CHAPTER 7

METHODS OF TAX AVOIDANCE
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In previous chapter we have discussed tax avoidance through tax planning. It is concluded that tax avoidance is exactly tax planning. From 'tax-payers' point of view tax avoidance is tax planning. Taxpayers plan their tax matters according to law provisions which provide maximum rebates, deductions, and exemptions. In the following chapter we will discuss the different modes of tax avoidance or planning. In this chapter we shall discuss the different methods of avoiding tax burden through following ways:

- Hindu Undivided Family
- Charitable Trust
- Partnership Firm
- Private Company
- Other methods

7.1 Hindu Undivided Family

According to Hindu Law, "Hindu Undivided family is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters". Daughters born in the family are its members till their marriage and women married into the family are equally members of the undivided family.

Generally the father of the family or the senior-most male member of the family manages the property of the family as 'Karta'. Membership to the family is possible only by birth.
7.1.1 Hindu Coparcenary

A Hindu coparcenary is a special feature of Mitakshara School of Hindu Law. Only a male person is a member of coparcenary and a female member cannot be a coparcener. It includes only those persons who acquire by birth an interest in the joint family property, these being the son’s grandsons and great-grandsons holding ancestral property. Coparceners are the persons who have a right to enforce partition. Only male members of a HUF can enforce partition. Female members of a HUF do not have right to partition, though they are entitled for maintenance out of the family property.

7.1.2 Two Schools of Hindu Law

There are two schools of Hindu Law which govern the concept of coparcenaryship, namely:-

(1) Mitakshara School:-It prevails all over the country except in West Bengal and Assam. In the Mitakshara School, the foundation of a coparcenary is first laid when a son is born to the Mitakshara father. The coparcenary commences not from the date of conception of a son in the mother’s womb but from the date the son is born. Each son acquires by birth an equal interest with his father in the family property. No female member can be a coparcener though she is entitled to maintenance.

(2) Dayabhaga School: - It prevails in West Bengal and Assam only. Under this school of Law, a son does not acquire any interest by birth in the ancestral property during the lifetime of his father. He acquires such interest only after the death of his father. He has no right to demand partition of the HUF property from his father. The father is absolute owner of the family property and he may alienate such property by sale, gift, will or otherwise.
Jain, Sikh and other Hindu families: - Hindu Law does not apply only on to those who are Hindu by birth, it equally applies to those who are converted Hindus. Thus it is applicable to Jain, Buddha, and Sikhs etc. These families may or may not be a governed by Hindu Law, but these are treated as HUF for the purpose of the Income Tax Act.

For two purposes, the Hindu Undivided Family has been treated as a separate entity. Under the income-tax Act, 1961 and the Wealth Tax Act, 1957, the term 'person' includes a HUF. When individual members of an HUF are assessed for tax as individuals, the share of their income from the joint family property is excluded from computation of their total income. It is done obviously to avoid double taxation. It can own property, sell property, earn incomes and enter into contracts with others, through its Karta. Members of an HUF are also called coparceners.

The soil of Hindu Law fertilized by tax laws was used for the prolific growth of HUFs in order to reduce tax liability in the hands of those governed by it. The HUF provided convenient and useful second personality for practically every Hindu male adult. The fact of the matter is that the HUFs, like any other person, natural or artificial, have been doing their tax planning, and at times, also engaged in tax avoidance. Its gigantic structure, it is alleged, has been used for massive tax avoidance. It is asserted that for the last three decades, assessees have contrived to acquire the status of HUF with the purpose of evading and avoiding tax. The Hindu benevolent rule of throwing into the common stock has been used as a convenient device of tax avoidance by an individual who is allowed to throw whatever he liked into the joint family’s hotchpotch, full or empty. Partition, total partial or fake, is cited as another instance of Hindu’s manoeurrability of dividing and subdividing the wealth and income into several convenient taxable units.

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Preferential tax treatment is given to the HUF for their proliferation. Probably, so long as the HUF continues to be a separate taxable entity, the tax-planning by whatever devices available, will continue to be made.

It is now well-known that the institution of the Hindu Undivided Family is widely used of tax avoidance. Before we see its modus operandi, it may, however, be stated that the law, at present, gives certain advantages to the Hindu Undivided Family and its members. Subject to certain exceptions, the income and wealth of the Hindu Undivided family are taxed separately from the income and wealth of the members. The Hindu Undivided Family also enjoys higher exemption limit and higher monetary limit for deduction from taxable income in respect of sums paid of life insurance premium, etc. Further, salary paid to the members and even its Karta is allowed as deduction in computing the taxable income of an income of a business conducted by the Hindu Undivided Family. It may be pointed out in many cases, members of a Hindu Undivided Family have their separate income, and neither are the proportionate shares of their wealth or incomes belonging to the family considered in their respective assessments even for the rate purposes nor, alternatively, are their separate incomes or wealth taken into account for determining the tax or the tax rate applicable to the Hindu Undivided Family. Members of a Hindu Undivided Family are thus able to enjoy the economic benefits of both kinds of income and wealth without any additional tax liability.

However, as the various devices used by the skillful, determined and resourceful assessee for legal avoidance of tax on a large scale became apparent and obvious, the legislature with a view to plugging these loopholes, made changes of a far reaching character. Some of legislative measures go to erode the basic structure of the HUF. Some feel that the
recent legislative modifications have given such terrible shocks and jolts to the very structure of the HUF that crooks are appearing. But, it seems, the HUF has so much in-built dynamism probably nothing can destroy it.

