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TAXPAYER'S LEGAL OPTION FOR TAX MITIGATION AND PLANNING

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Abstract: It is the duty of every Indian citizen to pay taxes here. Based on their unique income, they must pay income tax. Additional taxes, such as export tax, sales tax, excise tax, etc., must be paid before, during, or after the production, purchase or export of products. These taxes are used for development and welfare objectives. Due to the current economic climate, taxpayers must pay higher tax rates. There are therefore many legitimate strategies to lower the tax payment. This comprises tax breaks, incentives, deductions, and other provisions that reduce tax obligations. It is referred to as tax planning in legalese. India has legalized tax planning. There are several provisions which were stated under Income Tax act 1961. Tax planning is entirely legal and, in fact, a wise choice when done within the boundaries established by the relevant authorities. The government provides a variety of tax-saving alternatives with the goal of lowering tax burdens on taxpayers through ethical income tax planning strategies. The author discusses tax mitigation and planning techniques that is provided under various legal framework in India. The primary idea of the paper is to study the tax payer's right to plan and mitigate his tax payment under available legitimate ways by literature review.

Keywords: Tax planning, deductions, exemptions, tax liability

I. Background of the study

In general, centuries of taxation, colonial rule, and economic changes have influenced the historical setting of tax reduction in India. It is still an essential part of financial planning, but in order to guarantee that taxpayers legitimately reduce their tax payments, it must be carried out in accordance with India's changing tax rules and regulations. Key factors in modern tax minimization in India include speaking with tax experts and keeping up with legislative developments.

In India, taxes have a lengthy history that dates back to antiquity. There were other types of taxes levied, such as agricultural levies, trade taxes, and land revenue. There are allusions to tax collecting and revenue administration in ancient India in books like the Arthashastra.

India first experienced the establishment of a regular tax system during British colonial administration. There were levies levied, including excise fees, land revenue, and salt taxes. During this time, arguments over land assessments and tax rates with the colonial government frequently constituted tax mitigation methods. Following its 1947 declaration of independence, India kept improving its tax structure. The fundamental law controlling income tax in India is the Income Tax Act of 1961. With the complexity of the tax system, the idea of tax mitigation—within legal bounds—became increasingly important.

India started economic reforms in 1991 in an effort to liberalise its economy. As a result, taxes were altered, with lower tax rates and the implementation of measures to draw in foreign investment. The introduction of the Goods and Services Tax (GST) in 2017 marked a significant shift in India's indirect taxation system, replacing a complex web of state and central taxes. GST brought its own set of challenges and opportunities for tax mitigation as businesses needed to adapt to the new system. Tax mitigation in India continues to be a relevant aspect of financial planning for individuals and businesses.

The government periodically amends the tax code and introduces measures to curb tax evasion and aggressive tax avoidance. There were also few landmark judgements that stresses tax payers on tax planning.

Azadi Bachao Andolan v. Union of India (2003)[1]: This case dealt with the issue of tax avoidance through double taxation avoidance agreements (DTAA). The Supreme Court clarified that tax avoidance is legal, but tax evasion is not. It held that if a taxpayer follows a specific DTAA to avoid double taxation, it is a legitimate form of tax planning.

Vodafone International Holdings B.V. v. Union of India (2012)[2]: This case is significant in the context of international taxation and indirect transfer of Indian assets. The Supreme Court ruled that the Indian tax authorities did not have jurisdiction to tax the offshore transfer of shares of a foreign company, thereby supporting tax planning for foreign investments in India.

In the case of M.V. Valliappan and others v. ITO[3], the Madras High Court correctly determined that the McDowell decision could not be interpreted as mandating that every attempt at tax planning be disregarded or that any legally permissible transaction or arrangement that lessens the assessee's tax burden be viewed negatively.

II. Scope and objective of the study

The legal theory that permits taxpayers to structure their financial affairs in a way that lowers their tax burden, provided that they do so within the bounds of the law, forms the basis of the extent of a taxpayer's right to tax planning, sometimes referred to as tax optimisation or tax minimization. It is permissible for taxpayers to participate in legal tax planning actions, such as using applicable credits, exemptions, deductions, and incentives.

They have the option to use tax-advantaged accounts, capital gains management, and other tax-efficient strategies to organise their financial activities and assets. Ensuring that tax planning adheres to relevant tax rules and regulations is crucial. Tax evasion and illegal tax avoidance are prohibited acts for taxpayers.

