

# **SELF LEARNING MATERIAL on TAX PLANNING**

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## UNIT -I: TAX PLANNING

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## **OBJECTIVES**

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After reading the unit, you will be able to

- ❖ Explain the concept of Tax Planning
- ❖ Analyse the different forms of Tax Planning
- ❖ How Salaried Persons can plan for Tax
- ❖ Describe the concepts of Tax Evasion and Tax Avoidance

## **INTRODUCTION**

Tax planning involves a way in which an Assessee or a tax payer minimises tax liability legitimately. There are several areas under the Income Tax Act, 1961 such as allowances, exemptions, rebates, etc. by which one can reduce tax liability either by claiming or optimally utilising the same. By minimising the tax liability an assessee can save money for future investment, growth or expenses, etc. So, before an assessee goes for tax planning, it is very important to understand the meaning of the terms Tax Planning, Tax Avoidance, Tax Evasion etc. The main purpose of this unit is to give an overview of the basic terminologies related to tax planning to the students.

### **1.1 TAX PLANNING**

Tax planning is a combination of two terms 'Tax' and 'Planning'. Tax is a financial charge or any other Levy imposed on individual or a legal entity in pursuant to legislative authority. Whereas planning means 'thinking before doing'

#### **1.1.1 MEANING OF TAX PLANNING**

Tax planning is one of the important aspects of financial planning. Efficient tax planning enables you to reduce your tax liability to minimum. In general tax planning is planning for taxes in such a manner that ensures the amount of tax due will be paid in a timely manner. In India tax planning allows a tax payer to make the best use of the tax exemptions, deductions

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and benefits to minimise the tax liability. It involves conceiving of and implementing various strategies in order to minimise the amount of tax paid for a given period.

Tax planning is not a device to reduce tax burden. In fact it helps a tax payer to invest in government securities. As a result, the savings in tax helps the government to mobilise the funds by way of investment. By tax planning, the government is equally benefited. The Supreme Court in one case observed that “Tax planning may be legitimate provided it is within the framework of Law”.

### **1.1.2 STRATEGIES OF TAX PLANNING FOR SALARIED PEOPLE TO REDUCE THEIR TAX LIABILITY:**

Salaried individuals in India are not fully aware of the tax planning exercise which is why they rush at the end of the tax-planning season and make investments to reduce their tax liability.

1. Optimum utilisation of the entire Section 80C deduction: The maximum deduction available in Section 80C is Rs. 1,50,000. By making an investment in the avenues permissible u/s 80 C, tax planning can be done by the salaried people. Some of the avenues are as follows:
  - a. Public Provident Fund
  - b. Accrued interest on National Saving Certificate
  - c. Life Insurance Premium
  - d. National Saving Certificate
  - e. 5-Year fixed deposits with banks and Post Office
  - f. Equity Linked Savings Schemes (ELSS), etc.
2. Reduction of tax liability beyond Section 80C deductions: Above the deductions of 80C, one can also go for the following:
  - a. Home Loan u/s 24

- b. Medical insurance: By claiming deductions u/s 80D in respect of medical insurance premium for self, spouse, children or parents.
  - c. Donations: Tax advantages under Section 80G entitle the donations to particular funds/institutions.
  - d. By making an investment in SEZ unit.
  - e. By claiming any other deductions prescribed under section 80.
3. Reorganize the salary: Reorganizing the salary and incorporating certain apparatus can help in the long run in minimizing the tax liability.

Apart from these, there are numerous other strategies to reduce tax liability by claiming other deductions prescribed under the Income Tax Act, 1961.

## **1.2 TAX EVASION**

Tax evasion as the term refers to the phenomenon of evading tax. Tax evasion is usually understood to be an act in which an individual intentionally chooses to not pay income taxes due.

### **1.2.1 MEANING**

Tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting. Following are some of the ways of Tax evasion:

- a. Not showing real income (under disclosure of income).

- b. Inflating the expenses and thus reducing the income.
- c. Manipulation of accounts to reduce the income.
- d. Violation of rules and regulations of law with the intention to save tax.
- e. Benami transactions.

It is considered as a white-collar crime and is spreading like anything. It is the most serious problem faced by almost all the countries of the world.