The normal modes which Hindu Undivided Family has been utilizing for purposes of tax avoidance may be stated as under:-

a) Create as many smaller Hindu Undivided Families within the main family as possible so that each one of the sub-branches in the main family becomes a separate unit of assessment and thereby has its income and wealth subjected to lower rate of tax;

b) Where the Hindu Undivided Family has enormous properties, it makes partial partition of family assets, as many times as possible, so that neither the family nor the individual faces higher tax liability;

c) Whether there is ancestral property or not, have a self acquired property thrown into the family hotchpotch so that individual’s income liable to higher tax rate is reduced and also liability arising due to clubbing of income under section 64 of the Act is avoided;

d) Retain the ancestral property as the property of joint family as otherwise the property as well as the income from such property will be assessed in the hands of the members along with their individual income and wealth at a much higher rate.

e) A person can still effectively divide his sources of income into two groups: one of which to be held in his own individual capacity and the other to be held on the behalf of his HUF, or he can hold some sources of income on behalf of his smaller HUF. Thus there can be two or more taxable entities among which a person can effectively distribute his various sources of income. Unlike a firm there is no double taxation in the case of an HUF and unlike an association of persons, there is no option to assess the members of the HUF.
f) The Karta of an HUF can be paid reasonable remuneration for managing the business of the family. Such payment has to be made with the consent of the other members and it must be in the remuneration, can be paid to other working coparceners and so long as it is for the purpose of the business of the HUF. It can be claimed by way of deduction. Proper planning is necessary in this regard.

g) When the HUF is represented by a Karta in a partnership firm, the share in the profits of the firm belongs to HUF. However, so far as the firm is concerned, the Karta is a partner in his individual capacity. The partnership firm does not recognize the representative capacity of its partners and therefore when the Karta is a partner any interest paid to HUF cannot be disallowed as interest paid by the firm to its partners. This position can be taken advantage of by a tax avoider.

h) An HUF itself cannot be a partner in a firm. However, Karta or any other coparcener can represent the HUF in a firm. When the Karta representing the HUF the share he gets in the profits of the firm will be taxed as income of the HUF. The Karta of an HUF can enter into partnership with the separated member of the HUF. He can also enter into the partnership with the member of HUF in respect of his self-acquired property of that member.

i) A Coparcener continuing to be a member of coparcenary can hold his own separate or self-acquired property. In respect of his separate property or separate income he is taxed individually and as such he forms a separate taxable entity. Separate from the entity of HUF subject to the provisions of Section 64, the share which a member of HUF receives out of the income of HUF is exempt from income tax under Section 10 of the income tax Act, 1961. His share in the
coparcenary property is not taxable in his hands for the purpose of Wealth Tax Act. Thus there is no double taxation, as far as HUF is concerned. This points out that there is still some scope for tax planning with the help of HUF as a taxable entity.

j) At the same time he can be a member of a smaller HUF. For example, there can be HUF within HUF. One can be a member of larger HUF and a person can be a member of HUF of his father along with his brothers, etc. At the same time he can be a member of his own small HUF consisting of himself and his own descendants. The recognition of family within a family can be used with a great advantage for proper tax avoidance in appropriate cases.

7.1.3 Partition of a Hindu Undivided Family

According to Hindu Law, a HUF may be partitioned; partition of HUF may be total partition or a partial partition. According to explanation (a) to section 171, Total Partition means “It contemplates a complete partition of all the family properties included those which do not yield any income”.

According to explanation (b) to section 171, Partial Partition means a partition which is partial as regards the persons constituting the HUF, or the properties belonging to HUF, or both. It has been derecognized after 31st December 1978.

Partition—total or partial is capable of being employed effectively for purpose of tax avoidance. As pointed out earlier, according to the true notion of an HUF governed by the Mitakshara law, no individual member of the family while it remains undivided can predict his share in the joint family properties. The share of any living coparcener increases by the death of any
member and decreases by birth of any coparcener in the family. The essence of a coparcenary is the community of interest and unity possession among the coparceners so that the ownership is in the coparcenary.

Partition consists in a numerical division of the property. Partition is a severance of joint status and as such it is matter of individual volition. The Income-tax Act recognizes total as well as partial partition. Partition can be partial as regards the persons constituting the Hindu undivided family i.e., all the members need not separate from each other and one or more may separate leaving other to remain joint. It can be partial as regards the properties belonging to the family. In such a case, all the properties of the family need not be divided between the members of the family. The importance of the concept of partition is that to the extent to which any income-yielding property is found to be divided among the members the revenue would be a loser since the aggregate of the levied on the divided slices of income in the hands of the several members would ordinarily be lesser than the tax levied on the undivided whole carrying a higher rate of tax. Correspondingly the members would be gainers. Thus it may serve as a useful tax planning technique. Partition total or partial—would result in lesser tax liability than no partition.

The provision of Section 171 governing assessment of Hindu undivided families after partition and their impact have been explained as under:

Section 171 deals with two distinct and different situations:

(a) the case where an H.U.F. undergoes total partition and ceases to exist as an undivided family, and

(b) the case where continues to exist as an undivided family, but only some property is divided by way of partition among the members or some member separate from the undivided family.
Once a Hindu undivided family is assessed as such, it would continue to be so assessed even after it has disrupted and has ceased to exist unless a finding is given under section 171 recording partition. However, no finding of partition can be given unless there has been a physical division such division as the property admits of and not a mere severance of status. As a matter of tax planning, wherever partition takes place, the members should make a claim of partition at the time of making the assessment and try to get the partition recorded by the concerned I.T.O's order.

