Tax Planning Options

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There is this great quote by Benjamin Franklin, "There are only two things certain in life: death and taxes!!" As on date, we do not have any control on the former; but we definitely can exercise some control on the later. We shall study the options available to salaried persons for planning their finances to ensure minimum tax outgo.

Tax Evasion, Tax Avoidance and Tax Planning

The methods adopted to exercise control on the tax liability can be broadly put into three categories: Tax Evasion, Tax Avoidance and Tax Planning. The difference between these three methods some times becomes blurred owing to the perception of the tax authorities and / or taxpayer. However, one must try to understand the difference so that one does not do anything illegal.

Tax Evasion

Tax evasion involves breaking the law, not paying one's taxes when the law clearly mandates that they must be paid. The term Tax Evasion is generally used to mean illegal arrangements where liability to tax is hidden or ignored i.e. the taxpayer pays less than he is legally obligated to pay, by hiding income or information from tax authority. Thus, the tax liability is reduced by "illegal and fraudulent" means. This is a method by which a person reduces his tax liability by either deflating the income or by inflating the expenses. Both deflating the income and inflating the expenses have the same effect; the income gets reduced and tax liability is accordingly reduced. A very simple example of tax evasion is related to house rent received. Rent received, whether in cash or by cheque is taxable income. Many taxpayers take certain amount of rent in cash and do not pay tax on it. Another example is of interest received from Banks. Since banks deduct tax on the interest paid, one thinks that it is not required to be shown to tax authorities. But banks deduct tax @10% whereas the liability of the taxpayer may be more that that. Many taxpayers take the deduction of house loan interest as and when they pay the interest (even before taking possession of the house) and again claim the deduction of interest paid prior to possession after the possession is taken. All such practices are clearly illegal and must NEVER be resorted to.

Tax Avoidance

Tax Avoidance refers to the legal means so as to avoid or reduce tax liability, which would be otherwise incurred, by taking advantage of some provision or lack of provision in the law. Here the arrangement will be legal, but may not be as per intent of the law.

Taxpayer does not hide the key facts but is still able to avoid or reduce tax liability on account of some loophole or other, existing in the law. Tax avoidance basically means making use of the loopholes in the tax law to one's own advantage to reduce the tax burden. Although tax avoidance is strictly not illegal, it is NOT ADVISABLE because the taxpayer has defeated the intention of law maker and used this to his own advantage.

Another reason for 'avoiding tax avoidance' is that the lawmakers in India are permitted by the Constitution to make amendments to tax laws retrospectively (and to plug the existing loopholes). A very famous (or notorious?) example is of Vodafone case. Vodafone Group plc, a UK based company purchased CGP Investments Holding Limited, a Cayman Islands based company in Cayman Islands. CGP Investments Holding Limited held 2/3rd shares of Hutchison Essar Ltd. (HEL), an Indian Company and CGP Investments Holding Limited itself was a subsidiary company of Hutchison Telecommunication International Limited (Hutch), a Hong Kong based company. There were capital gains to Hutch, and Vodafone should have deducted appropriate tax on such capital gains. There exists section 195 in the Income Tax Act, 1961, about deduction of tax from payment of any sum chargeable to tax in India, when such payments are made to a non resident or to a foreign company. Accordingly, a notice was sent to Vodafone to pay tax of approximately Rs. 12,500 /- crores which they had failed to deduct. This was a clear cut case of tax avoidance as per Indian revenue authorities. After a long legal battle, the Supreme Court gave decision against the Union of India. The legislature changed the law retrospectively with effect from 1.4.1962 in the year 2012, to include an explanation that made the section applicable to all resident and non resident taxpayers, whether they had a place of residence / business in India or not.

Tax Planning

Tax Planning is defined as "an arrangement of a person's business and / or private affairs in order to minimize the tax liability".

