

ADVICE FOR TAX PLANNING

PARAS KOCHAR, *Advocate*

In this article I have tried to discuss the guidelines for tax planning which may help new and young tax consultants. Tax planning does not mean saving in tax only. Tax planning is an art and every Assessee or tax consultant should know the ways and means for tax planning. My article may help the young and new tax consultants in planning the tax affairs of their clients.

WHAT IS TAX PLANNING - Tax planning is not tax evasion and hence not illegal. However, we should always try to plan tax affairs of our clients within the four corners of law and not for avoidance of tax. In broader sense, tax planning does not only mean reduction of tax liability but it also includes timely tax compliances, proper application of tax laws and correct interpretation of tax laws.

The Income Tax Act is a vast act and it goes on changing every year. So one has to be very careful in planning tax affairs of his client. Whether the Assessee is a small tax payer or a big tax payer, he needs tax planning. There are certain fixed points which you should always keep in your mind while advising your clients. It is not that all the points mentioned below are required for every client, but if you cover these points while advising your clients, in most of the cases, your planning will be perfect and there will be very little chances of errors from your side. Mistakes are committed not because tax consultants do not know the law but because they sometimes do not concentrate on all the points. They miss certain provisions while advising their clients or they are not up to date. Ultimately, mistakes occur and the planning becomes defective.

PRILIMINARY REQUIREMENTS FOR TAX PLANNING - Tax planning should be made in a systematic manner and style. The preliminary requirements for tax planning are very simple but useful. Every tax consultant should be aware of these preliminary requirements for tax planning. I have tried to cover all the preliminary requirements for tax planning which may be useful for common assesses as under:

- (a) Every tax consultant should know the basics of the Income Tax Act and Rules. You must be knowing that there are certain forums of Google where tax queries are raised and solved. In such forums, certain queries raised are so ordinary and simple that it appears that the querist who are either Advocates or Chartered Accountants do not even know the basics of the Income Tax Law.
- (b) Apart from the Income Tax Act, one should also know the basics of various other acts such as Company Law, Hindu Law, CRPC, IPC, Partnership Act, LLP Act, Contract Act, Service Tax Act, Sales Tax Act, Evidence Act, Vat Etc.
- (c) Before you make any tax planning, you should consult books such as Ready Reckoner, Income Tax Act, Income Tax Rules or any other relevant book to be sure that your advice on income tax matters are correct. The more you read the law, the more you learn.
- (d) You should always discuss with seniors on every tax matter which is either new to you or where you have any doubt over the same.
- (e) Certain transactions or entries which prima facie look ordinary and simple may also require your special attention.

- (f) No half-hearted discussions should be made with clients while discussing tax matters with them. You should try to know the whole facts in detail otherwise your opinion can be wrong. You should also not give your opinion over telephone on any complicated issue if raised by your client. You should always ask him to send the query in writing.
- (g) If you have advised your client on a long term tax planning, discussion is required at regular intervals till the execution of such plan. *For example*, suppose your client is investing in shares and you advise that income from sale of such shares can also be treated as Capital Gains in place of Business Income on fulfilment of certain conditions and you give them certain suggestions in respect of the same. Such planning is for a longer period as your group is going to invest in shares and sell the shares after long period. In such a situation, you should keep track of such transactions regularly because sometimes guidelines and advises given by you may not be followed by your client properly. So, the entire planning may become faulty.
- (h) You should also not advise your client on the basis of what you have heard from others. Before doing so, you should check the provisions yourself. It is the common habit that we hear something from others during certain conversations and we make it a part of our advice.
- (i) You should know the latest case laws, circulars and notifications to provide perfect tax planning to your clients. You should apply the case laws only after going through the facts of the same and not only on the basis of outlines given in various journals. Whenever you find any important judgement, you should take note of the same in your diary or should feed the same on your computer. Now-a-days, you can also search case laws on google. The case laws should not be applied without reading it.