Partition as per Hindu Law can be effected orally and in case it is oral it would not be liable to stamp duty but if partition is in writing it requires stamp duty and also requires registration, it is in relation to immovable property of a value more than Rs. 100, the member should create ample evidence of partition having been effected because the I.T.O. is entitled to make an enquiry and ascertain as to whether partition was effected on the day and in the manner claimed by the assessee. Till partition is accepted by I.T.O., income as well as property would be included in the hands of the family. On partition, if property is received by a coparcener who has wife and/or children the property received on partition would be assessable in the hands of such coparcener in the status of Hindu Undivided Family but if the coparcener is unmarried then though the character at the property would be joint family property it would be assessable in the status of the individual till the coparcener is unmarried because there should be more than one member to constitute a Hindu undivided family, consisting of the individual and his wife with all its accretion, additions and conversion. It is also judicially settled that there is nothing in the Income-Tax Act to prohibit in respect of a business being a partition of joint property which they had partitioned among themselves. Thus partition can be effected number of times and can be successfully used as tax planning technique to minimize tax liability.
It may be noted that any distribution of capital assets on the total or partial partition of a HUF will not give rise to any tax liability on capital gains. Partition has been held not to be a transfer by the Supreme Court in Kesavlal Lalubahi’s case (1965) 55 I.T.R. 637. Partition does not also amount to an indirect transfer of the properties allotted to the wife and minor son within the meaning of Section 64. The Supreme Court held in C.G.T. vs. Getti chettiar (1972) 83 I.T.R. 599 that unequal partition does not involve element of gift for the purposes of Gift Tax Act. However, recently, the Supreme Court affirmed the decision of the Madras High Court in Ranganayaki Ammal vs. C.E.D. (1973) 88 i.e. 96 to the effect that an unequal partition does involve an element of disposition for purposes of Estate Duty Act. In this case, the Supreme Court held that if a person gives up a portion of his share at the time of partition of joint family property in favour of other members of an H.U.F. the portion so given up is liable to estate duty on the death of the person, if the death takes place within two years of the partition. In view of this position, unequal partition as a tax planning technique may not be profitable if the death takes place within two years of the partition.

7.2 Charitable Trust

Meaning of Trust and its Creation: - A trust is an obligation or responsibility imposed on one in whom confidence or authority is placed, it is a confidence reposed in a person by conveying to him the legal title to property which he is to hold for the benefit of another. If a person, out of free will, entrusts his property to the care of the person for a specific purpose or period, that other person has to uphold the trust reposed in him. His obligations include the protection of rightful ownership in the property, the preservation of the property, in as good a condition as practicable,
channeling the income from the property in accordance with the intentions of the owner and taking all steps to safeguard the property and the interest therein. The person holding the property, thus, binds himself with the owner in a fiduciary capacity conceptually holding trusteeship. The origin of 'trusts' can be traced back to the ancient times when the human motivation to do charity and dedicate property of charitable, pious and religious purposes found its manifestation in the form of math, dharmsalas, annachatras, sadavarts, educational and medical institutions, constructions of water tanks and wells bathing Ghats, implanting trees, etc. With the emergence of idol worship, endowments for temples and idols also came into existence. Besides public endowments/wakfs, private trusts can also be formed for looking after the welfare, or any other reason, unable to look after their own affairs. In India, and any person can make a trust, public or private. These are explained as under:

(1) **Public Trust**: - A public trust may be of charitable or religious nature and tends to promote the benefit of the public. Thus, public are always the beneficiary under a public trust.

(2) **Private Trust**: - A private trust tends to promote the welfare or specific persons and hence the beneficiaries are always specified individuals.

In other words, a 'trust' is an obligation annexed to the ownership or property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.

The person who reposes or declares the confidence is called the 'author of the trust' or settler. The person who accepts the confidence is called the 'trustee'.

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The person for whose benefit the confidence is accepted is called the ‘beneficiary’.

The subject matter of the trust is called ‘trust property’ or ‘trust money’;

The beneficial interest or interest of the beneficiary is his right against the trustees as owner of the trust property to the extent specified in the trust document.

7.2.1 Relevant provisions of Indian Trust Act, 1882:

Under section 7 of the Indian Trust Act, 1882 deals with creation of trust. A trust is created when the author of the trust indicates with reasonable certainty by any words or acts (a) an intention on his part to create thereby a trust (b) the purpose of the trust (c) the beneficiary (d) the trust property and transfer the trust- property of the trustee. It will, however, be worthwhile to mention that formal declaration is not necessary to constitute a valid trust. If the intention of the Settler of a trust is clearly established then no particular form or document is necessary to create trust. Every adult person of sound mind having the power of disposition can create a trust of his property held by him.

7.2.2 Objects of the Trust- Why to form a Trust:

Trusts are generally, formed or created to fulfil any or more of the following objectives:

i. For discharge of the charitable and/or religious sentiments of the author or settler of the trust, in a way that ensures public benefit;

ii. For claiming exemption from income-tax u/s 10 or 11, as the case may be in respect of incomes applied to charitable or religious purpose;

iii. For the welfare on the members of the family and/or other relatives, who are dependent on the settler of the trust;
iv. For the proper management and preservation of a property;

v. For the benefit and welfare of employees.

7.2.3 **Tax planning through trusts:**

We shall probe into various measures whereby a taxpayer can avoid or at least reduce his tax liability by forming trusts and diverting certain income to them.

**Measures of tax planning:**

Tax planning by creating private trusts is a long-tried and tested method of saving income tax. The legislature, therefore, has imposed tax on private trusts at the maximum marginal rate, barring certain exceptional cases of genuine hardship though the intention of the legislature has been to provide harsher tax treatment to the income of certain private trusts, yet there is ample scope of tax saving by planning the formation of trusts and their income earning activities, in such a manner as to attract at the normal slab rates applicable to AOPs and individuals, etc.

