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Personal Investment And Tax Planning - A Theoretical Perspective

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Abstract

As a pre-requisite of tax planning, each tax payer has to know their tax obligations in the rightperspective and the measures of tax planning available to them so that they can make best useof their earnings by reducing the incidence of tax. This could be achieved only by availing maximum amount of tax exemptions, deductions and relief that are available under the Act. Abetter awareness about the existing tax laws and the tax saving instruments is necessary to achieve this objective. The present study on personal income tax planning essentially involvesa study on the savings pattern, investment pattern and the extent of awareness of the individualabout the tax laws and the tax planning measures.

Key Words: Tax Planning, Tax Evasion, Tax avoidance

1.0. Introduction

Planning assumed a dominating role towards the close of the twentieth century and continues with ever expanding horizon in the twenty-first century also. For the economic development of any Country, planning has to be restored to in order to distribute the economic position of the weaker section of the society. For the proper implementation of the development programme,a sound base of public finance has also to be built up which require huge revenue and a major part of which is achieved through the collection of taxes. Raising public revenue through taxation is popular policy of an economy and it does not entail any extra burden on the government as in the case of borrowings. Thus taxation is considered to be the most effective source of raising public revenue, of course, with in the frame work of law. On the other hand payment of taxes reduces the disposable income of the tax payers and imposes a burden on them.

Tax planning is a way by which you arrange your financial affairs in such a way that without breaking up any law you take full advantage of all Exemptions, Deductions, Rebate and Reliefs allowed by law so that your tax liability will be reduced. Actually Government provides deductions, exemptions, reliefs, or rebate for the benefits of economy and society. Like if you made donation to scientific research [u/s 8GGA] then it's good for society and economy too. Tax planning involves making investments with the objective of minimizing tax liability and maximize his income by saving on taxes.

The amount of tax to be paid is related to the source of income viz. income from salary, incomefrom business, income from house property, interest income, income from dividends etc. and the amount and type of investment made. The income from different sources is taxed differently. There are provisions exemption of certain incomes, deduction from aggregate income and from the tax computed on total income. The deduction/exemption are available ondifferent tax saving instruments/schemes are also different. Therefore, tax planning will involve selection of right kind of instruments/schemes for investing the funds, type and amountof tax benefits available, liquidity and safety of investments etc.

1.1.Statement of The Problem

In India rate of taxation are not only high but tax laws are also very complicated, Therefore a tax payer should plan his financial affairs in such a way that he is not trapped in the tax-net. He should make every effort not only to maximize his profit, but also try to maximize post-tax profits. He should keep the incidence of tax at a minimum possible point. So that the profits after tax can be maximized. So tax planning is a step in this direction and, therefore, it has become indispensable for every tax payer. It is essential for this class of tax payers to know their tax obligation in the right perspective andthe measures of tax planning available to them so that they can make the best use of their earnings by reducing the incidence of tax. Tax planning is possible through appropriate savingsand wise investment decision. Tax payers normally turn away of their tax liability only towardsthe end of the financial year. This leaves them with little option to invest or save with the available income. The real issue would relate to having awareness on the numerous tax planning measures that would help in reducing the tax liability. And the key issue is awareness about investment opportunities.

1.2. Theoretical Framework

The fast economic development of a country is possible only if the government gets adequate revenue from the public. Since tax is the major source of revenue to the Government, it is the duty of every person to pay tax and to comply with the entire legal requirement related with tax. It is the statutory obligation of an assessee to estimate his tax liability, prepare tax returns and remit the same to the government in time as insisted by law. However, every tax payer try to reduce his tax burden as least as possible and at the same time the Government and the tax authorities are trying to increase tax remittance as much as possible. Tax payers adopt different method to reduce their tax burden.