### **1.2.2 IMPORTANCE**

Tax evasion is important for many reasons:

- a. It reduces tax collections, thereby affecting taxes that compliant taxpayers face and public services that citizens receive.
- b. Evasion creates misallocations in resource use when individuals and firms alter their behaviour to cheat on their taxes.
- c. Its presence requires that government expend resources to deter noncompliance, to detect its magnitude, and to penalize its practitioners.
- d. Tax evasion alters the distribution of income unpredictably; unless tax evaders are caught, they pay fewer taxes than honest taxpayers. Evasion may contribute to feelings of unfair treatment and disrespect for the law, creating a self-generating cycle that feeds upon itself and leads to even more evasion. It affects the accuracy of macroeconomic statistics.
- e. More broadly, it is not possible to understand the true impact of taxation without recognizing the existence of evasion.

### **1.2.3 CAUSES**

- a. Complicated tax laws and filing system.
- b. Generation of Black Money in the Public Sector.
- c. Absence of social security system.

- d. Lack of transparency in government spending system.
- e. Ineffective Enforcement of tax laws and weak surveillance system.
- f. Inflation and unstable economy.
- g. Prohibited Trades, etc.

#### **1.2.4 REMEDIES**

The remedies to Overcome (Reduce) Tax Evasion are as follows:

- a. Reducing Tax Rate: Government by reducing the tax rate on an individual income & income earned after investment will encourage them to avoid tax evasion & invest in various investment instruments available in India itself, like tax deduction available in Provident fund, Post office schemes, etc.
- b. Strong Surveillance System: Government should bring strong surveillance system in place which will check suspicious trade and transaction taking place and will have also have the complete authority to check tax defaulter, etc.
- c. Simplified Tax Laws and Filling Mechanism: Present tax laws and tax filling mechanism is very complex and very difficult for a layman to understand it and claim for various deductions available in various sections. Simplified tax law will make things easy for everyone to pay taxes.
- d. Transparency in Government Expenditure: There should be transparency on government expenditure at every level to make sure every rupee sent by government is reached at grass root level. This will avoid the vaporization of a large chunk of money done by higher-class official, politician, bureaucrats, contractors, etc. All offices of government should be brought under the audit of Comptroller and Auditor General of India (CAG). Bringing expenditures of ministry of defiance was one of the major such developments.
- e. Ban & Surveillance on Illegal Trade & Practices: Trades like smuggling of commodities, drugs, baiting on cricket & various other activities like election polls, flesh trade are one of the major causes of tax evasion as

these activities are illegal they are not viable to pay taxes on this and thus they evade taxes. Surveillance on these activities will reduce tax evasion and crime as well.

- f. Bringing Strong Corruption Laws: Corruption is the root cause of tax evasion; if corruption is reducing it will considerably reduce the tax evasion. And for reducing corruption and effective strong law like LOKPAL is needed, which can have the power to investigate every government employee and framing the maximum time for every case to make the final judgments unlike present which take years and still cannot punish them.

### **1.3 TAX AVOIDANCE**

Tax avoidance is a strategy which involves exploiting legal means of reducing taxes with the goal of minimizing tax liability.

#### **1.3.1 MEANING**

In the words of Justice Chinnappa Reddy, "Tax Avoidance is an art of dodging tax authorities without breaking the law." Tax avoidance is the legal utilization of the tax regime to one's own advantage, in order to reduce the amount of tax that is payable by means that are within the law. Avoidance is a perfectly legal approach to handling taxes, although sometimes avoidance practices can stray into the realm of being abusive, at which point people may cross the line into tax evasion. In tax evasion, people utilize illegal means to avoid paying all or part of their taxes; evasion can result in prosecution and fines or prison time.

Most taxpayers engage in a certain amount of tax avoidance, because people want to avoid paying more taxes than they need to. In a simple example, most people claim all of the exemptions available to them. Likewise, people may take advantage of retirement accounts which offer tax savings if they plan on saving money for retirement; as long as one is putting money aside, one might as well

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reduce taxes at the same time. These tax avoidance strategies are usually encouraged by financial planners and accountants.

### 1.3.2 CAUSES

- ❖ Lack of adequate tax incentives
- ❖ Poor Relationship of Tax Payers & Authority
- ❖ Proliferation of taxes
- ❖ Illiteracy of tax calculation
- ❖ High tax rates

### 1.4 DIFFERENCES

Although tax planning, tax evasion and tax avoidance are poles apart, but the basic purpose of these different terms is more or less the same which is reduction of tax liability to the extent possible. Sometimes tax evasion is ignorance of law but ignorance of law is not an excuse in the eyes of law. Tax evasion and tax avoidance are both practices designed to reduce the amount people pay in taxes. The difference is that one involves legal means, while the other is illegal and is a form of tax fraud. Professionals such as attorneys and accountants who assist people with illegal means of reducing tax liability can be penalized along with the taxpayer.

