualifying limit (5,70,000 - 1,00,00)*10%		
	47,000 - 50% of 47,000		23,500
	Total Income		**5,46,500**

COMPUTATION OF TAX PAYABLE (for the Assessment Year 2016-17)		
Total Income Rs 5,46,500		
	Tax on Rs 1,00,000 LTCG @ 20%	20,000
	Tax on other income Rs 4,46,500 * 30%	1,33,950
		1,53,950
Add:	Surcharge	Nil
		1,53,950
Add:	Education cess	4619
	Tax on Total Income (a)	1,58,569
Book Profit Rs 10,00,000		
	Tax on Rs 10,00,000 @ 18.5%	1,85,000
Add:	Surcharge	Nil
		1,85,000
Add:	Education cess	5,550
	Tax on Book Profit (b)	1,90,550
Tax Payable (a) or (b) whichever is more		**1,90,550**

Problem 5.2

From the following information compute the tax payable by Z & Co keeping in view the provisions of MAT u/s 115JB for the Assessment Year 2016-17:

	Statement of Profit & Loss (for the year ended 31st March 2016)		Note No	Figures as at the end of current reporting period
	Particulars			
I	Revenue from operations			30,00,000
II	Other income :			
	LTCG (exempt under section 10(38)	2,00,000		
	Interest on Gov't securities	25000		2,25,000
III	Total Revenue (I + II)			32,25,000
IV	Expenses:			
	Cost of materials consumed			
	purchase of stock in trade			
	changes in inventories of finished goods, work-in-progress and stock-in-trade			
	Employee benefit expenses			
	Depreciation and amortisation expenses			1,50,000
	Other Expenses:			
	Expenses related to sales			23,20,000
	Securities transaction tax paid relating to LTCG			5,000
	Total Expenses			24,75,000
V	Profit Before Tax (III - IV)			7,50,000
VI	Tax Expenses:			
	Income Tax paid			1,00,000
VII	Profit for the period (V - VI)			6,50,000

Surplus Statement	
Profit/Loss as per last Balance sheet (if any)	
Current Year's profit	6,50,000
	6,50,000
Less: Proposed dividend	2,50,000
Balance of profit carried to Balance Sheet	4,00,000

Additional Information:

1. the company revalued its assets from Rs 3,00,000 to Rs 6,00,000 and provided depreciation on Rs 6,00,000 @ 25%. The depreciation allowable as per Income Tax Act Rs 80,000.
2. B/F loss as per books of account Rs 2,00,000
3. B/F depreciation as per books of account Rs 50,000
4. B/F unabsorbed depreciation Rs 1,00,000

Solution

COMPUTATION OF TOTAL INCOME AND TAX PAYABLE For the AY 2016-17		
INCOOME FROM BUSINESS		
Profit as per statement of Profit & Loss		4,00,000
Add: Expenses disallowed		
1. STT paid	5,000	
2. Depreciation	1,50,000	
3. Proposed Dividend	2,50,000	
4. Income Tax	1,00,000	5,05,000
		9,05,000
Less : 1. LTCG	2,00,000	
Depreciation allowable	80,000	
2. interest on government securities	25000	3,05,000
Business Income for the year		6,00,000
Less : B/F unabsorbed depreciation		1,00,000
Taxable Business Income (a)		5,00,000
CAPITAL GAIN		
LTCG (Exempt u/s 10(38)		Exempt
INCOME FROM OTHER SOURCES		
Interest on Gov't securities (b)		25,000
Gross Total Income (a) + (b)		5,25,000
Deduction		Nil
Total Income		5,25,000

TAX ON TOTAL INCOME	
Tax on 5,25,000 @ 30%	1,57,000
Add: Surcharge	Nil
Add: Education Cess and SHEC @ 3%	4725
Tax Payable on Total Income	**1,62,225**

COMPUTATION OF BOOK PROFIT AND TAX PAYABLE For the AY 2016-17		
Profit as per statement of Profit & Loss		4,00,000
Add: Expenses disallowed		
1. Depreciation	1,50,000	
2. Proposed Dividend	2,50,000	
3. Income Tax	1,00,000	5,00,000
		9,00,000
Less : Depreciation allowable 3,00,000 @ 25%	75,000	
B/F loss or depreciation, whichever is less	50,000	1,25,000
Book Profit		**6,00,000**

TAX ON BOOK PROFIT	
Tax on 7,75,000 @ 18.5%	1,43,375
Add: Surcharge	Nil
Add: Education Cess and SHEC @ 3%	4,301
Tax Payable on Book Profit	**1,47,676**

Tax payable = Tax on Total Income or Tax on Book Profit whichever is more

= **1,62,230** (Rounded off)

UNIT – VI

TAX ON DISTRIBUTED PROFIT AND SECURITIES TRANSACTION TAX

This unit discuss about the tax on dividend distributed and tax on securities transaction. Firstly we can discuss about corporate dividend distribution tax and after that securities transaction tax is discussed.

CORPORATE DIVIDEND DISTRIBUTION TAX or DDT [Sec 115O – 115Q]

As per section 115-O(1), the Domestic Company shall, in addition to the income-tax chargeable in respect of its total income, be liable to pay additional income-tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise), whether out of current or accumulated profits, shall pay tax on such dividend at the following rates.

Income tax	15%
surcharge	12%
Education cess and SHEC	3%
Total	17.304%

Dividend received from subsidiary company to be reduced from the above dividend to be distributed[Section 115-O(IA)]: For the purpose of computation of tax on distributed profits, the amount of dividend distributed by the domestic company during the financial year shall be reduced by the following:

I. The amount of dividend, if any, received by the domestic company during the financial year, if
   i. such dividend is received from its subsidiary;
   ii. the subsidiary has paid tax under this section on such dividend; and
   iii. the domestic company is not a subsidiary of any other company.

II. The amount of dividend, if any, paid to any person for or behalf of the New Pension Scheme trust referred to in section 10(44).

However, that the same amount of dividend shall not be taken into account for reduction more than once.

For the purposes of section 115-O(1A), a company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company.

Section 115-O of the Act provides that dividend liable for DDT in case of a company is to be reduced by an amount of dividend received from its subsidiary after payment of DDT if the company is not a subsidiary of any other company.

Dividend distribution tax which is also known as additional tax will have to be paid by the principal officer of the domestic company and the company within 14 days from the date of:

a. Declaration of any dividend; or

b. Distribution of any dividend; or

c. Payment of any dividend,

whichever is earliest.

TAX ON INCOME DISTRIBUTED TO UNIT HOLDERS (115R, 115S and 115T)

Any amount of income distributed by: (i) a specified company, or (ii) a Mutual Fund to its unit holders shall be chargeable to tax and such specified company or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the following rate:

(a) Where the income is distributed to any person being an individual or a HUF by a money market mutual fund or aliquid fund	25% + 12% SC + 2% EC + 1%SHEC
(b) Where the income is distributed to any other person by a money market mutual fund or liquid fund	30% + 12% SC + 2% EC+1%SHEC
Where the income is distributed by a fund other than a money market mutual fund or a liquid fund and such income is distributed to Individual or HUF Any person other than individual or HUF	 12.5% + 12% SC + 2% EC + 1% SHEC 30% + 7% or 12% SC + 2% EC+ 1% SHEC

SCURITIES TRANSACTION TAX (STT)

STT is a kind of turnover tax where the investor has to pay a small tax on the total consideration paid or received in a share transaction. STT was introduced in the Budget of 2004 and implemented in Oct 2004. The objective behind the levy is to mitigate tax evasion as the same is taxed at source. Stocks, futures, option, mutual funds and exchange traded funds come under the ambit of STT. The STT applicable in the case of intraday transaction will be different from the one applicable in the case of delivery transaction. Likewise, the STT applicable in the case of buying a security will be different from the one applicable in the case of selling the security. STT will be applicable in the case of transaction that takes place in the exchanges. For availing the exemption in the case of long-term capital gain, the asset under consideration has to be subjected to STT. Present rate of Security Transaction Tax (STT) is described below.

SI No.	Taxable securities transaction	Tax rate from June 1, 2013 up to May 31, 2016	Tax Rate w.e.f. June 1, 2016	Payable by
1.	Purchase of an equity share in a company, where such contract is settled by the actual delivery or transfer of such share or unit.	0.100 per cent	0.100 per cent	Purchaser- on the value of taxable securities transaction based on the volume weighted average price.
	Purchase of a unit of an equity oriented fund, where such contract is settled by the actual delivery or transfer of such share or unit.	NIL	NIL	NA
2.	Sale of a equity share in a company, where such contract is settled by the actual delivery or transfer of such share or unit	0.100 per cent	0.100 per cent	Seller - on the value of taxable securities transaction based on the volume weighted average price.
	Sale of a unit of an equity oriented fund, where such contract is settled by the actual delivery or transfer of such share or unit	0.001 per cent	0.001 per cent	Seller - on the value of taxable securities transaction based on the volume weighted average price.
3	Sale of an equity share in a company or a unit of an equity oriented fund, where such contract is	0.025 per	0.025 per	Seller - on the value of taxable securities transaction

	settled otherwise than by the actual delivery or transfer of such share or unit.	cent	cent	based on the volume weighted average price.
4a	Sale of an option in securities	0.017 per cent	0.05 per cent	Seller - on the option premium..
4b	Sale of an option in securities, where option is exercised	0.125 per cent	0.125 per cent	Purchaser - on the settlement price.
4c	Sale of a futures in securities	0.010 per cent	0.010 per cent	Seller - on the price at which such futures is traded.

INCOME TAX AND STT

Taxation of profit or loss from securities transactions depends on whether the activity of purchasing and selling of shares / derivatives is classified as investment activity or business activity. Treatment of STT also depends upon whether the income from these securities transactions are included under the head 'Income from Capital Gains' or under the head 'Profits and Gains of Business or Profession'.

Income from Capital Gains: Any equity share, which has been sold through a recognised stock exchange and on which STT has been paid, is entitled to exemption from LTCG under Section 10 (38) of the Act. Similarly, in case of STCG of such shares, the gains shall be taxed only at 15%, plus surcharge and education cess under section 111A of the Act.

Important points to note:

- STCG and LTCG rates of 15% and NIL are available only if the specified security is sold through a recognised stock exchange. Private deals or transactions, not routed through a recognised stock exchange in India, will not be covered
- The purchase of the specified securities could be through any mode and need not be through a recognised stock exchange
- The exemption is not available to transactions where STT has not been paid
- Since LTCG is exempt, Long Term Capital Loss, arising from these specified securities, cannot be set-off against any other gain/income. This loss shall lapse
- As per section 40(a)(ib) of the Income tax Act, STT cannot be claimed as an expense in computing the income chargeable under Capital Gains.