A person can reduce his tax liability, fully utilizing the deduction, exemption, rebates and reliefallowed in the Act and Rules. Therefore reducing tax liability by availing the benefits of tax provisions, in a legally approved manner is called tax planning. Tax planning may be defined as “an arrangement or one’s financial affairs in such a way that without violating in any way the legal provision of an Act, full advantage is taken of all exemption, deduction, rebate and relief permitted under the Act, so that the burden of the taxation on an assessee, as far as possible the least”. In fact the provisions helpful for tax planning are inserted in the law with specific objective, leading to social and economic prosperity of the country. Tax holiday for newly started industrial undertakings in backward areas, deduction from total income for donation to relief funds, deduction for investment in National Saving Certificate, special deduction for handicapped assessees etc. are examples for provision in the Act helpful for tax planning. A person, who takes the advantages of the permissible deduction, rebates, etc. reduces his tax liability and at the same time helps in achieving the objective of the legislature also. In short, an assessee can lawfully reduce his taxburden by tax planning, instead of tax evasion or tax avoidance.

1.3. Concepts of Tax Planning

This part explains the important concepts of tax planning namely short range and long range tax planning, tax planning and tax laws, tax evasion and tax avoidance and tax management.

1.3.1. Short Range and Long Range Tax Planning

Tax planning may be classified into two broad heads: short range tax planning and long range tax planning Short range tax planning may be the same as year to year planning to achieve a specific or limited objective. For example, an employee whose income is likely to register an unusual growth in a particular year as compared to the preceding year, might plan to subscribe to the PPF/NSC within the prescribed limits in order to enjoy substantive tax relief By investing in such a way, he is not making permanent commitment but he is substantially making savings in the tax. Short term goals for each year should be identified and it should be consistent with the long term goals.

In the case of long range tax planning, each tax payer should identify and specific long term financial objectives. Long term goals must be flexible. Enough to adapt changes as well as strong enough to accommodate short term plans. The long range planning sometimes may not even confer immediate tax benefits. It aims at a long future period, the benefit of which may be spread over a number of years in future. For example, in case where an employee transfers certain shares to his minor son. The income arising from the shares will be clubbed with transferor's income under section 64 (IA) of the Act.

1.3.2.Tax Planning and Tax Laws

Tax planning involves in every case a thorough and up to date knowledge of tax laws. Tax lawsin India are highly complex and difficult to be understood by a common man. The complexity is further increased by frequent amendments made in the tax laws even year. Therefore it becomes necessary to have an up - to - date knowledge not only of the statutory law but also of the judge made laws in the form of various decisions of the Courts. One of the best methods to study tax planning is through the case law. The judgments of the Supreme Court and various High Courts reveal instances of successful and unsuccessful tax planning. The judgments touch up on various provisions of tax laws and their application to different situations. The question of interpretation of law can also have a bearing on the success or failure of tax planning. Moreover, a sound method of tax planning should be carefully planned after considering that whatever is done is not only strictly within the frame work of law, but is also in consonance with the legislative intentions and should be sensible to any reasonable person.

1.3.3.Tax Evasion and Tax Avoidance

Each tax payer is expected to make voluntarily disclosures of his income and tax liabilities through legal compliance. When a tax payer deliberately or consciously does not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as tax evasion. Tax evasion is considered as unethical and illegal. Tax avoidance, on the other hand, is a method of reducing tax liability by availing of certain loop holes and lacunae in the law. It is the art of escaping the burden of tax without breaking the law. However, this kind of tax planning demands a thorough knowledge of the provisions of the tax laws and relevant legal decisions as well as other statutes affecting any aspect of taxation. In this context, it is worth noting that taking advantageof the loopholes in law provides only short run benefits because, as and when the loopholes in the law are made public or sometimes even earlier, legislature steps into plug the loopholes.