#### 1.4.1 TAX PLANNING AND TAX AVOIDANCE

| <b>Tax Planning</b>  | <b>Tax Avoidance</b>   |
|--|--|
| 1. Tax planning is done by staying within the four corners of law. | 1. Tax avoidance is done by exploiting the loopholes of the law. |
| 2. It involves fair obedience of law.                              | 2. It involves foul play of law.                                 |
| 3. It is legal and acceptable by judiciary.                        | 3. It is illegal and unethical and is prohibited.                |
| 4. In it, transactions are real and natural.                       | 4. In it, transactions are fabricated artificially.              |
| 5. It is long run and dependable.                                  | 5. It is short run and not dependable.                           |

## 1.4.2 TAX PANNING AND TAX EVASION

| <b>Tax Planning</b>   | <b>Tax Evasion</b>   |
|---|--|
| 1. Tax planning is done by availing the maximum benefits of various deductions, exemptions. Rebates. Reliefs, etc. provided under the tax laws. | 1. Tax Evasion is done either by showing lesser income than actual or by hiding the very source of income. |
| 2. It involves fair obedience of law.   | 2. It is wilful disobedience of law and involves an element of deceit.                                     |
| 3. It is legal and acceptable by judiciary.   | 3. It is illegal and unethical and is prohibited.  |
| 4. It is based on the principle of disclosure.  | 4. It involves hiding the facts regarding incomes and expenditures.  |
| 5. It is a deliberate creation of law for wealth generation through encouraged savings and investment.  | 5. It is a white-collar crime and is seen as an offence.   |

## 1.4.3 TAX AVOIDANCE AND TAX EVASION

| <b>Tax Avoidance</b>   | <b>Tax Evasion</b>  |
|--|---|
| 1. An act of minimising tax liability by locating some weaknesses of law.                              | 1. An act of minimising the tax liability either by showing lesser income than actual or by hiding the very source of income. |
| 2. It is within the framework of law but it is against the basic intent of the legislative provisions. | 2. It is gross violation and disrespect of law.   |
| 3. It can be curbed by introducing anti-violence provisions of clubbing provisions.                    | 3. It can be curbed by implementing the law effectively.  |

## 1.5 SUMMARY

- ❖ Tax planning is not a device to reduce tax burden but is in fact helps savings by investments in government securities.
- ❖ Tax planning is an essential part of your financial planning.
- ❖ Tax planning also applies to various types of employee benefits that can provide a business with tax deductions, such as contributions to life insurance, health insurance, or retirement plans.
- ❖ Tax Planning India is an application to reduce tax liability through the finest use of all accessible allowances, exclusions, deductions, exemptions, etc., to trim down income and/ or capital profits.
- ❖ Tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means.
- ❖ Tax avoidance is a strategy which involves exploiting legal means of reducing taxes with the goal of minimizing tax liability.

## 1.6 FURTHER READING

### BOOKS:

- ❖ Singhania, V. K.& Singhania, Kapil. Direct Taxes Law & Practice. Taxmann Publications
- ❖ Ahuja, G. K. & Gupta, Ravi. Systematic Approach to Income Tax. Bharat Law House.
- ❖ Gaur, V.P., Gaur, P. & Puri, R. Direct Tax. Kalyani Publications.

### LINKS:

- ❖ [https://www.researchgate.net/publication/267378575\\_Reasons\\_of\\_Tax\\_Avoidance\\_and\\_Tax\\_Evasion\\_Reflections\\_from\\_Pakistan/link/545896820cf26d5090ab8540/download](https://www.researchgate.net/publication/267378575_Reasons_of_Tax_Avoidance_and_Tax_Evasion_Reflections_from_Pakistan/link/545896820cf26d5090ab8540/download)
- ❖ <https://www.edelweissmf.com/investor-insights/mutual-fund-investment-tips-and-articles/all-about-tax-planning>
- ❖ [https://ebooks.lpude.in/commerce/bcom/term\\_5/DCOM301\\_INCOME\\_TAX\\_LAWS\\_I.pdf](https://ebooks.lpude.in/commerce/bcom/term_5/DCOM301_INCOME_TAX_LAWS_I.pdf)

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