Profits and Gains of Business or Profession: This refers to the scenario where main business of the assessee is trading in securities. In such cases the gains or losses are classified as business income, which is taxed at the regular rate of income-tax. STT paid in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 of the Income-tax Act.

Problem 6.1

From the following information determine the tax payable u/s 115-O by a domestic company on dividend distributed by it:

1. It received dividend from its subsidiary company (which paid DDT) Rs 3,00,000 on 10/11/2015.
2. It distributed dividend Rs 28,00,000 on 15/12/2015 to its shareholders.
3. Out of Rs 28,00,000 the company paid dividend Rs 5,00,000 to a person on behalf of the New Pension System Trust.

Solution

Computation of Tax Payable by a Domestic Company on Dividend Distributed (for the AY 2016-17)		
Dividend Distributed		28,00,000
Less: Dividend received from subsidiary company Dividend paid on behalf of the New Pension System Trust	3,00,000 5,00,000	8,00,000
Dividend distributed to shareholders		20,00,000

Tax on Gross Dividend $= \frac{Rate\ of\ tax}{100 - Rate\ of\ tax}$ x *Dividend*

$= \frac{17.304}{100 - 17.304}$ x 20,00,000

= **Rs 4,18,497**

UNIT VII
TONNAGE TAX

In case of a company, the income from the business of operating qualifying ships, may, at its option, be computed in accordance with the provisions of Chapter XII-G. Thus, tonnage taxation is a scheme of presumptive taxation wherein notional income arising from operation of ships is determined on basis of tonnage of ships.

Qualifying ship (115VD)

For the purpose of tonnage tax, a ship is a qualifying ship if-

1. it is a sea going ship or vessel of fifteen net tonnage or more;
2. it is a ship registered under the Merchant Shipping Act, 1958 (44 of 1958), or a ship registered outside India in respect of which a license has been issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 (44 of 1958); and
3. a valid certificate in respect of such ship indicating its net tonnage is in force,

But does not include

a) a sea going ship or vessel if the main purpose for which it is used is the provision of goods or services of a kind normally provided on land;
b) fishing vessels;
c) factory ships;
d) pleasure crafts;
e) harbour and river ferries;
f) offshore installations;
g) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

Computation of tonnage income (115VG)

1) The tonnage income of a tonnage tax company for a previous year shall be the aggregate of the tonnage income of each qualifying ship computed in accordance with the provisions of sub-sections (2) and (3).
2) For the purposes of sub-section (1), the tonnage income of each qualifying ship shall be the daily tonnage income of each such ship multiplied by—

a. the number of days in the previous year; or
b. the number of days in part of the previous year in case the ship is operated by the company as a qualifying ship for only part of the previous year, as the case may be.

3) For the purposes of sub-section (2), the daily tonnage income of a qualifying ship having tonnage referred to in column (1) of the Table below shall be the amount specified in the corresponding entry in column (2) of the Table:

Qualifying ship having net tonnage	Amount of daily tonnage income
(1)	(2)
up to 1,000	Rs. 70 for each 100 tons
exceeding 1,000 but not more than 10,000	Rs. 700 plus Rs. 53 for each 100 tons exceeding 1,000 tons
exceeding 10,000 but not more than 25,000	Rs. 5,470 plus Rs. 42 for each 100 tons exceeding 10,000 tons
exceeding 25,000	Rs. 11,770 plus Rs. 29 for each 100 tons exceeding 25,000 tons.

4) For the purposes of this Chapter, the tonnage shall mean the tonnage of a ship indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner.
   Explanation: for the purposes of this sub-section, "deemed tonnage" shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.
5) The tonnage shall be rounded off to the nearest multiple of hundred tons and for this purpose any tonnage consisting of kilograms shall be ignored and thereafter if such tonnage is not a multiple of hundred, then, if the last figure in that amount is fifty tons or more, the tonnage shall be increased to the next higher tonnage which is a multiple of hundred and if the last figure is less than fifty tons, the tonnage shall be reduced to the next lower tonnage which is a multiple of hundred; and the tonnage so rounded off shall be the tonnage of the ship for the purposes of this section.
6) Notwithstanding anything contained in any other provision of this Act, no deduction or set off shall be allowed in computing the tonnage income under this Chapter.

Treatment of common costs (115VJ)

1. Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, common costs attributable to the tonnage tax business shall be determined on a reasonable basis.
2. Where any asset, other than a qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset shall be allocated between its tonnage tax business and other business on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

Problem 7.1

From the following information compute the tax payable by a tonnage tax company for the AY 2016-17.

1. The company has two qualifying ships. The net tonnage of Ship I is 27,749 ton 400 kg and Ship II 16,750 ton and 500 kg.
2. Ship I runs for 365 days during the previous year and Ship II for 150 days during the previous year.
3. Turnover of core activities Rs 20 crore.
4. Profit from incidental activities Rs 5.5 lakh.

Solution

Net tonnage of Ship I: 27,749 ton 400 kg = 27,700 ton rounded off
Net tonnage of Ship II:16,750 ton and 500 kg = 16,800 ton rounded off

Deemed Income	Ship I	Ship II
First 1,000 ton (70 x 10)	700	700
Next 9,000 ton (53 x 90)	4,770	4,770
Next 15,000 ton (42 x 150) 6,800 ton (42 x 68)	6,300 ----	---- 2,856
Next 2,700 ton (29 x 27)	783	----
Daily tonnage income	12,553	8,326
Ship used during the PY (days)	365	150
Deemed Income	(12,553 x 365) 45,81,845	(8,326 x 150) 12,48,900

Total Deemed Income = 45,81,845 + 12,48,900
= **58,30,745** (a)

Income taxable under other provisions of the Act:

Turnover of core activities = Rs 20 crore
Profit from incidental activities = Rs 5.5 lakh

(Note: profit from incidental activities up to 0.25% of turnover of core activities is part of deemed income)

Part of deemed income = 20 crore x 0.25%
= Rs 5,00,000

Taxable portion of incidental income = Actual – part of deemed income
= 5,50,000 – 5,00,000
= **Rs 50,000**(b)

Total Taxable income (a + b) = 58,30,745 + 50,000
= 58,80,745
= **Rs 58,80,750 (rounded off)**

Computation of Tax Payable	
Tax on Rs 58,80,750 @ 30%	17,64,225
Add : Surcharge	Nil
Add : Education cess and SHEC @3%	17,64,225 52,927
Tax Payable	**18,12,152**

Rounded off Rs 18,17,150

UNIT VIII
TAX PLANNING FOR INDIVIDUALS

Tax Planning, as we are aware, is the process of proper usage of beneficial provisions of exemptions, deduct ions, rebates and reliefs, while fulfilling the tax obligations. This process varies from individual to individual and depends, among many factors, taxable income, time schedule for investments, risk bearing inclination, existing investment pattern, expected returns etc. Over the years, tax planning scenario has become more dynamic and complicated, due to constant changes in the tax laws and falling interest rates. Further tax planning cannot be done in isolation; it should be a part of overall Financial Planning of an individual.

Income to be considered while computing total income of individuals

1) **Income earned by individual himself**.

   Income earned by an individual in his individual capacity i.e., Income from salaries, Income from house property, Profits and gains of business or profession, capital gains and income from other sources.

2) **Income earned as a partner of a firm or a limited liability partnership**.

a) Salary, bonus etc. Received by a partner is taxable as his business income.
b) Interest on capital and loans to the firm is taxable as business income of the partner.
c) Share of profit in the firm is exempt in the hands of the partner.

   Note: The income mentioned in (a) and (b) above is taxable to the extent they are allowed as deduction to the firm.

3) **Income earned as a member of HUF**

a) Share of income of HUF is exempt in the hands of the member.
b) Income from an impartibly estate of HUF is taxable in the hands of the holder of the estate who is the eldest member of the HUF.
c) Income from self-acquired property converted into joint family property.

4) **Income earned as a member of AOP, etc.**

a) Where the income of AOP or BOI is chargeable at maximum marginal rate: Share of income of a member from such AOP or BOI will not be included in his taxable income at all.
b) Where the income of AOP or BOI is taxed at normal rates i.e., the rates applicable to an individual: Share of income of a member from such AOP or BOI will be included in the taxable income of the individual only for rate purposes and a relief under section 86 shall be allowed.
c) Where no income tax is chargeable on the income of the AOP or BOI: Share of income of a member from such AOP/BOI will be chargeable to tax as part of his total income.

5) Income of other persons included in the total income of the individual.

a) Transferee's income, where there is a transfer of income without transfer of assets.
b) Income arising to transferee from a revocable transfer of an asset.
c) Income of spouse as mentioned in 64(1).
d) Income from assets transferred to son's wife of to any person for the benefit of son's wife.
e) Income of minor child as mentioned in section 64(1A).

Note: In case (a) and (b), income is includible in the hands of the transferor.

COMMON TAX PLANNING TOOLS

Tax planning is only possible through availing maximum deductions, exemptions, rebates, relief, concession and incentives. Important of them are discussed below. Taxes planning with respect to heads of income are discussed in the next unit.

1. Tax planning through life insurance

Tax saving and life insurance are synonymous in the Indian context. Think of life insurance and the first point that comes to mind is tax saving. This is because premium paid on any life insurance plan can be claimed as deduction under Section 80C of the Income Tax Act. In fact, tax saving and life insurance have become so closely associated with each other, that life insurance for many individuals is reduced to just a tax saving avenue. While the truth is, regardless of the tax benefits, life insurance is a potent tool that every individual must have in his financial portfolio – not as a tax planning instrument but as an insurance against an eventuality.

2. Tax planning through ensuring assured return

This tax planning tool is a dual edged weapon. It offers fixed and regular return along with as tool of tax planning.

a) Public Provident Fund (PPF)

Investments in PPF are for a 15-Yr period and they provide regular savings by encouraging that contributions are made every year. You can deposit a minimum of Rs 500 and a maximum of Rs 1,50,000 in a financial year, in lump sum or in twelve installments of any amount in multiple of rupees five. Any deposits in excess of Rs 1,50,000 in a financial year will be refunded without interest and this amount cannot be considered for income tax rebate. You can open a PPF A/c not only in your name but also in the name of your spouse and children. However, please note that aggregate deposits of up to Rs 1,50,000 p.a. are eligible for tax benefits under Section 80C.

Currently, PPF investments earn a return of 8.7% p.a. compounded annually. However, you should note that although the stated returns are assured, they are not fixed. The rate of interest is subject to change from time to time. Furthermore, withdrawals can be made only from the seventh financial year onwards. PPF being an assured return product is a safe investment avenue for you, if you are risk averse.