The legal practise of lowering one's tax burden by following the tax rules and making wise financial decisions is known as tax avoidance. Tax evasion is the criminal practise of hiding or falsifying income in order to avoid paying taxes. Evading taxes is a criminal act. Ethical and moral considerations may also be made by taxpayers while tax planning. Even if certain actions may be lawful in theory, they may provide moral dilemmas about justice and corporate social responsibility. Tax authorities have the authority to examine tax planning activities and audit tax returns. Authorities have the right to contest tax planning techniques if they think they violate the law.

III. Tax mitigation strategies

Sales of commodities are frequently conducted in low-tax nations, as demonstrated by Google's "Double Irish Dutch sandwich" business model. Tax treaties between nations are also utilised to reduce tax obligations. For example, Google established a subsidiary in the Netherlands in order to avoid paying withholding tax. While they may comply with the letter of the law, subsidiaries that serve as the foundation for tax mitigation schemes are occasionally denounced as "colorable devices" and are said to violate the fundamental principles of the legal system. Many legal rulings have distinguished between tax mitigation and tax evasion and have addressed whether tax mitigation techniques, even when they adhere to the text of the law, can be considered

[1] (2003) 263 ITR 706

[2] (2012) 6 SCC 613

[3] 170 ITR 238

unlawful. The House of Lords distinguished between tax avoidance and tax reduction strategies in the IRC v. Willoughby[4] case. The pertinent section is as follows: " One was to distinguish between tax mitigation and tax avoidance. The distinguishing feature of tax avoidance is that the taxpayer lowers his tax bill without experiencing the negative economic effects that Parliament intends for every taxpayer who meets the requirements to do so. The hallmark of tax mitigation, however, is when the taxpayer utilises a financially advantageous alternative provided by the tax legislation and really experiences the negative economic effects that the legislature intended for those who exercised their choice. Tax avoidance must be at least one of the taxpayer's goals if the analysis reveals that the taxpayer's selected strategy involves tax avoidance (as opposed to tax mitigation) in adopting that course whether or not the taxpayer has formed the subjective motive of avoiding tax."

In a different case, the Hon'ble Madras High Court observed that the assesse had given the entire investment—which represented the cumulative income for the pertinent prior years—to a newly established charitable trust known as the "M Ct. Muthiah Chettiar Foundation" with the goal of allocating it to particular charitable causes. By submitting the necessary paperwork and earning revenue during a ten-year period, the assesse-trust accepted the tax mitigation plan, allowing the assesse to enjoy complete tax independence throughout that time[5].

A five-judge panel of the Indian Supreme Court ruled in McDowell & Company Limited v. The Commercial Tax Officer[6] that tax planning is lawful as long as it stays within legal bounds, that colorable devices cannot be included in tax planning, and that it is immoral to promote or entertain the idea that it is honourable to use questionable means to evade paying taxes. Every citizen has a duty to pay taxes in a truthful manner without using any deception.

These tax planning techniques have become more popular as a means for multinational corporations to lower their tax obligations. Businesses that use specific corporate structures frequently avoid paying a significant amount of taxes that would otherwise be owed to them. owing to the growing popularity of these company structures and tax planning techniques, which, although following the letter of the law, ultimately result in significant tax evasion, which is contrary to the overall intent of the legislation. Many businesses have used similar arrangements to lower their tax payments as a result of these tactics' attractiveness to multinational enterprises.

IV. Legal options for tax mitigation and planning

In order to lawfully lower their tax liability, both individuals and corporations should consider tax reduction and tax planning. It's crucial to remember that, even while lowering taxes is a shared objective, it should never be achieved at the expense of the law. The following are some legal choices for tax planning and mitigation:

Tax-Advantageous Investments: Use tax-advantaged accounts to postpone or avoid paying taxes on contributions and gains, such as 401(k)s, IRAs, and HSAs. Invest in tax-efficient assets or funds, such as lower-dividend equities, index funds, or exchange-traded funds (ETFs).

Divided income: Businesses should think about dividing profits among partners or family members in a way that complies with tax laws.

Capital profits and Losses: To lower net taxable profits, balance capital gains and losses. In investing portfolio, consider the tax-efficient techniques such as tax-loss harvesting.