The various measures that may be deployed by a taxpayer in forming trusts and in planning his taxation are as under:

(I) **Tax planning through Specific Trusts** – One of the main principles of tax planning is to create maximum number of tax entities or assesses, as are possible. Thus, one should create a separate specific trust for each beneficiary, so as to bring a new taxable entity into form. Where it is necessary to form a single trust only, for more than one beneficiary, their shares should be specifically provided and should be clearly ascertainable.
This is because while discretionary trust is taxable under the provision of section 164(1) at the maximum marginal rate, income of a beneficiary under a specific trust is taxes in his own hands or in the hands of the trustees under section 162(1) in the same manner as it would in the hands of the beneficiary.

Thus, specific trusts may be created for an unborn child, a would-be son-in-law, as would be daughter-in-law, a would-be wife, a would-be husband and even for major children and other relatives. The main object of this trust is that the beneficiary is not free to use the asset trust and the income there from, thus avoiding the risk so misapplication.

(2) **Tax planning through discretionary Trusts** – Though it is better to form specific trusts as compared to discretionary trusts, in certain cases, discretionary trusts are also advantageous that is, where the trust is covered under the provisions of the section 164(1), when they are taxed as APOs, the normal rates.

(3) **Tax planning through Non-Business Trusts** – Income from business arising to any private, trust whether specific or discretionary, shall be taxed at the maximum marginal rate. It is therefore advisable that the trust should be so created and the trusts funds should be so invested, that income from business is avoided. It is pertinent to note that even if there is very small income from business in the hands of trust, the entire income shall be taxed at the maximum marginal rate.

Therefore, it is advantageous to avoid business income for trusts. There is no restriction on investment of trust funds in case of private trusts and the trusts may have income from property, capital gains and other sources. However, there is scope of tax – saving in case of business trusts also.
(4) **Tax Planning through Business Trusts**—Although trusts having income from business are liable to pay tax at the maximum marginal rate but the law provides an exception to this provision. Under the provision of proviso to section 164(1), income of business trusts shall be taxes at the normal rates if the following conditions are fulfilled:

(i) The trust is declared by a person by will exclusively for the benefit of any dependent of him for support and maintenance, and

(ii) Such trust is the only trust so declared by him.

Thus, while executing his will, one may create a trust settling a business undertaking there under, for the benefit of any of his dependent relatives. Relatives in relation to an individual mean the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

It may further be noted that such a trust should be declared as discretionary, since income of such a trust shall be taxed as a separate entity as APO (besides the beneficiary) thus claiming the exemption limit also whereas if such a trust is created as specific, tax shall be levied as it would be levied in the hand or beneficiary, and the basic exemption limit would not be allowed separately.

Thus, it would be advantageous to form a trust as against a firm, and the liability is further lower in case of discretionary trust than in case of a specific trust, when the case is covered u/s 164(1) Second proviso (a).

It may further be noted that there is not restriction in a trust becoming a partner in a firm. If a trust derives income from business through firm, the share income is exempt u/s 10(2A).
(5) **Tax Planning through Tax Deduction and Set off of Losses** – As we know that in computing the taxable income certain deduction are allowed under the different heads. Besides, loss under one head can be set off against income under other head, subject to certain exceptions, further; a trust can claim deduction under chapter VI-A from gross total income. The affairs of a trust should be so planned that the benefit of all such deductions may be claimed to the maximum possible extent.

(6) **Tax Planning through Long Term Capital Gains** – Income from long-term capital gains enjoys basically two important concessions. viz –

(i) Tax saving on account of application of the cost inflation index on the cost of acquisition; and

(ii) Tax saving on account of concession tax rates.

The rates of tax on long-term capital gains, as per section 112, shall be 20% (the amount of tax is further restricted in the case of listed securities and units of UTI or any mutual fund approval u/s 10(23D), to of the gain computed without allowing the benefit of indexation.)

Thus, trusts should keep investing a part of their funds regularly in capital assets in such a manner that income by way of long-term capital gains arises to the trust, every year hereby having a substantial tax savings.

(7) **Tax Planning for Oral Trusts** – Tax is levied at the maximum marginal rate on the income of an oral trust. However, as per Explanation 1 to section 160, an oral trust which is duly intimated to the Assessing Officer, shall be deemed to be written trust.
Thus, where an oral trust has been created, a statement in writing, signed by the trustee or trustees should be furnished to the Assessing Officer, within three months from the date of declaration of the trust. The statement should set out the following particulars –

(i) The purpose or purposes of the trust,
(ii) The particulars as to the trustee or trustees.
(iii) The particulars as to the beneficiary or beneficiaries, and
(iv) The particulars of the trust property.

The above information is not different than what is usually contained in a written trust deed. Thus, an oral trust can be converted to a written trust, within three months of its declaration.

It may be noted that an oral trust cannot be created under a will, since a will has to be always in writing.

8. Tax Planning through a Discretionary Trust Created Order a Will – Under clause (ii) of first proviso to section 164(1), where a discretionary trust was created by a person through his will and such trust is the only so declared by him, then income of such trust is liable to be taxed as income of an association of persons i.e. at normal slab-rates and not at the maximum marginal rate.

Thus, all tax-payers while making their wills should keep this fact in mind. It is advisable to declare a trust under the will, for future tax planning and tax saving for their heirs.

9. Tax Planning through a Trust for a Personal Deity – Under Section 2(31) a person includes an artificial juridical person and personal deity of God has been held to be an artificial juridical person. Thus, a person may create a trust by settling some of his property in favour of his personal deity, in such a manner that the deity is
assessable separately like an individual. The income so diverted to the
decity shall not be clubbed in the income of the settler. However, such
a trust should avoid carrying on any business which would entail tax
at the maximum marginal rate.