In the earlier days, it was established in various courts both in India and abroad that tax avoidance is legally valid. It has been laid down in the case of Ramaswami Naicher vs. State of Madras (1968) 69 UR 420) that "it is open to the tax payer to avoid tax if he can do so within the limits of the law without violating it." In recent years, however, the courts have changed their attitude towards tax avoidance and view tax avoidance with displeasure. The Supreme Court of India in the McDowell Co Ltd. vs. CTO 154ITR 148 (SQ said that "it is neither fair notdesirable to expect the legislature to intervene and take care of every' device and scheme to avoid taxation, it is up to the court to determine the nature of new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices for what they really are and to refuse to give judicial benediction". In the same judgment. Supreme Court judges made a clear distinction between tax avoidance and tax planning - tax planning may belegitimate provided it is within the frame work of law. Colorable deuces cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges." It is clear from the above judgment that what constitutes a crime is tax evasion and what is undesirable is tax avoidance but it is certainly desirable to engage in the practice of tax planning. However, there is a thin line of demarcation between tax avoidance and tax evasion. Therefore, it is said that a successful tax evasion becomes legitimate avoidance, while unsuccessful avoidance may be treated as tax evasion.

1.3.4.Tax Management

Tax planning is a wider term and it includes tax management also. Tax management is an important aspect of tax planning- Planning which leads to filing of various returns in time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. It is an exercise by which defaults are avoided and legal compliance is secured. The filing of returns with all proper documentary evidence for the various claims, rebates, reliefs, deductions and computation of income and tax liability would come under the purview of tax management the assessee is exposed to certain unpleasant consequences if obligations cast under the tax laws are not duly discharged. Such consequences take shape of levy of interest, penalty, prosecutions, forfeiture of certain rights etc. Therefore any effort in tax planning is incomplete unless proper discharge of responsibilities is made. Tax management includes

- Compiling and preserving data and supporting documents evidencing transactions,claims etc.
- Making timely payment of taxes.
- IDS and TC S compliance.
- Following procedural requirements.
- Timely filing of returns.
- Responding to notices received from the authorities.
- Preserving record for the prescribed number of years.
- Mentioning PAN. TAN etc. at appropriate places.

1.4. Objectives of Tax Planning

- Claim Deductions under sections 80C to 80U,
- It will reduce your tax liability and you have to pay less tax,
- Minimize the war between Tax Payer and Tax Administrator, Tax payer wants to pay lesstax and Tax Administrator wants to extract most of the tax, by using Tax Planning this war is minimized as tax payer is using all legal ways to reduce tax liability,
- Makes Investment: - By tax planning, an Tax payer will invest his money in some good funds which will result in productive returns for tax payer and transfer money to government for investment too.
- Helps in growth of economy,
- Makes society grow,
- Money saved by you will result in investment which will result in employment generation.

1.5. Factors Affecting Tax Planning

1. **Residential status and citizenship of the assessee**: We know that a non-resident in India is notliable to pay income-tax on incomes which accrue or arise and are also received outside India,whereas a resident in India is liable to pay income-tax on such incomes. Therefore, every assessee would like to be a non-resident in India, if he has any income which accrues or arises outside India.
2. **Heads of income/assets to be included in computing net wealth:** Before the Tax-planner goes in for his task; he has to have a full picture of the sources of income of the tax payer and the members of his family. Though total income includes all income from whatever source derived,the scope of tax planning is not similar in respect of all sources of income. The assessee can avail the benefits of exemption and deductions under each head of income. Further he can avail the benefit of rebate and relief under the Act.
3. **Latest legal position:** It is the foremost duty of a tax-planner to keep him fully conversant with the latest position of the taxation laws along with the allied laws and also the judicial pronouncements in respect thereof. For this purpose he must have a thorough and up-to-date understanding of the annual Finance Acts, the Taxation Laws Amendments, the amendments,if any, of the allied laws, the latest judicial pronouncements of the High Courts and the Supreme Court, various Circulars of the Central Board of Direct Taxes which seek to clarify the legal position in so far as the Revenue is concerned.
4. **Form vs. Substance**: A tax planner has to bear in mind the following principles enunciated by the courts on the question whether form or substance of a transaction should prevail in Income-tax matters.

   (a) **Form of transaction:** When a transaction is arranged in one form known to law, it will attracttax liability while, if it is entered into another form which is equally lawful, it may not.