Contributions to Charitable Organisations: Make donations to approved charities and get tax deductions for contributions made. To avoid paying capital gains tax, consider giving valued assets.

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[4] IRC v. Willoughby, (1997) 4 All ER 65

[5] Commissioner Of Income-Tax vs. M. Ct. Muthiah Chettiar Family, 2000 245 ITR 400 Mad https://indiankanoon.org/doc/1711034/

[6] McDowell & Company Limited vs. The Commercial Tax Officer, 1986 AIR 649

Retirement Planning: Contribute as much as possible to retirement funds to lower taxable income. To limit future tax obligation, think about backdoor Roth IRAs or Roth conversions.

Estate Planning: Use strategies such as trust creation, giving, and use the statutory estate tax exclusion amount to minimise estate taxes. Recognise the exemptions and legislation pertaining to estate taxes in corresponding area.

Organisational Structure: To maximise tax status, select the appropriate business form (such as an LLC, sole proprietorship, S-corporation, or C-corporation). Look at ways to categorise income as dividends or capital gains where it makes sense.

Tax Credits for Environmental Projects: Benefit from tax credits when you install solar panels or energy-efficient equipment in house or place of business.

Global Tax Preparation: To minimise tax liabilities, companies that operate internationally should use global tax and transfer pricing techniques. Respect the rules for overseas reporting, such as the overseas Account Tax Compliance Act (FATCA) and the Foreign Bank Account Reports (FBAR).

Deduction available under **Section 80C** of Income Tax act 1961, Investment shall be made in Equity Linked Saving Schemes, PPF/SPF/RPF, payments made towards Life Insurance Premiums, principal sum of a home loan, SSY, NSC, SCSS, etc and the maximum deduction can be availed is Rs. 1,50,000.

For example, if a person invests 1.5 lakhs in the notified schemes and their annual income is 6.5 lakhs, they can reduce their taxable income to 5 lakhs and, as a result, their tax liability will be zero. This is because a person with taxable income up to Rs 5 L is eligible for a rebate of Rs 12,500 under section 87A. After then, the funds may be used wisely. You may secure your total financial stability by preparing your taxes with just a basic income assessment and knowledge of fundamental tax laws.

Under **Section 80CCC** of Income Tax act 1961, Payment shall be made towards pension funds and upto Rs.1,50,000 can be claimed as exemption.

Under **Section 80CCD(1B)** of Income Tax act 1961, Investment shall be made in NPS and that shall be claimed as deduction upto Rs.50,000.

Under **Section 80CCD (2)** of Income Tax Act 1961, Employer's contribution towards NPS shall be claimed as deduction.

Under **Section 80TTA** of Income Tax act 1961, Interest on savings account. Upto Rs. 10,000.

Under **Section 80GG** of Income Tax act 1961, Income tax deduction on House rent paid. Condition to claim such deduction is that taxpayer must be an individual, he must be living on rent and paying rent. He should not have self-occupied residential property in any other place.

Under **Section 80E** of Income Tax act 1961, A person may be able to deduct interest from loans for education taken out in order to pursue higher education. The taxpayer, their spouse, their children, or a student for whom they have legal guardianship may take out an education loan.

Under **Section 80DD** of Income Tax act 1961, Deduction for Medical Treatment of Dependent with Disability. A resident individual or a HUF may claim this deduction.

Maxopp Investment Ltd. v. CIT (2018): This case is significant for tax planning related to capital gains tax. The Delhi High Court ruled that the benefit of grandfathering provisions should be allowed to taxpayers when calculating capital gains tax under the Securities Transaction Tax regime.

4.1 Deductions allowed for different heads of Income

It has been shown that tax preparation is an essential part of financial management for salaried Indians. For salaried individuals, tax exemptions and deductions for life insurance premiums, medical expenses, and mortgage interest are the most popular ways to reduce their taxes. It also found that participating in tax-saving options like equity-linked savings plans and public provident funds is one of the most popular ways for participants to prepare their taxes. It illustrates how crucial it is to understand the many tax planning choices available to Indian salaried individuals and to make good use of them in order to lower their tax liability and boost their savings. It highlights how important it is for those who are paid to understand tax rules and regulations and make use of their tax-saving options[7]. According to the research, progressive tax policies are essential for effectively addressing the issues faced by those in paid employment. It notes that the Indian tax system has experienced significant changes recently with the introduction of new tax-saving instruments and revisions to the tax laws. For example, the Direct Tax Code and the Goods and Services Tax (GST) have drastically changed the tax system. The analysis indicates that salaried individuals stand to gain by staying current with these developments and utilising opportunities for tax savings to reduce their tax liabilities[8]. Researchers found that people's average savings are positively impacted by age, marital status, number of children, and education level. The results show that higher earners—as well as those who are older, married, have children, and possess greater levels of education—also tend to save more money. Financial planners should be aware of these results since they may utilise them to identify the target markets for their investment and savings plans, after which they can adjust their advice.