We tend to think that tax planning has to do with saving of tax by making proper investments. Obviously, 'Tax Saving' is a major part of tax planning. But it is not all. Tax planning includes planning of income, planning of expenditure, planning of investments and tax management over a period of time. Tax Management simply means following proper schedule of tax payment and of other legal requirements related to tax, so that one does not have to pay heavy interest or late fee or penalty for not following correct procedures. There is a famous adage, "Law is not what law is, law is where to find law." It means that law is there. It is enacted and exists in the law books. But one must know exactly what provision is applicable to what situation, how to apply it and how to present it. This application of law is very important part of tax management.

Methods of Tax Planning

Various methods of Tax Planning may be classified as follows :

1. **Short Range Tax Planning:** Short range Tax Planning means the planning

thought of and executed for not more than one year to reduce taxable income in a legal way. *Example: Suppose, at the end of the income year, a taxpayer finds his taxes have been too high and his investments have been inadequate. He may reduce the tax liability to a great extent by making proper arrangements to get the maximum tax rebate u/s 80C. Such plan does not involve long term commitment, yet it results in substantial tax savings.*

2. **Long Range Tax Planning** : Long range tax planning means a plan chalked out to cover a period of more than a year. This type of planning may or may not help immediately as in the case of short range planning, but is likely to help in the long run. *Example: If a taxpayer transferred shares held by him to his minor son or spouse, though the income from such transferred shares is clubbed with his income, yet if that income is invested by the son or spouse, then the income from such investment will be treated as income of the son or spouse. Moreover, if the company issues any bonus shares for the shares transferred, that will also be treated as income in the hands of the son or spouse.*

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 covered by Section 10 with a view to reinvest the same. *Example: Reducing the investment in provident fund to invest that money in Rajiv Gandhi Equity Saving Scheme by an eligible person.*

4. **Purposive Tax Planning** : It means making plans with specific purpose to ensure the availability of maximum benefits to the taxpayer. *Example: Planning of reinvestment of long term capital gains arising from sale of property by investment in house property.*

Tax planning as a Financial Planning Exercise

It is important to change one's perspective towards tax planning. Most of us rarely think about tax planning from an investment point of view. If we ask ourselves, whether we really looked into the nature or type of the investment that we made for tax savings in detail? Does it fit well with our overall financial goals? More often than not, the answer is likely to be No. This is mainly because we tend to not invest sufficient time and thought in the tax planning exercise. To further worsen the matters, we tend to procrastinate and wait until the last minute. Subsequently, investment decisions are made in a rush.

On the other hand, if we invest time and effort in this exercise, it can go a long way in helping us achieve our financial goals. Tax planning investments are no different from conventional investments. Hence, it is imperative that we have an in-depth understanding of all investment avenues available which offer tax benefits. Subsequently, we can choose the ones that are suited for us and can help us achieve our goals as well. A systematic tax planning exercise will ensure disciplined and well informed investment decisions.

It is important for any investor to not invest blindly for the purpose of tax saving but also to look into the investment avenues thoroughly and check whether they fit in their investment strategy and match their risk appetite. For example, an investor who has to meet a financial commitment in the next three years, entirely investing in PPF would not be advisable as it has a lock in of 15 years. Instead, he should invest in liquid mutual funds or fixed deposits. Thus, choosing the right avenue becomes the most crucial step in your entire tax planning exercise. Presently, there are quite a few investment options available for the purpose of tax saving.

Tax Saving Opportunities through Family Members

If we plan our income and investments to be distributed among the family members, we can do substantial amount of tax saving by lawful means. We need to invest in way that our tax burden shifts to our family members and we can take the benefit of Income Tax Slabs. Saving tax through family results, not only in tax saving but also in higher returns on our investments.

Through Parents

We can save tax through our parents as well as through our Parent in-laws. To achieve this goal we need to give away a portion of our funds, either as a gift or a loan, to our parents as well as our parents in law, so that, our income tax burden becomes lighter in future as the income on funds transferred to them would bring in income taxable in their hands.

Gift to Parents: Income tax law allows senior citizens a tax-free income of Rs 2.5 lakh. Say we give a gift Rs 15 lakh to each parent in cash. Both parents can individually put this amount in Senior Citizens Savings Scheme. The Senior Citizen's Savings Scheme offers an attractive interest of 9.25% per annum. But the income is taxable and the investor must be over 55 years. Each parent will get yearly interest of nearly Rs 1.4 lakh. This will be totally tax free. They need not even file the tax returns since their income is below taxable limit. Similar planning can be done for parents in laws.