Income of the Charitable Trust is exempt under the provisions of
Section 11, 12 & 13 of the Income Tax Act, 1961. This exemption is subject
to fulfilment of the conditions laid out under the above sections. The points
that need to be borne in mind for proper Tax Planning with respect to
Charitable Trust are outlined below:

i. The Trust must be formed for a charitable object as defined under
section 2 (15) of the Income Tax Act. The definition given is an
inclusive or exhaustive one. The trust or institution must not have
been created for the benefit of any particular religious community or
caste.

ii. The application for registration in the prescribed manner, form and
time has to be made to the concerned authority as per section 12AA.

iii. Another condition to be fulfilled to enjoy the exemption is that the
accounts of the Trust/ Institution must be audited by a Chartered
Accountant, if it’s total income including voluntary donations but
without giving effect to the provisions of section 11 & 12 exceeds Rs.
50,000.

iv. No income should be used for the direct or indirect benefit of the
settler, trustee, their relatives or other specified persons. Such persons
for whose direct or indirect benefit the income should not be applied
are detailed under section 13 (3).
v. From assessment year 2008-09 such trust must apply 80% of their income towards charitable or religious purposes. Any receipt other than which for part of the corpus of the trust shall be taken into account for the purpose of such application. Section 11(2) allows for setting apart of or accumulating either the whole or part of the income for future application for charitable purpose in India. Such intention, purpose and period (not more than five years) have to be made known by way of a note in Form No. 10 to the A.O. The care has to be taken that the purpose specified is clear and specific. The following should be kept in mind:

- Income-tax refund is not income derived from property held under trust, hence need not be applied for section 11.
- Donation to another trust out of the income accumulated or set apart (which could not be used for the purpose for which it was set apart) does not amount to application of income towards charitable purposes.
- Donation to another trust with specific direction that the amount shall form part of the corpus of the trust shall qualify as application of income towards charitable object.

vi The funds together with the accumulated income must be kept deposited in one or more modes specified by section 11(5).

7.3 Partnership Firm

According to Section 4 of Indian Partnership Act, 1932, "Partnership is the mutual relations of those persons, who have agreed upon to share the profits of the business, the business may be run by all or any one of them".
A partnership firm has no separate, distinct and legal existence apart from its members under the general law of partnership, but it is a distinct taxable entity separate from its members under the Income-Tax Act. Each partner, of the partnership, is a separate entity by himself functioning in his individual capacity. Partnership firm has been a main media of reducing incidence of tax because of the fact that the Income-Tax Act recognizes firm as a separate taxable entity.

The Partnership form of business organization is another important instrument of carrying on business, and it has got obvious advantages from the tax angle as well. One important advantage of the partnership form of organization is that more persons can join together and collectively bring in their efforts to carry on the business, thereby making the business more profitable and large based. Even if the size of the business organization is not materially different from what it would have been if the business has been carried on as a sole proprietorship concern, the advantage would be for the partners, because, the income of the firm is first determined and then allocated to the partners. The partners are subject to tax only in respect of their respective share of the income of the firm.

The firm may be either registered or unregistered under the Income-Tax Act. Tax on registered firm is levied at nominal rates. Tax levied on the registered firm is reduced from allowable income under the provisions of Section 67. The net income as determined under the provisions of Section 67 is allocated between the partners in proportion to their profit sharing ratio and is taxed in the individual hands of the respective partners. An unregistered firm is taxed as such at the rates applicable to an individual and the allocated share is added in the hands of the partners for rate purposes (Section 856(iii)) and not for tax purposes unlike the partners of a registered firm.
There is substantial difference between tax on unregistered firm and registered firm. Where the firm is assessed as an unregistered firm the levy of tax is on the firm and not on the partners. But in the case of a registered firm the substantial levy is on the partners individually. Still the actual impact of tax will be less in the case of registered firm. This point out that one of the important tax planning considerations that is relevant to a firm is to take advantage of the benefit of registration. The application of registration should be in accordance with the provisions of Sections 184. The partnership firm must be evidenced by an instrument specifying individual shares of the partners. Application for registration should be made before the close of the accounting year in the prescribed form duly signed by all the partners excepting minors personally. On receipt of application the income-tax officer is entitled to enquire into the genuine of the firm and the constitution as specified in the instrument. In case he is satisfied he should grant registration; otherwise he may refuse registration and assess as unregistered firm. Registration once granted ensures for all succeeding years provided application in form No. 12 certifying no change in constitution is submitted in the prescribed form and in the prescribed manner. One of the conditions for getting the benefit of registration of a partnership firm under the Income-Tax Act is that the firm should be genuine. According the explanation to Section 185(i) a firm not to be regarded as genuine for the purposes of Section 185 and 186, under two circumstances. The circumstances are:

1. Where any partner of the firm is a benamidar of any other partner however if such partner is related to the other partner in the capacity of spouse or minor child, the firm will be treated as genuine because of the fact that in such cases Section 64 (1) (i) and(iii) will apply.
2. If any partner (in relation to the whole or any part of his share in the income or property of the firm) is a benamidar of any other person who is outsider and any of the partners had knowledge about this fact the firm will not be treated as a genuine firm. In this case, even if the relationship between the partner and his benamidar (who is not a partner in the firm) is that of spouse or minor child the firm will not be treated as a genuine firm. There is one exception to this provision. If the partner was a benamidar of some other person, communicates to the income-tax Officer the real position in the prescribed manner that the explanation will not apply and the firm will be treated as a genuine firm. Thus, even though a partner may be a benamidar for another person, the firm would not be regarded as non-genuine if the other partners of the firm communicate their knowledge or belief relating to the benamidar nature of the partner to the I.T.O. in the prescribed form within the prescribed time. This requirement calls for some planning on the part of the assessee so that the benefit of registration may not be denied to him due to his non-compliance with the statutory provisions. Thus in all cases where one or more partner was a benamidar of any outside person and if any of the other partners knew or had reason to believe the benami nature of the membership in the firm such knowledge or belief has to be communicated to the I.T.O. in form No.12 A in accordance with the provision or Rule No.24.