Apart from a deduction of upto Rs 150,000 p.a. on deposits in PPF account under Section 80C, interest income from PPF account is exempt from tax under Section 10(a)(i) of the Income Tax Act.

b) National Savings Certificate (NSC)

NSC is a time-tested tax saving instrument with a maturity period of Five and Ten Years. Presently, the interest is paid @ 8.50% p.a. on 5 year NSC and 8.80 % Per Annum on 10 year NSC. Interest is Compounded Half Yearly. While the minimum investment amount is Rs 100, there is no maximum amount. Premature withdrawals are permitted only in specific circumstances such as death of the holder.

Investments in NSC are eligible for a deduction of upto Rs 150,000 p.a. under Section 80C. Furthermore, the accrued interest which is deemed to be reinvested qualifies for deduction under Section 80C. However, the interest income is chargeable to tax in the year in which it accrues.

c) Bank Deposits and Post Office Time Deposits

5-Yr bank fixed deposits are eligible for a deduction under Section 80C. The minimum amount that you can invest is Rs 100 with an upper limit of Rs 150,000 in a financial year. Currently these deposits earn an interest in the range of 8.00% -9.50% p.a.

Post Office Time Deposits (POTDs) are fixed deposits from the small savings segment. The minimum amount to be invested is Rs 200 while there is no upper limit (only Rs 150,000 will be eligible for deduction). Although you can opt for deposit of 1-Year, 2-Years, 3-Years and 5-Years, only deposits with maturity of 5-Years are eligible for tax benefits under Section 80C. A 5-Year POTD earns a return of 8.5% p.a.; the interest is calculated quarterly and paid annually. Premature withdrawals are permitted after 6 months from the date of deposit with a penalty in the form of loss of interest.

The amount deposited in the 5-Year bank deposits and POTD are eligible for deduction under Section 80C; however interest income on bank deposits and POTDs are chargeable to tax.

d) Senior Citizens Savings Scheme (SCSS)

The SCSS is an effort made by the Government of India for the empowerment and financial security of senior citizens. So, if you are over 60 years old, you are eligible to invest in this scheme; while if you have attained 55 years of age and have retired under a voluntary retirement scheme, you are also eligible to enjoy the benefits of this scheme subject to certain conditions being fulfilled.

The minimum investment in this scheme is Rs 1,000 while the maximum amount has been restricted to Rs 15,00,000. Again, the deduction is limited to Rs 1,50,000. Investments in SCSS have tenure of 5 years and earn a return of 9.20% p.a. The interest payouts are made on a quarterly basis every year. After one year from the date of opening the account, premature withdrawals are permitted. If you withdraw between 1 and 2 years, 1.5% of the initial amount invested will be deducted. In case if you withdraw after 2 years, 1.0% of the initial amount is deducted.

Investments upto Rs 1,50,000 in SCSS are entitled for a deduction under Section 80C. The interest income is charged to tax, which is deducted at source. If you have no tax liability on the estimated income for the financial year, you can avoid the Tax Deduction at Source (TDS) by providing a declaration in Form 15-H or Form 15-G as applicable.

3. Tax planning with "market-linked" instruments.

This tool concentrates in the market-linked securities where risk and return are in the same direction. Some important avenues are discussed below.

a) National Pension Scheme (NPS)

NPS, introduced on May 1, 2009, is the new addition to the family of investments that qualify for deduction under Section 80C. It is basically an investment avenue to plan for your retirement. Contributions to this scheme are voluntary and available to individuals in the age bracket of 18-60 years.There are two types of accounts:

Tier-I account: In case of the Tier-I account, the minimum investment amount is Rs 500 per contribution and Rs 6,000 per year, and you are required to make minimum 4 contributions per year. Under this account, premature withdrawals upto a maximum of 20% of the total investment is permitted before attainment of 60 years, however the balance 80% of the pension wealth has to be utilized to buy a life annuity.

Tier-II account: While opening this account you will have to make a minimum contribution of Rs 1,000. The minimum number of contributions is 4, subject to a minimum contribution of Rs 250. However, if you open an account in the last quarter of the financial year, you will have to contribute only once in that financial year. You will be required to maintain a minimum balance of Rs 2,000 at the end of the financial year. In case you don't maintain the minimum balance in this account and do not comply with the number of contributions in a year, a penalty of Rs 100 will be levied. In order to have this account, you first need to have a Tier-I account. This account is a voluntary account and withdrawals will be permitted under this account, without any limits.

While investing money, you have two investment choices in NPS i.e. Active or Auto choice. Under the Active asset class, your money will be invested in various asset classes viz. E (Equity), C (Credit risk bearing fixed income instruments other than Government Securities) and G (Central Government and State Government bonds); where you will have an option to decide your asset allocation into these asset classes. In case of Auto Choice, your money will be invested in the aforesaid asset classes in accordance with predetermined asset allocation.

The return on your investment is not guaranteed; rather it is market-linked. At the age of 60 years, you can exit the scheme; but you are required to invest a minimum 40% of the fund value to purchase a life annuity. The remaining 60% of the money can be withdrawn in lump sum or in a phased manner up to the age of 70 years.

Investments in NPS are eligible for deduction up to a maximum of Rs 150,000 p.a. (part of the total 80C deduction). However, withdrawals will be subject to tax as the scheme has the Exempt-Exempt-Tax (EET) status.

b) Equity Linked Savings Schemes (ELSS)

ELSS are 100% diversified equity funds with tax benefits. A distinguishing feature of ELSS is that unlike regular equity funds, investments in tax saving funds are subject to a compulsory lock-in period of three years. The minimum application amount is Rs 500, with no upper limit. You can either make lump sum investments or investments through the Systematic Investment Plan (SIP).

Investments in ELSS are eligible for a deduction up to Rs 150,000 p.a. under Section 80C. Long term capital gains, if any, are exempt from tax.

4. Tax planning through availing other deductions

When it comes to tax savings, Section 80C lies at the top of the recall list. Every income-tax payer is familiar with the provisions of Section 80C and the investment avenues available under it. However, what many do not know is that there are other deductions under Section 80 which can be used to one's advantage to further reduce your tax liability. These deductions are related to medical insurance premium, education loan, expenses on medical treatment, donations to various organizations and funds, house rent paid, among others. We give below, a brief synopsis of some of the major ones

i. **Section 80D**

The premium paid on medical insurance policy (commonly referred to as a medi claim policy) to cover your spouse and you, dependent children and parents against any unexpected medical expenses, qualifies for a deduction under Section 80D. The maximum amount allowed annually as a deduction is Rs 25,000. If you are a senior citizen, the maximum deduction allowed is Rs 30,000. Further, if you pay medical insurance premium for your parents, you can claim an additional deduction of up to Rs 25,000 under this section. For example, if you pay a premium of Rs 25,000 for yourself and Rs 25,000 for your parents, you will be eligible for a total deduction of Rs 50,000. If your Parents are Senior Citizen than deduction amount can be of up to Rs. 55,000.

ii. **Section 80DD**

If you have incurred any expenditure on the medical treatment of a handicapped 'dependent' with disability, the same qualifies for deduction under Section 80DD of the Income Tax Act. The deduction is a fixed sum of Rs 75,000 p.a. if the handicapped dependent is suffering from 40% of any disability. If the disability is severe (i.e. 80% of any disability), then a higher deduction of Rs 125,000 can be claimed.

iii. **Section 80E**

This section definitely comes as a boon to all of you who intend taking a loan to pursue higher education such as full time graduation and post-graduation. The loan can be taken either by you for your education or for your relative's education. The term 'relative' here includes spouse, any child or of the student of whom individual is legal Guardian. The entire amount of interest which you pay on the loan during the financial year is eligible for deduction under this section. You should avail of a loan from an approved charitable institution or a notified financial institution. The deduction is available for a maximum of 8 years or till the interest is fully paid off, whichever is earlier.

iv. **Section 80G**

If you have given donations to certain specified funds, charitable institutions, approved educational institutions, etc., the donation amount qualifies for deduction under this section. The deductions allowed can be 50% or 100% of the donation, subject to the stated limits as provided under this section.

v. **Section 80GG**

If you have paid rent for any furnished or unfurnished accommodation occupied for the purpose of your own residence, you can claim deduction under this section. This benefit is available to both, self employed and salaried individuals who are not in receipt of any House Rent Allowance (HRA).

vi. **Section 80U**

Individuals suffering from specified disability qualify for deduction under Section 80U of the Income Tax Act. A fixed deduction of Rs 75,000 is allowed if the person is suffering from 40% of any disability. If an individual suffers from a severe disability (i.e. 80% of any disability), then a higher deduction of Rs 1,25,000 is allowed.

5. Tax benefits and home loans

The Income Tax Act gets a little benevolent when it comes to housing loans. It encourages you to buy your house with a housing loan because of the tax saving benefits that come along with it. Both, repayment of principal and payment of interest are eligible for deduction from your total taxable income. When it comes to repayment of principal, you can claim a deduction up to Rs 150,000 under section 80C for both, self-occupied and rented property. The interest component of the loan covered under section 24(b) is eligible for a deduction up to Rs 200,000 p.a. for a self-occupied property. For rented property the actual interest payable is eligible for deduction.

6. Tax planning by availing Relief of tax.

If you have received arrears of salary in Financial year 2015-16 related to previous years then your tax liability for Financial Year 2015-16 will be on higher side due to arrears received in current year but good news is that you can bifurcate your income from arrears in respective years on notional basis and can avail relief u/s 89(1) of Income tax Act , 1961.

UNIT IX
TAX PLANNING WITH REFERANCE TO HEADS OF INCOME

This unit concentrates on possible ways of tax planning to heads of income.

TAX PLANNING - SALARY

Existence of 'master-servant' or 'employer-employee' relationship is absolutely essential for taxing income under the head "Salaries". Where such relationship does not exist income is taxable under some other head as in the case of partner of a firm, advocates, chartered accountants, LIC agents, small saving agents, commission agents, etc. Besides, only those payments which have a nexus with the employment are taxable under the head 'Salaries'. Salary is chargeable to income-tax on due or paid basis, whichever is earlier. Any arrears of salary paid in the previous year, if not taxed in any earlier previous year, shall be taxable in the year of payment.

The scope of tax planning from the angle of employees is limited. The definition of salary is very wide and includes not only monetary salary but also benefits and perquisites in kind. The only deductions available in respect of salary income are the deduction for entertainment allowance and deduction for professional tax. Following are the some of the tips of tax planning under the head salaries.

I. **Salary Structure**

The employer should not pay a consolidated amount as salary to the employee. If so paid entire amount is taxable. So split the salary as basic pay, allowances and perquisites in order to get exemptions and deductions available to allowance and perquisites. The employer has to make a careful study and fix the salary structure in such a manner that it will include allowances which are exempt.