APPLICATION OF PROVISIONS OF TAX LAWS - There are certain important provisions in the tax laws which you should always keep in mind. Although, the tax consultants are aware of the provisions of the Income Tax Act, it sometimes happens that they fail to apply the provisions properly. These provisions are very common but are very important to know for day to day tax affairs and working. Moreover, these provisions are applicable to a large number of assesses. These provisions are dealt in brief as under –

Important Provisions:-

- 01.** In recent time, most important provision is section 14A. While computing income, you should make disallowances in respect of expenditure incurred for earning exempted income by applying provisions of Section 14A. I have seen that a number of Chartered Accountants do not include the amount of disallowance as per provisions of section 14A in Tax Audit Report or do not make disallowance in Return of Income even if it is applicable. If you find that by applying rule 8D, the disallowance u/s 14A may be very huge, you don't apply rule 8D but you should still make disallowance u/s 14A by adopting any other suitable and justified method while computing the income.
- 02.** I have explained above in para (d) above that even transactions which looks simple may also require special attention. Transfer of funds from one group company to another requires due care. Section 2(22)(e) which was not applied by the assessing officer for a long time is now being applied regularly and huge additions are being made by the assessing officers. You should verify as to whether the transfer of funds are covered by section 2(22) (e) of the Income Tax Act. Funds transferred may be treated as deemed dividend. Apart from this, you should also look into company laws in respect of transfer of funds from one group company to another
- 03.** If a company has Interest Income and loss from Sale of Shares which is shown as inventory in the Balance Sheet, you should check explanation to section 73 before giving any opinion to your client.

- 04.** In case of transactions related to purchases, expenses, loans or advances, you should verify whether Section 40A(3), Section 269 SS and Section 269T are being violated or not. In case of real estate dealing, the Assessee buys land and pay some amount in cash. But since the Assessee shows such land in his stock in trade, section 40A(3) comes into operation. If land is shown as capital assets, section 40A(3) is not violated. Similarly, care should be taken for application of section 269SS and section 269T.
- 05.** If ratio of Gross Profit is similar in comparison to previous Assessment Year, it is all right, otherwise, the A.O. may examine it deeply. So you must see this aspect in the case of your client and should make out the reasons of low G.P., if any, to satisfy the A.O.
- 06.** In case of company assessee, you should try to find out whether MAT u/s 115JB is applicable or not. Do not forget to take benefit of tax credit of MAT, if any. In case of assessee other than companies, AMT u/s 115 JC should also be kept in mind.
- 07.** You should know the turnover of your client and if it is below 1 Crore, you should see whether Section 44AD applies or not. This Section does not apply to companies.
- 08.** If shares are purchased 3 months prior to record date and sold within 3 months of record date, any loss on sale of shares will not be allowed to the extent of the dividend. If you find that your client has dividend income, you should verify whether Section 94(7) is applicable or not.
- 09.** Shares and Commodity Transactions may be treated as business transactions and hence loss from such transactions may be deemed as business loss and profit from such transactions may be treated as deemed business profit provided transactions are made through certain notified stock exchange only. The tax consultant should know these provisions to give proper advice to his/her clients.
- 10.** As a tax consultant, you must see that Administrative Expenses like Conveyance, General Expenses, Sales Promotion, etc. are excess in comparison to previous year, subject to turnover and increase in price rise. However, in case there is heavy increase or fall in such expense, you must be ready to give suitable explanation to the Assessing Officer at the time of Scrutiny Assessment.
- 11.** In respect of Brought Forward Losses, Unabsorbed Depreciation and also Set-off of Loss, due care should be taken. You should keep in mind as to how Speculation Loss, Long Term Capital Loss or Short Term Capital Loss, brought forward Business Loss are set-off. How Business Loss is set-off during the year against income from other heads and how brought forward Business Loss is set-off should be understood. I find regular mistakes in adjustments of such losses made by the assessee or the professionals. You should be very careful in such situation.
- 12. TDS :** This provision is the most important provision in the Income Tax Act. For violation of the provision, an assessee may have to pay interest and penalty. He may also be prosecuted. He may also have to bear heavy tax liability. You should always guide your client that :
 - a.** TDS should be deducted at appropriate rate.
 - b.** TDS should be deducted under correct head.
 - c.** TDS should be paid compulsorily within due date.
 - d.** TDS return should be filed within due date.
 - e.** TDS form should be filed properly.
 - f.** TDS should be deducted at the time of payment or credit.
 - g.** There are various provisions for applying for lower deduction of tax at source. In certain cases you can also issue forms to the Deductors for not deducting tax at source subject to certain conditions.