The time limit within which the above communication must be made regarding the benamidar nature of a partner is laid down by clause 2 of Rule24 A as under:
(i) Where the firm has not been registered such communication must be made before the end of the previous year for the assessment year in respect of which registration is sought.

(ii) In cases where the registration of the firm has already been done and the firm has to file Form No.12 for the continuation of the registration, such communication shall have to be filed before the expiry of the time allowed under Section 139 (1) or 139(2) for furnishing the return whether originally or on extension.

This new provision is likely to affect cases where a partner is a trustee or Karta or a H.U.F. or a representative of some other concern. A joint family, a partnership firm, a trust or an association of persons has no separate legal existence and such a quasi corporation or loose association cannot by itself be a partner, but any one or more persons comprised in such a body of individuals can become a partner with others. The persons representing the quasi corporations or loose associations may be loosely designated as representative asessees. Even though their representative capacity might have been described in the deed of partnership itself they are answerable for everything connected with the firm to their respective corporations or associations. But so far as the partnership is concerned it is the individual, who is a partner regardless of his representative capacity and the individual alone who has joined the partnership and who is a partner which others collectively called the firm. In all such cases, it will be necessary to communicate the fact in the prescribed manner to the income-tax officer so that the firm may not be refused registration on the ground that it is not a genuine firm.
The decision of the Supreme Court in Murlidhar Hinat Singka Vs C.I.T. (1966) 62 I.T.R. 323 also points out some scope for tax planning through firms. In this case the Supreme Court recognized the concept of a sub-partnership. A sub-partnership is a partnership within a partnership. It presupposes the existence of a partnership and is entitled to registration. If any portion of a partner's share of profit of a registered firm is diverted from him by overriding title, such as under an agreement of sub-partnership, such portion would not be taxable in the partner's hands.

In spite of the clubbing provisions of Section 64, as a measure of tax planning, it may still be advantageous to form a partnership with wife and minor children admitted to the benefits of partnership may be aggregated in the assessment of the spouse or partner under Section 64 (1) there is a separate formation of capital of the wife and minor children assessable to wealth-tax and estate duty separately in their hands; and if this capital is utilized by them for investment purposes outside, then the income from such investments also is assessable separately in their hands.

Where the wife of an individual is partner of a registered firm in which the individual is also a partner or if the minor child of an individual is admitted to the benefits of any partnership the income of the wife or minor child has to be included in the total income of the individual under Section 64(1). Circular No. 104 dated 19th December 73 issued by the CBDT points out some scope for tax planning in cases where such firm incurs losses. Where losses are incurred by the firm, the share of loss of the wife or minor child can be set off under Section 71 against any other income of the individual in the same assessment year while computing his total income, and if after setting off such a loss there is still a loss left, then the balance should be allowed to be carried forward and set off allowed under Section 72 in subsequent years.
The prohibition contained in Section 40(b) relating to interest, salary, bonus, commission or remuneration paid by a firm to any of its partners also points out the need for some planning. The prohibition is absolute. There is no distinction between such payments made as an independent person. The prohibition will not affect rent paid to a partner or the price of the goods supplied by a partner. Such payments made as an independent person. The prohibition will not affect rent paid to a partner or the price of the goods supplied by a partner. Such payments are admissible deductions. If such payments are received by the spouse or minor child of the assessee, such income is not includible under Section 64 (1) (i) or (iii) in either spouse’s or parents total income and such income is not income arising directly or indirectly from membership in the firm, that is not by way of contributions to the capital of the firm or on accumulated profits qua, partner but by virtue of some other capacity such as landlord or supplier or goods or under a separate and distinct contract or for other services rendered. Similarly the amount of rebate allowed to the partners of a firm will not be added back to the profits of the firm under Section 40(b) but it is an admissible deduction under Section 37 from the gross amount received. These principles must be taken into account while planning payments to partners.

By virtue of Section 67(2), the nature of income remains the same whether it is in the hands of the firm or in the hands of the partners. For instance, capital gains earned by the firm during its continuance or on dissolution amount to capital gains in the hands of the partners. Under Section 47 (ii), the distribution of Capital assets of the partnership on its dissolution does not amount to “transfer” since the adjustment of the rights of partners in a dissolved firm is neither a transfer nor is it for a price as laid down by the Supreme Court of C.I.T. v. Dewar’s Corporation (1968) 68
I.T.R. 240 (S.C.) and C.I.T. v. Bankey Lal Vaidya. (1971) 79 I.T.R. 594 (S.C.) If on an agreed valuation, assets are taken over by one or more partners on dissolution by payments to other partners then such a transaction does not attract capital gains tax under Section 45. Where on the dissolution of a firm one of the partners takes over or on the retirement of a partner the remaining partners take over the whole of the business of the firm and pay to the retiring partner the value in money of his share in the assets, there is only a distribution of the assets of the firm and consequently there is no transfer attracting liability to tax. In case the partnership firm holds immovable property as its assets and such immovable property is taken over by one or more partners of the firm it would not require registration under the Indian Registration Act because it is merely by way of adjustment of the right of the partners on dissolution by giving each his share in the net partnership assets after deduction of liabilities and prior changes. In such a transaction there is no element of transfer of interest in the partnership asset by the retiring partner to the continuing partner.