II. **Employees Welfare Schemes**

There are several employees welfare schemes such as PF, approved superannuation fund, gratuity, etc... Payments received from such funds by the employees are totally exempt or exempt up to significant amounts. The employer is well advised to institute such welfare schemes for the benefit of the employees.

III. **Insurance Policies**

Any payment made by an employer on behalf of an employee to maintain a life policy will be treated as perquisite in the hands of employee. Further, payments received from the employer in respect of Key man Insurance Policies constitute income in the hands of the employees. But the premium paid by employer on accident insurance of employee will not be treated as perquisites.

IV. **Rent Free Accomodation/ House Rent Allowance**

An employee should analyze the tax incidence of a perquisite and an allowance, whenever he is given an option. The employee should work out the taxability of HRA and taxability of RFA separately and select least taxable item.

Dearness Allowance, Dearness Pay

It should be ensured that, under the terms of employment, dearness allowance and dearness pay form part of basic salary. This will minimize the tax incidence on house rent allowance, gratuity and commuted pension. Likewise, incidence of tax on employer's contribution to recognized provident fund will be lesser if dearness allowance forms a part of basic salary.

V. **Commission**

The Supreme Court has held in Gestetner Duplicators (p) Ltd. Vs CIT that commission payable as per the terms of contract of employment at a fixed percentage of turnover achieved by an employee, falls within the expression "salary" as defined in rule 2(h) of part A of the fourth schedule. Consequently, tax incidence on house rent allowance, entertainment allowance, gratuity and commuted pension will be lesser if commission is paid at a fixed percentage of turnover achieved by the employee.

VI. **Un commuted / Commuted Pension**

An un commuted pension is always taxable; employees should get their pension commuted. Commuted pension is fully exempt from tax in the case of Government employees and partly exempt from tax in the case of non government employees who can claim relief under section 89.

VII. **Provident Fund**

An employee being the member of recognized provident fund, who resigns before 5 years of continuous service, should ensure that he joins the firm which maintains a recognized fund for the simple reason that the accumulated balance of the provident fund with the former employer will be exempt from tax, provided the same is transferred to the new employer who also maintains a recognized provident fund.

Since employers' contribution towards recognized provident fund is exempt from tax up to 12 percent of salary, employer may give extra benefit to their employees by raising their contribution to 12 percent of salary without increasing any tax liability.

VIII. **Medical Allowances**

While medical allowance payable in cash is taxable, provision of ordinary medical facilities is not taxable if some conditions are satisfied. Therefore, employees should go in for free medical facilities instead of fixed medical allowance.

IX. **Retirement Benefits**

Since the incidence of tax on retirement benefits like gratuity, commuted pension, accumulated unrecognized provident fund is lower if they are paid in the beginning of the financial year, employer and employees should mutually plan their affairs in such a way that retirement, termination or resignation, as the case may be, takes place in the beginning of the financial year. An employee should take the benefit of relief available section 89 wherever possible. Relief can be claimed even in the case of a sum received from URPF so far as it is attributable to employer's contribution and interest thereon. Although gratuity received during the employment is not exempt u/s 10(10), relief u/s 89 can be claimed. It should, however, be ensured that the relief is claimed only when it is beneficial.

X. **Pension Received by Non Residents**

Pension received in India by a non resident assessee from abroad is taxable in India. If however, such pension is received by or on behalf of the employee in a foreign country and later on remitted to India, it will be exempt from tax.

XI. **Leave Travel Concession**

As the perquisite in respect of leave travel concession is not taxable in the hands of the employees if certain conditions are satisfied, it should be ensured that the travel concession should be claimed to the maximum possible extent without attracting any incidence of tax.

XII. **Free Gift of Assets**

As the perquisites in respect of free gift of movable assets(other than computer, electronic items, car) by employer after using for 10 years or more are not taxable, employees can claim these benefits without adding to their tax bill.

XIII. **Perquisites**

Since the term "salary" includes basic salary, bonus, commission, fees and all other taxable allowances for the purpose of valuation of perquisite in respect of rent free house, it would be advantageous if an employee goes in for perquisites rather than for taxable allowances. This will reduce valuation of rent free house, on one hand, and, on the other hand, the employee may not fall in the category of specified employee. The effect of this ingenuity will be that all the perquisites specified u/s 17(2)(iii) will not be taxable.

TAX PLANNING – INCOME FROM HOUSE PROPERTY

The Annual value of a house property is taxable as income in the hands of the ownerof the property. For tax purpose, properties may be classified as "Self Occupied Property" and "Let out Property".

Self-occupied property

For one self-occupied house property, which has not been let out, the Annual Value is taken as nil. (Where the owner holds more than one house and both are in the occupation of the owner for residential purposes, then only in respect of one residence at owner's choice, annual value will be taken as nil. For the other house, the tax shall be computed by treating the property as let out). Where the house is self-occupied, the interest on capital borrowed after 01.04.1999 for acquisition / construction is allowed as deduction subject to a maximum of Rs. 2 lakhs, provided the construction/ acquisition is completed within 3 years from the end of the financial year in which the loan was borrowed. On all loans taken prior to the above date and also on loans taken for repairing, renewing or reconstructing the property, the ceiling is Rs. 30,000. However, in the case of self-occupied property, taxes levied by the local authority (i.e. municipal tax) cannot be claimed as deduction.

Let out property

Taxable value of the let out property shall be the higher of the following:

A. Amount for which property might reasonably expected to let ; or

B. Actual annual rent received / Receivable.

However, where the property was let out but vacant during the whole or part of the year, then taxable value will be the amount actually received.

The municipal taxes actually paid during the financial year [irrespective of the period to which it pertains] will be deducted from the taxable value to arrive at the Annua lvalue of house property. From this, standard deduct ion @30% of Annual value of the property and Interest on borrowed capital for the purpose of acquisition, construction, reconstruction, repairs, renovation etc. are allowed as deduct ions, to arrive at the taxable income.

Common to both Self occupied and Let out

If there is a "Loss from House Property", the same can be set off against income from any other head in the same assessment year. I f the loss cannot be set off against income from any other head in the same assessment year, the loss is allowed to be carried forward and set off in 8 subsequent years against income from house property only. Further, loss under the head house property can be notionally set off against salary income, at the time of deduct ion of tax from salary. Pre- construction interest [i.e. interest paid/ payable, on fund borrowed for acquisition or construction, pertaining to the period prior to the financial year in which the property was acquired or construction completed] can be claimed only as deduction in five equal installments commencing from the financial year in which the house property is acquired or construction completed, in the Income Tax return submitted by the borrower.

Following are some of the tax planning tips under the head Income from House Property.

I. If a person has occupied more than one house for his own residence, only one house of his own choice is treated as self-occupied and all the other houses are deemed to be let out. The tax exemption applies only in the case of on self-occupied house and not in the case of deemed to be let out properties. Care should, therefore, be taken while selecting the house(One which is having higher GAV normally after looking into further details) to be treated as self-occupied in order to minimize the tax liability.

II. As interest payable out of India is not deductible if tax is not deducted at source (and in respect of which there is no person who may be treated as an agent u/s 163), care should be taken to deduct tax at source in order to avail exemption u/s 24(b).

III. As amount of municipal tax is deductible on "payment" basis and not on "due" or "accrual" basis, it should be ensured that municipal tax is actually paid during the previous year if the assessee wants to claim the deduction.

IV. As a member of co-operative society to whom a building or part thereof is allotted or leased under a house building scheme is deemed owner of the property, it should be ensured that interest payable (even it is not paid) by the assessee, on outstanding installments of the cost of the building, is claimed as deduction u/s 24.

V. If an individual makes cash a cash gift to his wife who purchases a house property with the gifted money, the individual will not be deemed as fictional owner of the property under section 27(i) – K.D. Thakar vs. CIT. Taxable income of the wife from the property is, however, includible in the income of individual in terms of section 64(1)(iv), such income is computed u/s 23(2), if she uses house property for her residential purposes. It can, therefore, be advised that if an individual transfers an asset, other than house property, even without adequate consideration, he can escape the deeming provision of section 27(i) and the consequent hardship.

VI. Under section 27(i), if a person transfers a house property without consideration to his/her spouse(not being a transfer in connection with an agreement to live apart), or to his minor child(not being a married daughter), the transferor is deemed to be the owner of the house property. This deeming provision was found necessary in order to bring this situation in line with the provision of section 64. But when the scope of section 64 was extended to cover transfer of assets without adequate consideration to son's wife or minor grandchild by the taxation laws(Amendment) Act 1975, w.e.f. A.Y. 1975-76 onwards the scope of section 27(i) was not similarly extended. Consequently, if a person transfers house property to his son's wife without adequate consideration, he will not be deemed to be the owner of the property u/s 27(i), but income earned from the property by the transferee will be included in the income of the transferor u/s 64. For the purpose of sections 22 to 27, the transferee will, thus, be treated as an owner of the house property and income computed in his/her hands is included in the income of the transferor u/s 64. Such income is to be computed under section 23(2), if the transferee uses that property for self-occupation. Therefore, in some cases, it is beneficial to transfer the house property without adequate consideration to son's wife or son's minor child.

TAX PLANNING – PROFIT AND GAINS OF BUSINESS OR PROFESSION

Business is any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Profession is defined to include any profession or vocation, which calls for intellectual or manual skill. I t covers doctors,lawyers, singers, musicians etc.

Profits and Gains from Business or profession, income received from providing services etc will be treated as Business or Professional income under this head.

The following are some of the important expenses, those can be claimed as deductible expenses.

a) Rent , rates, Taxes, Repairs and Insurance of Premises/ Buildings (Taxes only on actual payment basis)

b) Repairs and Insurance of Plant &Furniture, machinery

c) Depreciation on Building, Plant &Furniture, machinery

d) Insurance premium paid for Stocks/ Stores/ Health Insurance of Employees

e) Interest paid on borrowed capital - from Public financial institution on actual payment

f) PF/Gratuity/ Superannuation Fund contribution etc. on actual payment

g) Bad Debts writ ten off

h) Salary, bonus, commission etc. to employees

i) Expenditure incurred on Entertainment, Traveling, Presentation articles, Advertisement, Maintenance of Guest House etc.

Every business has to follow either cash or mercantile system of accounting.Various tax planning tools under the head profit and gains of business or profession were discussed in the next coming units

TAX PLANNING - CAPITAL GAINS

1) Since long-term capital gains bear lower tax, taxpayers should so plan as to transfer their capital assets normally only 36 months after acquisition. It is pertinent to note that if capital asset is one which became the property of the taxpayer in any manner specified in section 49(1), the period for which it was held by the previous owner is also to be counted in computing 36 months.3

2) The assessee should take advantage of exemption u/s 54 by investing the capital gain arising from the sale of residential property in the purchase of another house (even out of India) within specified period.