Pay them Rent if you Live in Their House: If we live in our parents' house, we can pay them rent and claim House Rent Allowance exemption. This is possible only if the property is registered in the name of our parents. The owner will be taxed for the rental income after a 30% deduction. So, if you pay your father a rent of Rs 3 lakh a year (Rs 25,000 a month), he will be taxed for only Rs 2.1 lakh and you will get the benefit of HRA exemption.

It gets even better if the property is jointly owned by both parents. Then you can divide the rent two-ways so that the tax liability gets split between the two parents. If their income exceeds the basic exemption limit, you can help them save tax, by investing in their name under Section 80C options.

Buy them a Health Insurance Policy: This is the simplest and most commonly used strategy to save tax through our parents. If we buy a health insurance policy for them, we get deduction for the premium paid under Section 80D. Up to Rs 15,000 a year is deductible from our taxable income if we buy a health insurance policy for our parents. If the parents are senior citizens, the deduction is even higher at Rs 20,000.

Through Children :

Gift Tax has been removed since 1st October, 1998. Now we are free to gift away our money to our children without having to pay the gift tax. Investment made by Major Children out of the gift received from us will be taxed in the hands of our children. If, for any reason, one is not inclined to give gifts to major children; then one may give interest-free loan to adult children and can legally reduce your taxable income from business / profession.

Through Spouse

Married taxpayers can make a substantial saving of income tax by setting up two independent income tax files, one each for the husband and the wife. However, one must take care to ensure that no direct gift or transfer from husband is made to the wife. Otherwise, clubbing provision will get attracted.

Tax Saving Opportunities through Creation of HUF

What is a HUF?

HUF stands for Hindu Undivided Family. HUF can be formed by a married couple or by members of a joint family. HUF can be formed by two members, at least one among the two should be a male member of the family. After the Amendment in the Hindu Succession Act, in 2005, a Hindu Widow and her unmarried daughter can constitute a HUF, even when the widow had not adopted a son since, daughter is also a coparcener. But only one male without a female member can not form a HUF. There is a 'Karta' and other members of HUF.

Tax perspective

HUF is considered as a separate entity and is therefore taxed separately. This helps to separate tax obligations of an individual from that of his family. Tax slabs of HUF are same as that of an individual, with an exemption limit of 2 lakhs and qualify for most of the tax benefits like an individual.

How to create HUF?

HUF has to be created keeping in mind the legal and financial requirements.

- **Legal requirement** – A HUF is created through executing a deed, getting HUF PAN and opening a bank A/c in the name of HUF.
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- **Capital Infusion**- HUF corpus can be created with money received as gifts from relatives or with assets received under a will or inheritance, as it enjoys tax exemption. Caution should be taken that personal assets and funds are not transferred to the HUF account, as income generated from it shall later be clubbed under personal income under Section 64 (2).

How it works?

Although Salaried individual cannot divert his salary income into HUF, he can get a leverage if he plans to earn additional income and can do it in the name of a HUF, thereby reducing his taxable income. Suppose, an individual earns income from salary of Rs. 12 Lakhs, and also earning additional income from business. Now, if he creates an HUF and does business in the name of a HUF, then this business income will be taxable under HUF and he could reduce his tax liability after availing benefits under various sections which would otherwise not be allowed, had he earned it in his own name. Similar is the case with income from agriculture.

Hence, setting up of an HUF can definitely help reduce tax liability, however, HUF transactions should be carefully thought through and planned properly so as to face the precision of income-tax scrutiny given the fact that tax authorities are skeptic towards HUF returns.