Therefore, it is your duty to advise for TDS matters properly to your clients to avoid disallowances, Penalty, Prosecution, Interest, Fine etc.

- 13. Gifts** : Gift can be received by a person from his relatives as provided in Section 56(2). The list of relative is very exhaustive. Whenever you are asked by a client that he has received gift from such and such relative, check the provisions and then advise him. *For example*, gift received from Mama is not taxable but there is controversy in respect of gift received from Nana. So don't advise from your common sense. Further, there is a common belief among assesses that gifts received from blood relation is not taxable u/s 56(2), but it is not so. Also verify Section 64 of the Income Tax Act along with section 56(2) for certain gifts.
- 14. Section 43B** : If Government dues or statutory liabilities such as Provident Fund payment, Sales Tax or Vat payment, Excise Duty, Custom Duty, etc. have not been paid within due date as mentioned, the outstanding amount will be added to income and your assessee may incur tax liability unnecessarily.
- 15. Section 40A(ia)** : This is a very important Section. If you have not paid your TDS as per provisions of the Income Tax Act, the principle amount on which you were liable to deduct tax at source will be added to your income. You should again warn your client that he should not forget to make payment of TDS within the due date.
- 16. Section 43CA** - This is a latest amendment, in respect of sale of immovable property in a real estate business. You should take in to account the stamp duty value of such transaction.
- 17. Transfer Pricing** - In case of international transaction and also in case of domestic transactions exceeding a particular limit, provisions of transfer price applies.

HEADS OF INCOME - Apart from the important provisions, you should also look into the various heads of income and should advise your clients after going through the said heads of income deeply.

- 1. Salary Income** : Tax planning for salaried people is most complicated as perquisites, various allowances, arrear salary are difficult to compute. For claiming some of the allowances or perquisites, you should go through the necessary documents. Investment planning of salaried persons should be properly looked into.
- 2. Income from House Property** : When you are planning Income from House Property, you should first see whether Rental Income is House Property Income or Business Income and what is Gross Annual Value. Normally, the assessee or the tax consultant does not take into account the Gross Annual Value. They simply compute the income on the basis of Gross Rent. Apart from this benefit of Interest for Pre-construction period should be availed. If your client has taken loan for the purpose of construction of his house, interest up to pre-construction period shall be allowed to be set-off in five subsequent assessment years after the said house property is constructed or acquired. Deemed Rental Income should be considered if your client is having two residential houses and one is vacant. The notional income from such house shall be taxable.
- 3. Business Income** : When you are planning business income of your assessee, you should see the nature of expenses being claimed against such income i.e. whether a particular expense is Capital or

Revenue or Personal. Amortisation of preliminary expenses should be properly computed. There is lot of controversies in respect of capital expenses and revenue expenses.

- 4. Capital Gain** : While planning Capital Gain, you should particularly take care that the Capital Gain is not assessed as Business Income or vice versa. You should properly check the period of holding, exemption in respect of Residential House, exemption in respect of Investment in Shares, Mutual Funds etc. Cost of acquisition and indexed cost should be determined correctly. Section 50C should also be kept in mind while claiming Capital Gain from sale of properties. Lot of appeals are being filed for violation of Section 50C.

OTHER IMPORTANT POINTS : The provisions of Clubbing of Income, Deduction under Chapter VIA and Exempted Income u/s 10 should always be kept in mind while planning the tax affairs of clients.

Other points :

- **House Hold Drawings** - Your client is showing personal or household expenses correctly and properly in the books of accounts. If not you should advise him to do so. You can judge the reasonableness of house hold expenses on the basis of various expenses incurred.
- **Wealth Tax** - In many cases, I have noticed that the Assessee forgets to file the Wealth Tax Return and in case of companies, most of the assesses are not even aware of Wealth Tax and are not furnishing Wealth Tax Returns.

As soon as you check the Balance Sheet of your client you should check whether Wealth Tax is applicable on the wealth of your clients and if so you should also plan his Wealth Tax matter.

CONCLUSION - Tax advice should be based on clear interpretation of tax laws. Case laws for tax advices and tax planning should not be blindly followed. The case laws should be followed only when the matter is under dispute. The finance ministry changes the law from retrospective effect even after a judgement is given by apex court or high court. If the above provision are kept in mind, there will be very little chance of faulty tax planning.