3) In order to claim advantage of exemption under sections 54B and 54D it should be ensured that the investment in new asset is made only after effecting transfer of capital assets.

4) In order to claim advantage of exemption under sections 54, 54B, 54D, 54EC, 54ED, 54EF, 54G and 54GA the tax payer should ensure that the newly acquired asset is not transferred within 3 years from the date of acquisition. In this context, it is interesting to note that the transfer (one year in the case of section

54EC) of a newly acquired asset according to the modes mentioned in section 47 is not regarded as "transfer" even for this purpose. Consequently, newly acquired assets may be transferred even within 3 years of their acquisition according to the modes mentioned in section 47 without attracting the capital tax liability. Alternatively, it will be advisable that instead of selling or converting assets acquired under sections 54, 54B, 54D, 54F, 54G and 54GA into money, the taxpayer should obtain loan against the security of such asset (even by pledge) to meet the exigency.

5) In 2 cases, surplus arising on sale or transfer of capital assets is chargeable to tax as short-term capital gain by virtue of section 50. These cases are: (i) when WDV of a block of assets is reduced to nil, though all the assets falling in that block are not transferred, (ii) when a block of assets ceases to exist.Tax on short-term capital gain can be avoided if –Another capital asset, falling in that block of assets is acquired at any time during the previous year; orBenefit of section 54G is availed. Tax payers desiring to avoid tax on short-term capital gains under section 50 on sale or transfer of capital asset, can acquire another capital asset, falling in that block of assets, at any time during the previous year.

6) If securities transaction tax is applicable, long term capital gain tax is exempt from tax by virtue of section 10(38). Conversely, if the taxpayer has generated long-term capital loss, it is taken as equal to zero. In other words, if the shares are transferred, in national stock exchange, securities transaction tax is applicable and as a consequence, the long-term capital loss is ignored. In such a case, tax liability can be reduced, if shares are transferred to a friend or a relative outside the stock exchange at the market price (securities transaction tax is not applicable in the case of transactions not recorded in stack exchange, long term loss can be set-off and the tax liability will be reduced). Later on, the friend or relative, who has purchased shares, may transfer shares in a stock exchange.

TAX PLANNING – CLUBBING OF INCOME

a) Under section 64(1) (ii), salary earned by the spouse of an individual from a concern in which such individual has a substantial interest, either individually or jointly with his relatives, is taxable in the hands of the individual. To avoid this clubbing, as far as possible spouse should be employed in which employee does not have any interest. In such a case this section will not be attracted, even if a close relative of the individual has substantial interest in the concern. Alternatively, the spouse may be employed in a concern which is interrelated with the concern in which the individual has substantial interest.

b) Income from property transferred to spouse is clubbed in the hands of transferor. However, it has been held that income from savings out of pin money (i.e., an allowance given to wife by husband for her dress and usual house hold expenditure) is not included in the taxable income of husband. Likewise, a prenuptial transfer (i.e., transfer of property before marriage) is outside the mischief of section 64(1) (iv) even if the property is transferred subject to subsequent condition of marriage or in consideration of promise to marry. Consequently income from property transferred without consideration before marriage is not clubbed in the income of the transferor even after marriage. Income from property transferred to spouse in accordance with an agreement to live apart, is not clubbed in the hands of transferor. It may be noted that the expression "to live apart" is of wider connotation and covers even voluntary agreement to live apart.

c) Exchange of asset between one spouse and another is outside the clubbing provisions if such exchange of assets is for adequate consideration. The spouse within higher marginal tax rate can transfer income yielding asset to other spouse in exchange of an equal value of asset which does not yield any income. For instance, X (whose marginal rate of tax is 33.66%) can transfer fixed deposit in a company of Rs.100,000 bearing 9% interest, to Mrs. X (whose marginal tax is nil) in exchange of gold of Rs.100,000; he can reduce his tax bill by Rs. 3029(i.e., 0.3366 x 0.09 x Rs 100000) without attracting provisions of section 64.

Problem 9.1

Mr X is employed in XYZ Ltd. His employer offered him HRA or RFA. Which one he has to select under the following two cases

	Case I	Case II
salary	3,20,000	3,00,000
allowances	1,20,000	3,00,000
HRA/ FRV of rent free house	1,20,000	3,00,000

In both the cases house is situated in Delhi and rent paid is equal to HRA.

Solution

Assessment Year 2017-18

Case I

Calculation of Taxable H.R.A	
Least of the following is exempt: (1) HRA received	1,20,000
(2) Rent paid – 10% salary Rs 3,20,000 1,20,000 – 32,000	88,000
(3) 50% of salary	1,60,000
Taxable HRA (1,20,000 – 88,000)	32,000
Computation of value of RFA	
15% of salary Rs 4,40,000	66,000

Decision: in this case it is better to take HRA instead of RFA

Case II

Calculation of Taxable H.R.A	
Least of the following is exempt: (1) HRA received	3,00,000
(2) Rent paid – 10% salary Rs 3,00,000 3,00,000 – 30,000	2,70,000
(3) 50% of salary	1,50,000
Taxable HRA (3,00,000 – 1,50,000)	1,50,000
Computation of value of RFA	
15% of salary Rs 6,00,000	90,000

Decision: in this case it is better to take RFA instead of HRA.

Problem 9.2

Kamal uses two houses for his residential purposes. The following relate to these:

	House I	House II
Municipal valuation	60,000	30,000
Fair Rent	85,000	32,000
Standard Rent	65,000	36,000
Municipal tax paid	10%	10%
Fire Insurance Premium	600	360
Loan for house construction	9,44,000	---
Date of loan	10/04/2014	---
Rate of interest	15%	---
Interest	1,41,600	---
Date of completion	10/03/2015	---

Give Tax planning advice to Mr Kamal.

Solution

Option I : Opt House I as self occupied and House II as deemed let out.
Option II : Opt House I as deemed let out and House II as self occupied.
We can work out both the option.

Option I		**Option II**	
House I – self occupied		House II – Deemed let	
Annual value	Nil	out	65,00
Less: Interest upto Rs	1,41,6	Gross Annual Value	0
2,00,000	00	Less: Municipal Tax paid	6,000
Loss (a)	1,41,6	Annual Value	59,00
House II – Deemed let out	00	Less : 30% of Annual	0
Gross Annual Value		Value	17,70
Less: Municipal Tax paid	32,00	Interest on loan	0

Annual Value Less : 30% of Annual Value Income (b) Loss from House Property (a) –(b)	0 3,000 29,00 0 8,700 20,30 0 **1,21,3** **00**	loss (a) House II – self occupied Annual value Less: Interest Loss (b) Loss from House property	1,41, 600 1,00, 300 Nil Nil Nil **1,00,** **300**

Advice : Mr Kamal has to select Option I in which tax burden is very less.

Problem 9.3

A company is paying following remuneration to an employee in Delhi who was earlier employed in Mumbai.

a. Salary: Rs 20,000 p.m.
b. Conveyance Allowance: Rs 2,000 per month
c. Education Allowance of Rs 600 p.m. for his children
d. Establishment and upkeep allowance of Rs 5,000 per month
e. Entertainment allowance of Rs 10,000 per month
f. Medical expenses up to Rs 10,000 p.a are reimbursed upon submission of medical bills.
g. Employee is married and has two children. He has been paid a leave travel allowance of Rs 5,000 for going to Kashmir.

Consider the tax implication both from the point of view of the company and the employee. You are required to suggest a method which will bring the minimum advantage both to the company as well as employee.

Solution

Tax implications for components of salary are as under:

I. From viewpoint of Employee:

a. Salary: It is taxable under Section 17(1) of the Act.
b. Conveyance Allowance: Employee is entitled to claim exemption of Rs 1600 pm towards conveyance allowance.
c. Education Allowance: Employee is entitled to claim exemption under Section 10(iv)(ii) read with Rule 2BB and maximum exemption is upto Rs 100 per month per child for maximum of 2 children.
d. Entertainment Allowance: It is fully taxable in employee's hands.
e. Establishment and Upkeep Allowance: It is fully taxable for an employee under Section 17(2).

f. Medical Expenses Reimbursement: It is exempt upto Rs 15,000 for an employee amount reimbursed beyond Rs15,000 will be taxable.
g. Leave Travel Allowance: It is wholly taxable Section 10(5) applies to reimbursement but not to a fixed allowance.

II. From the viewpoint of Employer:

Employer will get the deduction under Section 37(1) for the following:

a. Salary:
Note: For claiming deduction, salary should be provided after commencement of business. If it is incurred prior to commencement of business, it should relate to scientific research relating to business within 3 years prior to its commencement under Section 35(1).
b. Conveyance Allowance
c. Education Allowance
d. Entertainment Allowance
e. Establishment and Upkeep Allowance
f. Medical expenses and reimbursement
g. Leave Travel Allowance

Tax Planning:

i. Entertainment Allowance: Expenditure incurred by an employee in entertaining company's customers or for official purposes should be reimbursed to him to avoid his tax liability.
ii. Education Allowance: Instead of education allowance, education facility should be provided. Education facility is not taxable in the hands of an employee who is non-specified. For a specified employee, the company is suggested to evolve a scheme of scholarship based on merit. It is not an Income of Employee. Employer may claim deduction u/s 37(1). Also, employee is entitled to claim exemption up to Rs100 per month per child.
iii. Medical Expenses: Instead of medical allowance, reimbursement for medical expenses should be provided as medical allowance is fully taxable while medical reimbursement is exempt up to Rs 15,000.
iv. Establishment and Upkeep Allowance: This allowance can be given under the name of House Rent allowance to an employee so as to enable him to claim exemption under Section 10(13A) read with Rule 2A. Employer is entitled to claim deduction under Section 37(1).
v. Leave Travel Concession: The company is advised to grant leave travel concession or reimbursement to enable the employees to seek exemption under Section 10(5) instead of Leave Travel allowance which is fully taxable.
vi. Retirement Benefit Scheme: The Company is advised to introduce retirement benefit scheme, i.e., Introduction of Recognized Provident Fund (RPF). Employer's contribution is deductible u/s 36 read with Section 43B. Employee

gets deduction u/s 80C. Repayment at retirement is exempt if employee has served 5 years or more.

Problem 9.4

Jafar is employed with PK Ltd. at a salary of Rs 40,000 per month. He is also paid House rent allowance of Rs 10,000 per month. His wife, Sona is also employed at a salary of Rs 20,000 per month with G Ltd. Where Jafer holds 20% shares. Sona does not hold adequate qualification for the post which she is holding. Sona is the owner of a house, which is self occupied by the family. Municipal value of house is Rs 3,00,000. The house was constructed in the year 2015-16 with borrowed funds. Interest on loan is payable of Rs 1,75,000 p.a. Sona has insured the house and paid insurance premium of Rs 5,000 to National Insurance Company. Sona has also paid Rs 15,000 as Municipal taxes.