   (b) **Genuineness of transaction**: It is important to observe whether the transaction is a genuineor not. If in case it is not then in such a situation depiction of truth is needed and it is not the question of form and substance. It will be open to the authorities to pierce the corporate veil andlook behind the legal façade, at the reality of the transaction.

   (c) **Expenditure:** In the case of expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment.

1.6. Importance of Tax Planning

For Tax payer :-Tax payer has to pay less tax by using tax planning because he is using all available exemptions, deductions, reliefs, and rebates. All is done within the boundaries of Law.

For Government:-To use deduction or exemptions you have to invest money in some scheme which results that you money is transferred back to government and then they can use it to develop the country.

For Society :-If government invest or start any new project or even tax payer invest his saved money so he will generate employment, Government can invest in better projects which develops society.

1.7. Methods of Tax Planning

Various methods of Tax Planning may be classified as follows:

1. **Short Term Tax Planning:** Short range Tax Planning means the planning thought of and executed at the end of the income year to reduce taxable income in a legal way. Suppose, at the end of the income year, an assessee finds his taxes have been too highin comparison with last year and he intends to reduce it.
2. **Long Term Tax Planning**: Long range tax planning means a plan callled out at the beginning of the income year to be followed around the year. This type of planning does not help immediately as in the case of short range planning but is likely to help in the long run;
3. **Permissive Tax Planning:** Permissive Tax Planning means making plans which are permissible under different provisions of the law, such as planning of earning income coveredby Sec.10, especially by Sec. 10(1), planning of taking advantage of different incentives and deductions, planning for availing different tax concessions etc.
4. **Purposive Tax Planning**: It means making plans with specific purpose to ensure the availability of maximum benefits to the assessee through correct selection of investment, making suitable programme for replacement of assets, varying the residential status and diversifying business activities and income etc.

a. Tax Planning of Employees

In the matter of taxation of salaries, the law of income tax has recently been made comprehensive. Almost every type of salary, or remuneration of every kind of employee, government or private, is covered under it. Therefore, it becomes very important for an employee; however high or low placed he may be. to understand at least those fundamental principles of income - tax law which directly or indirectly affect him, before he is caught unaware in the net of taxation. Employees, next to the business community, constitute the biggest sector of income taxpaying public and contribute the most to the income tax in the country. Since income from salary has been accounted correctly and there is less or no scope for evasion, this class of tax payers is considered as die most honest in die records of Income Tax Department.

In view of this, tax planning is of great importance to every employee because it leaves the maximum possible amount of salary after payment of taxes with them. This could be achieved only by availing maximum amount of tax exemptions, deductions and relief. Therefore, tax planning is the scientific planning made by the employees to attract minimum liability to tax and or postponement of the tax liability for the subsequent period by availing of various incentives, concessions, allowances, rebates and relief provided, in the context of existing tax laws.

The Indian Income Tax Act allows for certain deductions which can be claimed to save tax atthe time of filing of income tax return by all classes of Taxpayers (i.e. Salaried Individuals, Professionals, businessman etc.). These deductions which help in saving tax are only availableif the taxpayer has done proper tax planning during the year. If an Individual has done proper Tax Planning to save tax, such deductions would be subtractedfrom the gross total income and income tax would be levied on the balance income as per the income tax slabs in force.

1. Save Tax under Section 80C, Section 80CCC, Section 80CCD

To promote the culture of savings and to direct the savings of the common man into the rightfulresources, the Govt allows certain deductions provided the amount saved is invested in the Instruments as specified in Section 80C, Section80CCC & Section 80CCD. The maximum combined deduction allowed under these 3 sections is Rs. 1,50, 000.

2. Save Tax under Section 80D, Section 80DD, Section 80DDB

The Income Tax Act also allows for deductions to save tax if the expenditure has been made by the taxpayer for insuring his own health or the health of his relatives. Different amount of deductions are allowed under each of these sections which help in tax saving depending on thetype of Insurance Policy.