This position points out the scope for tax planning in cases of dissolution/retirement. On the other hand, if the firm first disposes off assets to outsiders and then distributes the sale proceeds realized among themselves, then, the exemption under Section 47 (ii) is lost. The real nature of the partner’s interest as a partner is that during the continuance of the partnership he has a right to the share of profits of the business and on retirement or dissolution he has a right to the proportionate value of the partnership assets which is the very incident of a partner’s share, there is no transfer of capital assets under Section 47(2) for he gets the amount in the very working out of his rights as partner. It may also be noted that in cases
where property has been allotted to a partner in satisfaction of his claim to his share, the property cannot be deemed in law to be sold to him. Consequently, where a firm has been allowed development rebate on its machinery or plant installed under Section 33 and where at any time before the expiry of eight years from the date of such installation, the firm is dissolved and the distribution of the assets of the partnership made among its partners, there is no sale or transfer as contemplated by Section 34(b) read with Section 155 (5) no sale or transfer as contemplated by Section 34(3) (b) read with Section 155(5) and the development rebate granted to the firm cannot be withdrawn. Similarly where a firm is succeeded by a company and the conditions specified in Section 33 (b) are satisfied the development rebate allowed earlier will not be withdrawn. This principle will be applicable with considerations are relevant to a firm contemplating transfer of assets to partners on dissolution.

The Supreme Court held in a case that if a partner revalues his goods and invests such goods as a contribution in the partnership firm at a revalued or enhanced value, it cannot be considered as a sale by the partner to the partnership firm. Such an act would not give rise to tax liability on capital gains.

A partnership firm can also be used as a mode of transferring immovable assets to its partners or even to a limited company may be made a partner in the partnership firm owing immovable and other assets and after a few year of working the partnership may be dissolved and on such dissolution the entire business or only immovable properties or other assets could be taken over by the limited company. In fact such a method of tax planning can be effectively made use of for conversion of a firm into a limited company. Such a method would minimize the tax liability arising out of such conversion.
Tax planning with the help of partnership may also help to reduce the impact of aggregation of agricultural income with non-agricultural income for rate purposes with effect from 1.4.1974. The tax impact of aggregation may be reduced to some extent by forming a partnership for purposes of some agricultural operations and bringing in agricultural lands as capital and allowing an investment company to enter into partnership with very small shares going to the individuals and a very big share to the company. This is because the aggregation of agricultural income with non-agricultural income is not applicable to registered firms and companies. Similarly, in view of the stringent tax measures against the institution of Hindu Undivided Families and the recent amendments denying many tax concessions to Hindu Undivided Families under certain circumstances the Kartas or Copareeners or members of H.U.F. may from business partnerships for reducing their tax liabilities.

The above explanation was accordingly omitted. It is submitted that the change is quite understandable; otherwise there would be no end to conclusion of this type.

We think the above provision will go a long way in checking tax avoidance which occurs by diversion of income to the members of the family.

Under the Indian Partnership Act, minors can be admitted to the benefits of partnership. They are entitled to a share in the profits of partnership business while not being liable for its losses. This provision has unfortunately been misused widely. Tax avoidance in this field is practiced normally through the following modes:
(a) In order to circumvent the provision relating to the clubbing of the income of minor children with that of the parents, if both are partners in a firm it is so arranged that partners of one firm get their minor children admitted to the benefits of partnership in another firm, in exchange for admitting in their firm the minors children of the partners of the firm, so that it is not possible to club the income of the minors with that of the parents.

(b) As the minors can be admitted only to the benefits of partnership, the rich partners of the firm take in as many minors as possible, so that while gains in the business get distributed over a number of persons, losses suffered by the firm get distributed to the partners other than minors, thereby reducing the tax burden of such wealthy partners.

(c) Taxpayers generally so arrange their affairs by what are known as “cross transfers” and other ways that it becomes difficult to prove that there has been a direct or indirect transfer of assets to the minor children within the meaning of section 64 of the Income-tax Act, 1961. Amount received by the minor as a result of such a cross transfer and in other ways is shown as capital contributed by him in a firm where neither of his parents is a partner and the minor’s share income has consequently to be assessed in his hands, and cannot be clubbed with the income of his parent.

(d) Separate nucleus is built up for a minor ever since his birth so that his share from a firm in which capital is contributed out of such nucleus cannot be included in the income of his parent.
7.4 Private Company

7.4.1 Tax Planning in the Case of Company: In the present day world, corporate sector is playing a significant role in almost all fields of economic activity. Companies have become a favourite form of business organization. Corporations have thoroughly integrated in the present day business culture and have become the most important economic institutions. These are more disciplined, better organized and professionally managed sector of the economy. We live presently in a society of corporations. Mr. Williams T. Cosset, an ex- Vice President and General Counsel of Ford Motor Company of USA once observed as under:-

"The modern stock corporation is a social and economic institution that touches every aspect of our lives, in many ways. It is an institutionalized expression of our way of life. During the past 50 years, industry incorporate form has moved from the periphery to the very centre of our social and economic existence. Indeed, it is not inaccurate to say that we live in a Corporation Society."