Jafer pays insurance premium of Rs 26,000 for himself, his wife and two children. He also pays school fees of Rs 24,000 for the children.

Suggest a scheme of tax planning to minimize the tax liability during the financial year 2016-17.

Solution

Tax Planning:

a. Jafer is advised to reduce his shareholding with G Ltd. from 20% to 19% to avoid clubbing of salary income of Sona (Jafer's wife) under Section 64(1)(ii).

b. Sona should not treat the house as self occupied. She should let it out to Jafer and issue a rent receipt of an amount say Rs 20,000 per month.

   On the basis of rent receipt, Arun is entitled to claim the exemption in respect of house rent allowance to reduce his tax liability. Besides, she can claim full deduction in respect of interest payable on housing loan, whereas she can claim maximum deduction of Rs 1,50,000 for such interest when the house is self occupied for residence.

UNIT - X
TAX PLANNING IN STRATEGIC MANAGEMENT DECISIONS

In business, the decisions are taken with a view of optimize returns to the stakeholders. A dominant aspect to be considered taking in view the tax consequences of the same on the bottom-line so as to share minimum profits with Government without violating any tax or any other laws in force. It is significant that tax consequences alone need not bind the management to take a decision and it is only a factor which influences the management decisions. Moreover, in case of taxes, there are both direct as well as indirect taxes and in efforts for planning implications of both category of taxes are required to be considered. Management decisions, which have a bearing on the bottom line are analyzed below from the point of view of income-tax implications. Following are the important managerial decisions were tax become a major determinant.

I. MAKE OR BUY DECISIONS

When a business concern requires a product or any part or component of the product for its existing unit, it has to decide whether it should make the product or buy it from other manufacturers. Various tax considerations with respect to these decisions are:

1. If the organization has surplus capacity and even decide to buy a product it may require to sell surplus plant and machinery. In such a case it may be liable to capital gains tax.
2. If anew undertaking is established to make the product which fulfils the conditions of section 80-IB/80-IC of the Act, a deduction is allowed to such undertakings.
3. If the product is a capital asset, its cost will not be allowed as a deduction in computing the income in both cases. But in both cases, the organization can claim depreciation.

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II. OWN OR LEASE DECISIONS

Leasing is an arrangement that provides a person with the use and control over an asset, for a price payable periodically, without having title of ownership. Here the decision with respect to own the asset by paying the cash in full or leasing the product by paying periodical installments. It is an important consideration in tax planning. The assessee should follow such a method for obtaining an asset which reduces his tax liability and profits after tax are greater. For this purpose some people suggest that own funds should not be used in purchase of an asset because interest on owned fund is not deductible in computing total income, whereas interest on borrowed funds is deductible. We can invest the own fund outside the business and the interest earned will offset the interest payment of outside loan. This situation can best understand through the following illustration.

III. REPAIR OR REPLACE DECISIONS

Repair of an asset is revenue expenditure where as replacement is capital expenditure as per tax point view. If the factors other than tax were not predominant, they can select repairs as a part of tax planning. Following points should be kept in mind to reduce the tax liability while taking a decision to repair or replace an asset:

1. There are some conditions to carry-forward and set-off of business losses. Hence, if in the relevant previous year less income is expected, it will be better to slow down the pace of repair and renewal of a part of asset in such a manner that it is spread over a number of years. On the other hand, if the income is increased, the repair work can be increased.
2. As far as possible a part of the asset should be replaced and not the entire asset. In case of replacement of a part of asset, the cost of replacement is allowed as a deduction in computing the income for tax purpose.

IV. SHUT DOWN OR CONTINUE DECISIONS

When a business suffers loss continuously, whatever reasons of loss may be, the management has to decide whether the business should shut down or continue. While taking this decision, the impact of Income tax provisions should not be over looked. Various tax planning considerations are:

1. If the business is discontinued, the business losses and unabsorbed depreciation still can be carry forwarded and set off against profits and gains of business or profession. (in the case of unabsorbed depreciation – set off against income under any head)
2. The benefit of deductions under section 33AB (Tea Development Account/ Coffee Development Account/ Rubber Development Account) and 115VT (Reserve for shipping business) may be withdrawn and liable to tax for the year in which business is discontinued.
3. If the business is discontinued and the assets used for scientific research and family planning are sold, the selling price to the extent of deduction claimed shall be deemed as the profits of the previous year in which such assets are sold.
4. If a person is running more than one business the loss making business should not be discontinued but operated in a minimal way so that the losses and expenses like retrenchment compensation, interest on borrowed funds, bad debts etc. adjusted with profit making units.

V. TAX PLANNING RELATING TO CORPORATE RESTRUCTURING

The following suggestions could be useful for tax planning in respect of amalgamation merger, demerger, etc.

1. Since the unabsorbed losses and unabsorbed depreciation cannot be allowed to be carried forward or set off in the hands of the amalgamated company, except in the cases prescribed under Section 72A of the Act, it is suggested:
   - that the scheme of the amalgamation can be put off till such time the full benefit of set off is availed of by the amalgamating company; and
   - that the loss carrying company should absorb or take over the business of the profit-making company. In other words, the profit making company should merge itself with the loss incurring company. This would help in carrying forward the benefits of all unabsorbed losses and depreciation for set off against the profits derived from the business of the profit-making company.
2. To save from disallowance of the debts of the amalgamating company which subsequently become bad in the hands of the amalgamated company, the amalgamated company should plan to make suitable provision for the expected losses on account of bad debts at the time of fixing the consideration while taking over the business of the amalgamating company.

   In view of the Court judgment of CIT v. T. Veerabhadra Rao (1985) 22 Taxmann 45, the bad debts are not allowed to an assessee by way of personal relief but to a business. So, it is possible for the amalgamated company to claim bad debts even in respect of debts taken over from the amalgamating company.
3. A company whose shares are not quoted on a recognised stock exchange may avail the benefit of amalgamation by amalgamating itself with another company whose shares are quoted on a recognised stock exchange. This would help shareholders of unlisted company to take the advantage of the quoted price of their shares in the stock exchange.
4. A company holding investments in immovable properties may avail the benefit of non-applicability of the provisions of the Urban Land Ceiling Act by amalgamating itself with an industrial company.
5. A loss incurring company and a profit-making company may merge in order to reduce the overall incidence of liabilities to tax under the Income Tax Act, 1961.
6. In case the conditions provided under Sections 2(1B) and 72A of the Act are not satisfied, it may be suggested that the profit making company should merge itself with the loss making company, so that the loss making company does not lose its existence and enjoys all other benefits.
7. Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, at least 75% of the shareholders of the amalgamating company should become shareholders of the amalgamated company. In case more than 25% of the shareholders are not willing to become shareholders of the amalgamated company, it is proposed that the amalgamating company may persuade the other shareholders who may be willing, to purchase the shares in the amalgamated company to acquire the shares of the remaining shareholders

so that the percentage of dissenting shareholders does not exceed 25%. Alternatively, the amalgamated company prior to, amalgamation, may purchase shares from such dissenting shareholders so as to make such dissenting shareholders to go below the specified percentage of 25%.

There is a recent trend of going in for reverse merger. It means that the profit making company merges into the sick company thereby becoming eligible to carry forward of losses etc. without the aid of Section 72A of the Act. The profit making or healthy company extinct and loose its name and the surviving sick company retains its name. It is actually device of bypassing merger under Section 72A of the Act and has become popular now a days.

TAX PLANNING RELATING TO FINANCIAL MANAGEMENT DECISIONS

When a company raises long term loans from financial institutions or by way of public issue of debentures or inviting deposits from the public, it should plan that the expenses incurred on such issues of debentures or expenses towards stamp duty, registration fees, and lawyer’s fees should be incurred only after the date of the ‘setting-up’ of the business. The interest on loan paid before the commencement of production but after setting up of the business on the loans taken by the company for the acquisition of its plant and machinery and other assets, forms part of the actual cost of the asset and it should be capitalized in actual cost of asset. Thus, the company would be allowed to capitalise the expenditure and claim a higher depreciation and investment allowance.

The company should also plan the optimum use of the share capital and the borrowed funds. The borrowings should be utilised as far as possible for the acquisition and installation of assets like, buildings, plant and machinery so that interest could for the period after setting up of the acquired assets but before the commencement of production could be capitalised. The interest and higher amount of depreciation (due to capitalisation of expense) may be claimed as revenue expenditure pertaining to the business of the company.

The company should also plan to purchase the depreciable assets on credit terms and an agreed amount of interest can be paid on such credit purchases or the company may purchase these company assets on the basis of the hire purchase agreement enabling the company to claim the amount of interest paid as revenue business expenditure. The company would also be entitled to claim either the depreciation for use of the asset or may treat the hire charges as the rent for the asset in the normal course of business and claim deduction on revenue account.

The following table will help the finance manager framing suitable plans relating to capital structure:

	Capital	*Borrowings*
Dividend/Interest	Not deductible	Fully deductible
Cost of raising finance	1/5th allowed under Section 35D	Fully deductible in first year.

Taking the same sources of finance, the comparison between pre-commencement period and post commencement period is as follows:

(a) (i) Dividend is not deductible either for pre-commencement period or in the post-commencement period in India.

(ii) Interest is capitalised for pre-commencement period, i.e. added to the cost of project' (cost of fixed assets) and its depreciation is calculated on capitalised value of assets. In post-commencement period, interest is fully deductible.

(b) (i) Cost of raising finance in case of capital is not deductible as revenue expenditure but amortised under Section 35D of the Act. If such expenditure is incurred after the commencement of the business. Section 35D is applicable, provided the expenditure is undertaken for expansion purposes in case of industrial undertaking.

(ii) Cost of borrowing funds in case of pre-commencement period is capitalised and in case of post commencement period, it is deductible fully in the year.

The above consideration will go a long way in suggesting the managements of corporate entities to adopt a suitable capital structure and selecting the appropriate financing sources by providing an optimum capital mix for the organization

Problem 10.1

A Ltd. wants to acquire a machine on 1st April, 2017. It will cost Rs 1,50,000. It is expected to have a useful life of 3 years. Scrap value will be Rs 40,000.

If the machine is purchased through borrowed funds, rate of interest is 15% p.a. The loan is repayable in three annual instalments of Rs 50,000 each.

If machine is acquired through lease, lease rent would be `60,000 p.a.

Profit, before depreciation and tax is expected to be Rs 1,00,000 every year. Rate of depreciation is 15%. Average rate of tax may be taken at 33.99%.