3. Tax Planning through Home Loan

If you have taken a Home Loan, you are allowed to claim deduction for repayment of principalamount of home loan u/s 80C. Moreover, you are also allowed to claim deduction of interest paid on home loan under section 24. The maximum deduction allowed in some cases is Rs. 2,00,000 and in some cases there is no maximum limit of claiming this deduction for paymentof interest on home loan.

4. Save Tax through Education Loan u/s 80E

If a taxpayer has taken an education loan for the higher education of himself or spouse or children or the student of whom he is the legal guardian, he can claim deduction under Section80E and save taxes. This deduction is only allowed for the repayment of interest and not for the repayment of principal amount of education loan.

5. Tax Planning of Long Term Capital Gains

If any Long Term Capital Gain is arising to a taxpayer from the sale of any Long Term CapitalAsset, he can claim exemption from paying such Capital Gain Tax if he invests the amount of gain from sale of property in specified instruments. Any Asset is considered as a Long Term Capital Asset if that asset was held by the taxpayer for more than 3 years. This Exemption is considered very beneficial while doing the Tax Planning to save income tax of a taxpayer.

6. Income Tax Deductions for Donations u/s 80G

If a taxpayer makes a donation for charity, social or philanthropic purpose or makes a contribution towards National Relief Fund, then this donation can be claimed as a deduction u/s80G of the Income Tax Act. In some cases, 100% of the donation made is allowed to be claimed as a deduction whereas incertain cases only 50% of the donation made is allowed to be claimed as a deduction for the purpose of saving taxes.

b. Investment

Investment is the employment of funds with the aim of achieving additional income or growthin value. The essential quality of an investment is that, it involves "waiting" for a reward. It involves the commitment of resources which have been saved or put away from current consumption in the hope that some benefit will accrue in future. The term investment does not appear to be a simple as it has been defined. Investment has been categorized by financial experts and economists. It has also often been confused with the term speculation.

Investment is the allocation of monetary resources to assets that are expected to yield some gain or positive return over a period of time. The assets range from safe investment to risky investments. Investment in these forms are also called "financial investment". From the point of view of people who invest their funds, they are the suppliers of "capital" and in their view investment is the commitment of a person's fund to derive future income in the form of interest., dividend, rent, premium, pension benefits, or the appreciation of the value of their principal capital. To the financial investor, it is not important whether money is invested for a productive use or for the purchase of second hand instruments such as existing shares and stock exchange. Most investments are considered to be transfers of financial asset from one person to another.

Investment involves selection of the right kind of instrument/ schemes with the objective of maximizing returns on investments. The instruments carrying higher risk usually yield higher returns on investments. The instruments carrying higher risk usually yield higher returns but they may not yield any returns or many even results in loss. The decision regarding the type ofinstrument/ investments depends up on the risk taking capabilities of individuals. As the risk taking capability vary from person to person according to their risk taking nature, age, family and other responsibilities or obligations, availability of surplus funds for investments etc., the choice of investment instruments will vary from individual to individual.

Tax Planning involves making investments with the objective of minimizing the tax liability and maximizing returns. Everyone should try to do tax planning to maximize his income by saving on taxes.The amount of tax to be paid is related to the sources of income viz. income from salary, income from business, income from house property, interest income, income from dividends etc. and the amount and type of investments made. The income from different sources is taxeddifferently. There are provisions exemption of certain incomes, deductions from aggregate income and from the tax computed on total income. The deductions/exemptions are available on different tax saving instruments/schemes are also different. Therefore, tax planning will involve. Maximize Tax Savings following investment schemes are available:

1. **NSC (National Saving Certificate)**

National saving scheme have been started by the government of India mainly to finance its economic development plans through the mobilization of savings of smaller income groups. This scheme is operated mainly through the post offices. Because of the tax free nature of the scheme, its main purpose is to attract higher income group of people also.