Deduction under **Section 16**: With effect from the 2019–20 fiscal year, taxpayers are eligible to deduct a standard amount of Rs. 50,000 from their salary income, or the actual amount of income, whichever is lower, under section 16.

Included first in the gross compensation calculation is the amusement allowance. Section 16(ii) thus permits a standard deduction. Governy personnel are permitted to do so.

Professional taxes on occupations, trades, callings, and professions may be collected by State and Local Governments. According to Section 16, the total professional tax collected does not exceed Rs. 2,500 annually.

Deduction under **Section 24**: The yearly sums paid to the local municipal corporation are known as municipal taxes. To get the Net Annual Value of a housing property, the Gross Annual Value must be subtracted from municipal taxes. Consequently, only if the property owner makes a payment within that fiscal year may municipal taxes be subtracted.

Standard Deduction under **Section 24A**: The Net Annual Value of the property is subject to a standard deduction rate of 30%. It is acceptable regardless of how much more or less was actually spent on the property.

- If assessee is an homeowner and he live in his own home, he is eligible to deduct up to INR 2 lakh off the interest on his home loan.
- In the event that the loan is taken out on or after April 1, 1999, and paid back

Expenses allowed as deduction under **Section 36**:

- Payment of insurance premiums
- Employee commissions or bonuses
- Interest paid on borrowed funds
- donation to an established provident fund
- National Pension Fund (NPS) contribution
- donation to the authorized gratuity fund
- Contribution to employee welfare programs
- Compensation for the use of deceased animals in commerce

[7] Bansal and Verma (2017)

[8] Gupta's 2009 book, The Trends and Responsiveness of Personal Income Tax in India

- Bad debts cancelled
- Allowance for bad debts in the event that banks or other financial organizations fail.
- costs associated with encouraging family planning among staff members etc.

Deductions under **Section 57**:

The following deductions are deducted before calculating the income subject to tax under this heading, "Income from Other Sources":

1. Any fair amount given as commission or compensation in the event of dividend income (including interest on securities) with the intention of realizing dividends or interest.

2. In the event that the income is a family pension:

- 15,000 rupees or
- 33 1/3% (33.33%) of that amount,
- whatever is less.

3. Regarding revenue from the rental of furniture, plants, or machinery:

- building repairs [section 30(a)(ii)]

1. current insurance premiums, plant, and machinery maintenance [section 31]
2. depreciation on furniture, plants, machines, or buildings [section 32]and
3. unabsorbed loss

4. Any additional expenses that are not capital

4.2 Exemptions allowed under Section 10 of Income Tax act 1961

Section 10 (13A) of Income Tax Act

The Income Tax Act's Section 10(13A) addresses house rent allowance (HRA). Taxes do not apply to the portion of earnings that assessee receive to pay for housing costs and house rent. On the other hand, Section 10 (13A) Rule 2A lists a few exclusions. The following minimum quantities qualify for the exemption:

- For individuals residing in Delhi, Mumbai, Chennai, or Kolkata, Actual HRA got 50% of [basic salary + DA], or 40% of [basic income + DA] for those residing in other cities.
- Real rent received (-) 10% of base pay plus DA

Section 10 (5) of Income Tax Act

The employee's domestic travel expenses (airfare, train or bus fare) are the only ones covered by the LTA exemption. Additional costs include lodging, meals, sightseeing, and local transportation; these are not included. Furthermore, the exemption is only applicable to LTA that employer has included in CTC.

Section 10 (26) of Income Tax Act

This section grants tax exemptions to Scheduled Tribe members in Tripura, Nagaland, Mizoram, Manipur, and Arunachal Pradesh.

Section 10 (14) (I) of Income Tax act

Assessee is exempt from paying certain expenses in this section if they are related to the business of employer. It also covers travel, transportation, stipend for research, and other things.