A ltd. seeks your advice whether it should:

(i) Acquire the machine through own funds, or borrowed funds; or

(ii) Take it on lease.

Advice whether asset should be taken on lease or on purchase. Whether it should be acquired through own funds or borrowed funds? Present value factor shall be taken @ 10%.

Note: The Profit or loss on sale of the asset is to be ignored.

Solution

In all the scenarios, profit is same, therefore, we can advice on the basis of present value of Outflow and loans.

(I) PURCHASING MACHINE

i. Through own funds

	Particulars	Year 0	Year 1	Year 2	Year 3
	Cash Outflow	(1,50,000)	---	---	---
(1)	Cash inflow Tax Relief on Depreciation @33.99%	---	7,650	6,500	5,525
(2)	Sale Proceeds of machine	---	---	---	40,000
	Total	**(1,50,000)**	**7,650**	**6,500**	**45,525**
	Present value Factor @10%	1	0.909	0.826	0.751
	Present Value of Cash Outflows	(1,50,000)	6,954	5,369	34,189

Net Present Value of Cash Inflows (–) Outflows = Rs (1,03,487)

ii. **Through Loan Funds**

	Particulars	Year 0	Year 1	Year 2	Year 3
(1)	Cash Outflow: Loan repayment	---	(50,000)	(50,000)	(50,000)
(2)	Interest Payment	---	(22,500)	(15,000)	(7,500)
(1)	Cash inflow Less: Tax Relief on Depreciation/Loss @ 33.99%	---	7,650	6,500	5,525
(2)	Less: Tax Relief on Interest	---	7,650	5,100	2,550
(3)	Sale Proceeds of machinery	---	---	---	40,000
	Total	---	**(57,200)**	**(53,400)**	**(9,425)**
	Discounting factor @ 10%	1	0.909	0.826	0.751
	Present Value of Cash outflows	---	**(51,995)**	**(44,108)**	**(7,078)**

Net present value of cash flows = **Rs (1,03,181)**

(II) **ACQUIRING MACHINE ON LEASE**

Particulars	Year 0	Year 1	Year 2	Year 3
Cash Outflow on Lease rent:	---	(60,000)	(60,000)	(60,000)
Cash inflow : Tax Relief on Lease Rent @ 33.99%	---	20,390	20,390	20,390
Net Cash Outflow	---	**(39,610)**	**(39,610)**	**(39,610)**
Discounting factor @ 10%	1	0.909	0.826	0.751
Present Value of Cash outflows	---	**(36,005)**	**(32,718)**	**(29,747)**

Net Present value of cash flows = **Rs (98,470)**

Conclusion: *Cash outflow is least if machine is acquired on lease. Hence, machine shall be acquired on lease.*

Working Note 1 - Calculation of Tax relief on Depreciation and Balancing Allow

Year	Opening Balance	Depreciation @ 15%	Tax Relief @33.99%
1	1,50,000	22,500	7,650
2	1,27,500	19,125	6,500
3	1,08,375	16,257	5,525

UNIT - XI
TAX PLANNING IN SETTING UP OF BUSINESS

Before setting a business organization we should analyze tax provisions and incentives applicable to that. This unit focuses on tax planning tools for setting up of business organization.

(a) SETTING UP AND COMMENCEMENT OF BUSINESS

Setting up a business within the scope of the Income Tax Act is a particular point to be considered for the purpose of tax planning strategy. It is different from the commencement of business. The company may be incurring certain expenditure of revenue nature during the intervening period after setting up and before the commencement of business (production). It is provided in the tax laws that the general expenses prior to the date of setting up are inadmissible but those incurred from the date of setting up and before the commencement of the business may be allowed as deduction for tax purposes provided they are of revenue nature and are incurred wholly and exclusively for the purpose of business.

(b) FORM OF THE ORGANISATION

The first aspect of setting up of new business entity is deciding the form of organisation/ownership pattern. The selection of particular form of organisation depends not only on the magnitude of financial requirements and owner's liability, but also on the tax considerations. In the case of a company, the law interferes with the corporate planning process from the moment it comes into existence. At times, tax laws affect even the periods prior to the existence of a company and it can also extend upto the point of time when the company ceases to exist. For example, a director of a private limited company in liquidation, has to keep in view the provisions of Sections 178 and 179 of the Income Tax Act, 1961 dealing with misfeasance etc. Normally, depending upon the level of operation, expected profitability need for external financing and expected requirements of technical expertise, a suitable form can be chosen. But in view of the continuity of business, the benefits arising out of limited liability, organised accounting and the overall long-term tax benefits flowing to the company form of organisation, the corporate enterprise may be regarded as an effective instrument of tax planning. The company being a separate legal entity, confers certain valuable benefits in the matter of tax planning to its shareholders and the persons connected with the management of the company.

Tax liability is an important consideration guiding the choice of a legal form of business organisation. In some circumstances however this consideration is of no significance. For example large business is generally compelled to organise itself in the form of a company as this form of organisation makes it possible to raise large amounts of capital required. Similarly retail business of small size can only be economically operated as proprietorship or partnership firm. When there is freedom of choice taxation becomes an important consideration.

i. Company Form of Organisation

The important tax privileges and advantages to a company over the other forms can be summarized as under:

1. Allow ability of remuneration, for the persons who are managing the affairs of the company and also owning its shares.
2. The provisions relating to clubbing of income under Section 64 of the Income Tax Act, 1961 do not apply even if the business is carried on by family members through a company. This ultimately leads to reduction of tax liability on the part of the individual members. However, if spouse of an individual having a substantial interest in a company receives remuneration from the same company, such remuneration is added to the income of the individual unless the spouse is technically or professionally qualified. [Section 40A (2)(b) of the Income Tax Act, 1961].
3. Any income by way of dividend referred to in Section 115-O is exempt under Section 10(34).
4. Companies are subjected to flat rate of tax, regardless of the quantum of their income.
5. There are certain special tax concessions, allowances and deductions given under the Income Tax Act,1961 available to the company form of business enterprises such as deductions allowed under Section 33AC and Sections 36(1)(ix) and 35D of the Income Tax Act, 1961 etc.
6. Incorporation of a company has the incidental advantage of attracting large capital since the shareholder, who has to contribute only a miniscule part of the capital requirement, is assured of limited liability and free transferability of his shares.

ii. Partnership Firm or Limited liability Partnership

A partnership form of organization is easy to establish. The only procedure for the formation of partnership is to draw up a partnership deed and a nominal charge in terms of cost of stamps for the deed is to be incurred. This form of organization is suitable due to the following factors:

1. The decision making on important business matter is quick as compared to a company form of organization because partners meet frequently together. Therefore, decision on any important business matter cannot be delayed.
2. The chance of getting involved in risky activities is very less because every important decision is made with the concurrence of all the partners.
3. As compared to sole proprietorship, the problem of raising additional resources is much less. Whenever the business expands and it is necessary to raise finance,

it will be easy to raise it by admitting a new partner or raising it by way of borrowings because of number of partners and their joint and several liability to pay the debts of the firm, the lenders will be more interested in lending.

4. The firm can pay interest on capital and loan to partners at the maximum rate of 12% p.a. Further it can also give remuneration to its working partners subject to the limits mentioned in Section 40(b).
5. This form of organisation is suitable from income-tax point of view in such cases where the amount of profit is not large and the partners of the firm do not have any other additional income except by way of remuneration and interest from the partnership firm. In such a case the profit of the firm shall be lower and the individual partners can also avail of the maximum ceiling of income exempt under the Income tax Act.
6. The share in the profit of the partnership firm is exempt form tax under Section 10(2A) of the Income-tax Act.
7. The risk as to losses and liability incurred is divided amongst the partners.
8. As in the case of company form of organization where the change of business requires a long procedure, there is no tedious procedure in the partnership form of organization. The business can be changed only with the consent of partners.
9. The firm is taxable at a flat rate of 30% + education cess @2% + SHEC @1% for assessment year 2016-17 after allowing interest and remuneration to working partners (if provided in the partnership deed and subject to Section 40(b) of the Income-tax Act.

However this form of organization is not suitable due to the following reasons:

1. The risk taking capacity of the partners becomes limited. Every decision relating to important business matters is made with the consultation of other partners, which restricts the risk taking activities which may yield much higher profits.
2. As far as the operations of business are limited to small or medium scale, there is no problem in financing the expansion of business operation. But when business gets expanded to a large scale, then it will be suitable to adopt a company form of organization because partnership can be formed up to such number as may be prescribed but not exceeding 100.
3. One of the main drawbacks is that one partner becomes liable for the acts of another. Therefore, a partner is liable for the wrongs of another partner if it is done within the legal limits.
4. In the new scheme of assessment of partnership firms, the share of partners is exempt from tax under Section 10(2A) but the partners remuneration and interest, subject to limit mentioned in Section 40(b), is taxable in the hands of the partners under the head profits and gains of business or profession. Also, the

firm cannot claim deduction in respect of interest payable to partners in excess of 12% per annum.

5. Where the partnership firm does not comply with the requirements of Section 184 of the Income Tax Act, although the firm shall be assessed as firm, it shall not be allowed any deduction on account of interest and remuneration to its partners.
6. A partnership firm may come to a sudden closure of business on account of death, lunacy or insolvency. In the case of a business running efficiently and profitably, such as happening will cause a great loss. Also, dissolution will attract Section 45(4) which imposes tax liability in respect of capital gain arising on transfer of capital assets from the firms to partners.

   Entrepreneurs now have an alternative and innovative form of business organization i.e. Limited Liability Partnership (LLP) which combines the benefits of company and general partnership form of business organizations. LLP has separate legal entity, perpetual succession and limited liability of partners. From income tax point of view it is treated same as general partnership firm therefore its profits will be taxed in the hands of the LLP not in the hands of its partners.

iii. Sole proprietorship

The most common form of ownership found in the business world is sole proprietorship. In this form of organization, the proprietor is the only owner of the business assesed and he is solely responsible for the affairs of the business.

1. A sole proprietorship is easy to establish because of little interference of government regulations.
2. The cost of adopting this form of organization is small because of there being no legal requirement.
3. All the profits of the business go in the hands of proprietor himself.
4. In case of persons carrying on business on small scale and having small income from other sources, this form of organization would be suitable because the proprietor can avail of the tax ceiling limit of individual.
5. Besides the deductions which are allowed to all assesses under Chapter VIA, a sole proprietor, being assessed as individual, is entitled to get all deductions.