Exhausting the Limit Under Section 80C

You can claim a deduction of up to Rs 1 lakh under Sections 80C. If you are in the 30% tax bracket, you can save up to Rs 30,900 by investing in the following approved tax-saving instruments as given in the chart below:-

Option	Lock in Period (Yrs)	Interest	Other Benefits	Limitations
Public Provident Fund	15	8.70%	Interest is Tax Free	Lock in Period
Traditional Endowment Plans	5	6-7%	Maturity Amount tax free	See Note Below
Unit Linked Insurance Plans	5	12-15%	-	See Note 2 Below
Tax Saving Funds (ELSS)	3	12-15%	-	No Capital Gains Tax being Long Term
Fixed Deposits	5	8-9%	-	Interest is Taxable
Nation Savings	5	8.50%	-	Interest is taxable

Certificates				
Senior Citizen Savings Scheme	5	9.20%	-	Number of preconditions. Interest is Taxable.
Tuition Fee for Children	-	-	-	-
House Loan Principal	-	-	-	-

Note: 1. AGIF covers the Army personnel adequately. Also, in case of demise of an army person, there will be ex-gratia payments given from various quarters. Hence, Army persons should avoid taking additional insurance policies merely for tax saving purpose.

2. ULIP is a Hybrid plan where some amount of premium is invested in securities and balance for insurance cover. Instead, it is better to invest directly into securities or through mutual funds.

Other Tax Saving Measures available in the Income Tax Act

Rajiv Gandhi Equity Savings Scheme: Under this scheme, first-time equity investors can invest up to Rs 50,000 in approved stocks and mutual funds and claim tax deduction on 50% of the amount, or Rs 25,000, under Section 80 CCG of the Income Tax Act. But to claim this exemption, their income should not be more than Rs 12 lakh a year. They should also have a demat account. They can avail of the tax benefit under the scheme for three years.

Health insurance premium: One can claim deduction for health insurance premium paid for self, spouse, children and parents under Section 80D. The limit is Rs 20,000 for senior citizens and Rs 15,000 for others. If you are paying health insurance premium for your parents, you can additionally claim up to Rs 20,000 in case of senior citizens and up to Rs 15,000 in other cases. Expenses incurred up to Rs 5,000 on preventive health checks are also deductible within this limit.

Expenses for Treatment of Handicapped Dependent: If any of your dependent relative (spouse, children, parents or siblings) is handicapped, expenses incurred towards his or her treatment and maintenance are deductible up to Rs 1 lakh if the disability is severe (80% or more) or Rs 50,000 /- otherwise (40% or more disability). The disabilities covered are: Blindness, Low Vision, Leprosy, Hearing Impairment, Locomotor Disability, Mental Retardation, Mental Illness, Autism, Cerebral Palsy and Multiple disabilities.

Deduction in case of disabled persons: An individual suffering from physical disability as given in paragraph above, can claim up to Rs 1 lakh deduction in case of severe disability or Rs 50,000 otherwise.

Medical expenditure on self or dependent relative: Up to Rs 40,000 /- (Rs. 60,000 /- in case of senior citizens) spent on treatment of specified diseases suffered by self or a dependent relative is tax deductible. Some specified diseases include Certain Neurological Diseases causing 40% disability, Malignant cancer, AIDS, Chronic Renal Failure, Haemophilia and Thalassaemia. You need to furnish a certificate by a registered doctor to claim these deductions.

Interest paid on education loan: Interest paid on education loan to finance higher education of self, spouse, children or a person of which the individual is a legal guardian is deductible under Section 80E. Loans taken to fund any regular or vocational course are also eligible under this Section. The deduction is available for eight years or till the interest is paid in full, whichever is lower.

Interest repayment on home loan: The interest paid on a loan taken to buy a house for living is deductible up to Rs 1.50 lakh a year in case of a self occupied house and without limit in case of a house which is rented out.

No tax deduction is available on under-construction properties the deduction for construction period can be claimed for five years after the completion of the project. However, up to Rs 1 lakh deduction is allowed on interest payment if the loan amount is less than Rs 25 lakh, the value of the property is less than Rs 40 lakh, loan is sanctioned for first home and the loan is sanctioned during financial year 2013-14.

Conclusion

To conclude, one can say that planning to pay minimum tax by using legal means is a right of every taxpayer and one must exercise this right to get the optimum results.

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