Section 10 (11) of Income Tax Act

Assessee is exempt from paying interest on a provident fund upon retirement or resignation under this section. Additionally, it covers any payments make using a Sukanya Samriddhi Account.

Section 10 (34) of Income Tax Act

Exemptions from the dividends may get when assessee invest in Indian companies are detailed in this section. Nevertheless, this exemption is only available up to Rs. 10,000; any amount above that will required to pay tax.

Section 10 (26AAA) of Income Tax Act

If assessee is a Sikkimese person who earns money in Sikkim or through dividends or interest on securities, he is exempted from paying taxes on this portion of income under Section 10 (26AAA).

Section 10 (38) of Income Tax Act

Gains on the sale of equity shares in a mutual fund focused on equity are considered long-term capital gains and are not subject to income tax calculations. The Securities Transaction Tax, however, needs to be paid.

Section 10 (23C) of Income Tax Act

Section 10 (23C) of the Income Tax Act exempts educational and medical establishments with yearly gross receipts of no more than Rs. 5 crore.

Section 10 (37) of Income Tax Act

Exemptions from capital gains resulting from the forced purchase of urban agricultural land are offered by this section.

Section 10 (10A) of Income Tax Act

This section exempts government employees from paying taxes on the money they receive from accumulated pensions.

Section 10 (10D) Of Income Tax Act

Assessee is exempt from paying taxes on income from bonuses or life insurance policies under this section.

Section 10 (35) Of Income Tax Act

Any proceeds from the sale of certain units of mutual funds

Sections 10(11) and 10(12) of Income Tax act

GPF exemption is exempt a GPF balance of Rs. 2.5 lakh from taxation.

Section 10(14) of Income tax act

The internet allowance that employer provides is not taxable under Section 10(14).

Food allowance exemption under Section 10 (14) Assuming two meals a day and 22 working days per month, the food allowance provided by your employer is also exempt from taxes up to Rs. 26,400 per year. And so on.

V. Limitation

The current tax rules and regulations of the jurisdiction in which the taxpayer conducts business must always be complied with while preparing taxes. Tax planning does not refer to any unlawful conduct; rather, it refers to tax evasion, which is prohibited. GAAR has been enacted in several nations to discourage sophisticated tax evasion tactics. Under GAAR, tax authorities can ignore transactions or arrangements that are solely intended to benefit the taxpayer and have no business substance. Tax authorities may also have unique anti-avoidance legislation, such as those controlling offshore tax shelters or transfer pricing laws, that target certain kinds of transactions or behaviours in addition to GAAR.

It is frequently the case that taxpayers must include precise and comprehensive information in their tax forms. Penalties may apply if certain transactions or assets are not disclosed. The economic substance theory, which mandates that a transaction or business arrangement have a valid business purpose beyond merely tax benefits, is applied in some jurisdictions. Tax authorities have the right to contest transactions that don't have any economic merit. If a person violates tax regulations or underreports their income, tax authorities have the authority to apply fines and interest. The sustainability of current tax planning tactics may be impacted by changes in tax rules. Taxpayers need to adjust their plans to account for the new restrictions.

VI. Conclusion

Taxpayers have the right to employ various tax planning strategies to legally reduce their tax burden. However, adherence to the tax laws and regulations of their jurisdiction is non-negotiable. Engaging in illegal tax evasion or aggressive tax avoidance is not only unethical but also subject to legal repercussions. Given the complexity and ever-changing nature of tax laws, consulting with tax professionals, such as Certified Public Accountants (CPAs) and tax attorneys, is advisable. These experts help tailor tax planning strategies to individual circumstances and ensure compliance with current regulations. Tax mitigation and planning encompass a wide array of strategies, from utilizing tax-advantaged accounts and investment vehicles to making the most of tax credits and deductions. Additionally, income splitting, charitable contributions, and estate planning can all play a role in reducing tax liability. In summary, tax mitigation and planning offer a means to minimize tax liability in a lawful manner, but they require careful consideration, professional guidance, and a commitment to ethical conduct. Taxpayers should be proactive in seeking legitimate avenues for tax optimization while always being mindful of their obligations to remain in compliance with the tax laws of their jurisdiction. Ultimately, the prudent management of one's tax affairs can contribute to financial stability and long-term success.