However, this form of organization is also not suitable due to:

1. The liability of the proprietor is unlimited and it can extend even to his personal assets. When the proprietor incurs losses and business assets are not sufficient to meet the liabilities of business, his personal assets can be used for discharging the business liabilities.
2. The proprietor does not get deduction on account of remuneration payable to him for rendering of services. It is felt that profits are the reward for contributing capital and taking risk and remuneration must be given for the service rendered

by the proprietor which should be allowed as deductible expenditure. However, income-tax law does not allow the deduction of remuneration.

3. Another drawback of this form of organization is that it does not provide opportunities to finance the expanding business activities. In the case of a partnership firm, on the other hand, capital can be raised by the existing partners or by admitting another partner.

iv. Hindu Undivided Family

A joint Hindu family pays tax on its total income at prescribed rates on the basis of slab system. The family can pay reasonable remuneration to the Karta and other family members for their services to the business and it is allowed as a deduction in computing the business income. However, interest on capital contributed by the family for the business is not deductible in computing business income. The member of the family, who has received the remuneration from the family will include it in his income under the head Salaries.

A Hindu undivided family will also get a basic exemption of Rs 2,50,000 for assessment year 2016-17. Besides the deductions which are allowed to other forms of organisation, it is allowed certain deductions under Sections 80C, 80D, 80DD, 80DDB and 80GG like individuals. The tax rates in case of HUF are same as applicable to individual. The demerits of HUF, however, are similar to that of individuals.

(c) LOCATIONAL ASPECTS

Tax planning is relevant from location point of view. There are certain locations which are given special tax treatment. Some of these are as under:

a. Full exemption under Section 10A for ten years in the case of a newly established industrial undertaking in free trade zones, etc. [Not allowed w.e.f. A.Y. 2012-13].
b. Full exemption under Section 10AA for initial five years, 50% for subsequent five years and further deduction of 50% for a further period of five years in the case of newly established units in special economic zones on or after 1.4.2005.
c. Full exemption under Section 10B for 10 years in the case of a newly established 100% export-oriented undertaking. [Not allowed w.e.f. 2012-13].
d. Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of Special Economic Zone.
e. Deduction under Section 80-IB in the case of profits and gains from certain industrial undertaking other than infrastructure development undertaking.
f. Deduction under Section 80-IC in case of certain undertaking or enterprises in certain special category States.
g. Deduction under Section 80-ID in respect of profits and gains from business of hotels and convention centres in specified area.
h. Deduction under Section 80-IE in respect of certain undertakings in North-Eastern States.

(d) NATURE OF BUSINESS

Tax planning is also relevant while deciding upon the nature of business. There are certain businesses which are granted special tax treatment. Some of them are as follows:

a. Newly established industrial undertaking in free trade zones, etc. [Section 10A]. [Not allowed w.e.f. A.Y. 2012-13].
b. Newly established units in special economic zones [Section 10AA].
c. Newly established hundred per cent export-oriented undertakings [Section 10B]. [Not allowed w.e.f. A.Y. 2012-13].
d. Tea Development Account, Coffee Development Account and Rubber Development Account [Section 33AB].
e. Site restoration fund [Section 33ABA].
f. Specified business eligible for deduction of Capital Expenditure [Section 35AD].
g. Amortisation of certain preliminary expenses [Section 35D].
h. Expenditure on prospecting for certain minerals [Section 35E].
i. Special reserve created by a financial corporation under Section 36(1)(viii).
j. Special provision for deduction in the case of business for prospecting for mineral oil [Sections 42 and 44BB].
k. Special provisions for computing profits and gains of business on presumptive basis [Section 44AD].
l. Special provisions in the case of business of plying, hiring or leasing goods carriages [Section 44AE].
m. Special provisions in the case of shipping business in the case of non-residents [Section 44B].
n. Special provisions in the case of business of operation of aircraft [Section 44BBA].
o. Special provisions in the case of certain turnkey power projects [Section 44BBB].
p. Special provisions in the case of royalty income of foreign companies [Section 44D].
q. Special provisions in case of royalty income of non-residents [Section 44DA].
r. Certain income of offshore Banking Units and international Financial Service Centre [Section 80-LA].
s. Profit and gains of industrial undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA].
t. Profits and gains of an undertaking or an enterprise engaged in development of Special Economic Zone. [Section 80-IAB].
u. Profits and gains from certain industrial undertaking other than infrastructure development undertaking [Section 80-IB].
v. Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC].

w. Deduction in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site. [Section 80-ID].
x. Special provisions in respect of certain undertakings in North-Eastern States. [Section 80-IE].
y. Profits and gains from the business of collecting and processing of bio-degradable waste [Section 80JJA].
z. Employment of new workmen [Section 80JJAA].
aa. Special tax rate under Sections 115A, 115AB, 115AC, 115AD, 115B, 115BB, 115BBD, 115BA and 115D.

UNIT -XII
TAX PLANNING – SEZ, EPZ, EOU, INFRASTRUCTURE…

This unit discusses Tax Planning through establishing a business undertaking in SEZ / EPZ or establishing EOU or establishing infrastructure undertaking.

TAX PLANNING RELATED TO SPECIAL ECONOMIC ZONES

In India Special Economic Zones (SEZ) Act were passed during the year 2005. The Act intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations. There are so many income tax incentives available to SEZs. Important of them were discussed below

I. SPECIAL PROVISIONS IN RESPECT OF NEWLY ESTABLISHED UNITS IN SPECIAL ECONOMIC ZONES. (10AA)

A new section 10AA has been inserted to give income-tax concession to newly established units in Special Economic Zone.

The following conditions should be satisfied to claim deduction under section 10AA

Condition 1: The assessee is an entrepreneur as defined in section 2(j) of SEZ Act, 2005. Entrepreneur is a person who has been granted a letter of approval by the Development Commissioner to set a unit in a Special Economic Zone.

Condition 2: The unit in Special Economic Zone begins to manufacture or produce articles or things or provide services during the financial year 2005-06 or any subsequent year. Manufacture for this purpose means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining.

Condition 3: The assessee has income from expose of articles or thing or from services from such unit. In other words, the assessee has exported goods or provided services out of India from the Special Economic Zone by land, sea, air or by any other mode, whether physical or otherwise.

Condition 4: Books of the account of the taxpayer should be audited. The taxpayer should submit audit report in Form No. 56F along with the return of income.

Amount of deduction: If the above conditions are satisfied, one can claim deduction under section 10AA. Deduction depends upon quantum of profit derived from export of articles or things or services (including computer software). It is calculated as under

$$\frac{\textit{Export turnover}}{\textit{Total turnover of the business carried on by the undertaking}} \times \text{Profits of the business}$$

Deduction for First Five Assessment Years:

100 per cent of the profit and gains derived from export of articles or things or from services is deductible for a period of 5 consecutive assessment years. Deduction for the first year is available in the assessment year relevant to the previous year in which the unit begins to manufacture or produce articles or things or provide services.

Deduction for Sixth Assessment Year To Tenth Assessment Year:

50 per cent of the profit and gains derived from export of articles or things or from services is deductible for the next 5 years.

Deduction for Eleventh Assessment Year To Fifteenth Assessment Year:

For the next 5 years, a further deduction would be available to the extent of 50 per cent of the profit provided an equivalent amount is debited to the profit and loss account of the previous year and credited to Special Economic Zone Re-investment Allowance Reserve Account.

II. EXEMPTION OF CAPITAL GAINS ON TRANSFER OF ASSETS IN CASES OF SHIFTING OF INDUSTRIAL UNDERTAKING FROM URBAN AREA TO ANY SPECIAL ECONOMIC ZONE (54GA)

Applicable to	Conditions	Quantum of deductions
Any assessee being anindustrial undertaking	1. Machinery, plant, building, or land used for the business of an industrial undertaking situated in an urban area should have been transferred. 2. Transfer should be due to shifting to any Special Economic Zone whether developed in any urban area or any other area. 3. Within a period of 1 year before or 3 years after the date of transfer purchased machinery, plant or acquired building or land or constructed building and completed shifting to the new area.	If the cost of the new assets and expensesincurred for shifting are greater than the capital gain, the whole of such capital gain. Otherwise capital gain to the extent of the cost of the new asset.

III. DEDUCTIONS IN RESPECT OF PROFITS AND GAINS BY AN UNDERTAKING OR ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE [SEC. 80IAB].

Discussed in Unit IV

IV. DEDUCTIONS IN RESPECT OF CERTAIN INCOMES OF OFFSHORE BANKING UNITS AND INTERNATIONAL FINANCIAL SERVICES CENTRE [SEC. 80LA]

Discussed in Unit IV

TAX PLANNING RELATED TO EPZ AND EOUs

EXPORT PROMOTION ZONES (EPZ)

Export Processing Zones are specified areas in a country where quotas and tariffs are eliminated in the hope of attracting foreign investments and new business. It can also be defined as production centers which is labor intensive and which involve the import of raw materials and the export of finished products. The government of India offers many tax incentives to the Export Processing Zones that have been set up in the country. The various Tax Incentives provided to EPZs in India are 100% exemption from income tax for a period of five years and after that 50% income tax exemption for a period of two years. Further the various Tax Incentives offered to EPZs in India are that 100% foreign direct investments (FDI) are allowed in the manufacturing sector through the automatic route and the units within the EPZs have the facility to hold foreign exchange receipts up to 100% in the account of Exchange Earners Foreign Currency. Also the various Tax Incentives offered to Export Processing Zones in India are that the units in the EPZs are allowed commercial external borrowings without any maturity restrictions. The various Tax Incentives provided to EPZs in India are that foreign direct investment (FDI) up to 100% is allowed in the units within the EPZs for providing telephone services in the EPZs and exemption from paying customs duties on the import of raw material, capital goods, and consumables spares.

EXPORT ORIENTED UNITS (EOUs)

Special provisions in respect of newly established hundred per cent export-oriented undertakings (10B)

Subject to the provisions of this section, a deduction of such profits and gains as are derived by a hundred per cent export-oriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software, as the case may be, shall be allowed from the total income of the assessee :

Provided that where in computing the total income of the undertaking for any assessment year, its profits and gains had not been included by application of the provisions of this section as it stood immediately before its substitution by the Finance Act, 2000, the undertaking shall be entitled to the deduction referred to in this sub-section only for the unexpired period of aforesaid ten consecutive assessment years :

Provided further that for the assessment year beginning on the 1st day of April, 2003, the deduction under this sub-section shall be ninety per cent of the profits and gains derived by an undertaking from the export of such articles or things or computer software:

Provided also that no deduction under this section shall be allowed to any undertaking for the assessment year beginning on the 1st day of April, 2012 and subsequent years :

Provided also that no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified under sub-section (1) of section 139.

TAX PLANNING RELATED TO INFRASTRUCTURE AND BACKGROUND AREAS

There is lot of tax incentives available to infrastructure development companies in India. it is discussed in detail Unit IV.