2. **Post Office Deposits Schemes**

Post Office Schemes are generally like the commercial banks schemes. They have s saving account, ten year cumulative time deposit accounts which are also recurring in nature. The saving accounts operate in the same way as commercial banks through cheque and there is no restriction on withdrawals.

3. **Public Provident Fund Scheme**

Public Provident Fund (PPF) is a savings-cum-tax-saving instrument in India. It also serves as a retirement-planning tool for many of those who do not have any structured pension plan covering them. The account can be opened in designated post offices, State Bank of India branches and branches of some nationalized banks. ICICI Bank was the first private sector bank which was authorized to open PPF accounts

4. Mutual Funds as a Tax Saving Option

Investments in tax-saving mutual funds, also known as equity-linked savings scheme (ELSS),qualify for tax benefits. Tax-saving mutual funds invest in stock markets, among other assets,and are more suited for investors with medium to high risk appetite. Investments are locked in for three years. Investments towards tax-saving mutual funds are covered under Section 80C of the Income Tax Act up to a maximum of Rs 1.5 lakh. Proceeds on death / maturity are tax-free under Section 10(D).

5. Life Insurance as a Tax Saving Option

Life insurance is a contract between a person and an insurance company for a number of yearscovering either the life time period or a fixed number of years. In India, life is protected by a monolithic institution called the Life Insurance Corporation of India. Life insurance is called an investment. Life insurance plays an important role in the individual's financial portfolio offering security tothe individuals family in case of an eventuality. This makes it the breadwinner's primary responsibility to take life insurance at the earliest for the family's security.

6. Health Insurance as a Tax Saving Option

Health insurance or Mediclaim as it is more popularly known, covers expenses incurred from an accident/hospitalization. Mediclaim also covers pre and post hospitalization expenses,subject to the sum assured. Health insurance offers tax benefits under Section 80D.

7. NPS (New Pension Scheme)

The NPS or the New Pension Scheme is regulated by the Pension Funds Regulatory and Development Authority – PFRDA. Any citizen of India over the 18 – 60 years age bracket can participate in it. It is extremely cost effective since fund management charges are low. The fund managers manage the money in three separate accounts having distinct asset profiles viz. Equity (E), Corporate bonds (C) and Government securities (G). Investors can choose to manage their portfolio actively (active choice) or passively (auto choice). Contributions made to the NPS are covered under Section 80CCD of the Income Tax Act.

8. Bank Deposit

Tax saving fixed deposit gives you fixed return as well as benefit of tax savings. It is one of the five most popular tax saving option. Maturity period of a tax saving fixed deposit is 5 years. Get tax deduction up to Rs.150000. Deduction is available to individual u/s 80. Interest earning from tax saving fixed deposit is taxable. If your total income plus interest of fixed deposit is below the tax free limit, you need not to pay any tax. The return in tax saving fixed deposit may be greater than any other tax saving investments.

Tax-saving is an important part of financial planning. An intelligent tax-planning strategy canserve the dual objective of helping individuals meet their financial goals and save tax in the process.

1.8. Conclusion

Careful planning throughout the year can assist tax payer in reducing the taxes they pay – as well as help them to achieve their financial goals. Tax planning should not be done in isolation,but instead should be driven by the tax payer's overall financial goals and integrated with their total financial plan. By developing and implementing appropriate strategies to shift current andfuture tax liabilities, they can improve their prospects of meeting long-term and short-term objectives. For example, accurately projecting their income taxes they help them to determine the cash flow available to them in the coming year. Keep in mind that tax laws are often complex and frequently change. As a consequence, they should consult their tax advisor before making investment and tax decisions

Tax planning has a wider philosophy and is closely associated with the individual assessees earnings and their propensity to save. The gap between the savings and if that savings can relieve one from tax, the tax planning is effective. The whole process relates to viewing the Income Tax Act in terms of revenue for the Government and their disposable income for the assessors we want a rationalized, simplified operational tax system where an assessee is assessed but not feel exploited.

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