Broadly, the major forms of business organizations could be classified under three broad head viz., the sole proprietor, the partnership, and the company. In the sole proprietorship, there is a single person who makes all decisions, provides finance and is personally liable for everything done by the business. In the partnership, these functions are performed by two or more functions either of who may make binding decisions and each of whom is, generally, personally responsible for everything done by the business. Both these forms of organizations cannot command enough financial resources and requisite talents. Hence, corporations developed. The present day business is leaning more and more towards the company form of organization because of various socio-economic reasons including resource requirement.
7.4.2 Some other Planning aspects in case of Companies:

Like other taxable entities, the management in the case of corporations also likes to minimize tax burden in their cases so that tax savings could be utilized for improving the functioning of the company. Some major aspects that would need consideration in this direction are mentioned hereinafter:

A. Location of the business of the company—For availing of income-tax benefits, decision in the matter of location of the business is extremely important. Certain sections of the Income-Tax Act, 1961 given substantial tax benefits if the undertakings are located in certain areas complying with certain conditions. The examples are:

i. Section 10 A of the Income-Tax Act has tax benefits for certain years for newly established undertaking in Free Trade Zones (FTZs) or special economic zones for electronic hardware technology parks or software technology parks on the fulfilment of the prescribed conditions.

ii. Section 10B is special provision for giving tax benefit to newly established 100 per cent export oriented units for some years on satisfaction of the stipulated conditions.

iii. Section 10C provides exemption for 10 consecutive assessment years for certain industrial undertakings set up in North-Eastern region which the Central Government may by notification in the official gazette specify.

iv. Under section 80-IB tax benefit is available for a newly set up industrial undertaking in an industrially backward state or district. Broadly, the exemption is available equal to 100 per cent of profit for 10 years.
v. Tax holidays have been provided for 10/5 years with effect from assessment year 2008-09 for certain undertakings u/s 80-IC which are set up in Himachal Pradesh, Sikkim, Uttarakhand, and North Eastern States. Sikkim and North Eastern region undertaking will get 10 years holiday. Other two for 5 years.

B. Nature of Business—Certain tax benefits accrue on the nature of business. The instances relating to hardware/software products have already been mentioned earlier. Some other instances relate to venture capital companies (section 10 (23FB)), infrastructure capital companies (section 10(23F)), telecommunication services (section 35ABB), shipping business (section 35AC), projects outside India (section 80HBB), Export business (section 80HHC). Earning in convertible foreign exchange from tour operators’ business or business of travel agents (section 80HHD). Export of computer software (section 80HBB) business relating to export or transfer of film software (section 80HHF), business of collection and processing of bio-gradable waste (section 80JJA) etc.

C. Financial Arrangements—Capital v. Loan financing—In any planning for tax purposes, financing arrangements have to be carefully worked out. In this exercise factors to be taken into account relate to risk, cost control and tax benefits. One of the main reasons for raising finance through borrowing (as against issue of equity shares) is to increase earning on equity share capital. But excessive use of debt capital increases the financial risk of the company.

D. Business restructuring—Tax savings can also be achieved through the medium of business restructuring which can be brought about by (i) amalgamation (ii) demerger (iii) inter-transfers between holding and subsidiary companies, (iv) joint ventures etc.
Through amalgamations, liability of capital gains by virtue of the provision of section 47 (iv) can be availed of as any transfer, in a scheme of amalgamation of capital assets by the amalgamating company to the amalgamated company, is not taken as 'transfer' on the satisfaction of the prescribed conditions. Similarly, transfer of shares in an Indian company held by a foreign company to another foreign company in a scheme of amalgamation also is not treated as transfer for the purposes of levy of tax on capital gains if the prescribed conditions are satisfied. Allotment of shares in the amalgamated company to the shareholders of the amalgamating company are also exempt from capital gain tax (sections 47 (vii) and 49 (2)). Likewise, carry forward and set off of loss and depreciation of the amalgamating company u/s 72 A of the IT Act will be treated as the loss/depreciation of the amalgamated company for the previous year in which the amalgamation is affected on the fulfilment of the prescribed conditions.

Where a company after declaring dividend is amalgamated with recipient company within same previous year, dividend was held not assessable as income of recipient company as it was its own money which assessees received-Mafatlal Gobalbhai & Co. (P) Ltd. v CIT (1991) 58 Taxman 150 (Bom). Tax benefits have also provided in the cases of demerger. The company whose undertaking is transferred pursuant to demerger is known as “demerged” company, the company to which the undertaking is transferred is known as “resulting company”. The tax benefits available in cases of demerger are: -

(i) Where any capital asset is transferred by the demerged company to the resulting company, the actual cost of the transferred asset to the resulting company shall be taken to be the same as it would have been if
the demerged company had continued to hold the asset. However, such actual cost shall not exceed the written down value of such capital asset in the hands of demerged company.

(ii) For depreciation, \(^5\)th proviso to section 32(1) will apply and in the year of demerger, the depreciation on the assets transferred would be appointed proportionately on the basis of number of days of user between the demerged and resultant companies. The same principle will apply in cases of amalgamations between the amalgamated and amalgamating companies.

(iii) Benefit in the matter of tax on capital gains is also admissible. There would be no tax on capital gains in the following situations:

Any transfer in a demerger of a capital asset by the demerged company to resulting company provided that resulting company is an Indian company[sec. 47 (vide)];

Any transfer of shares held in an Indian company by a demerged foreign company to the resulting foreign company if the following conditions are satisfied:

(a) The shareholders holding not less than three-fourths in value of shares of the demerged foreign company continue to remain shareholders of the resulting foreign company, and

(b) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated [sec. 47 (Vic)];

(c) Any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking [sec. 47(vide)];
In the case of demerger the accumulated loss and unabsorbed depreciation of the demerged company will be allowed to be carried forward and set off in the hands of the resulting company.

Expenses on amalgamations/demergers are permitted to be amortized u/s 35DD and are allowed to be deducted equally in 5 years i.e. one fifth expenditure each year.

(E) Planning through holding subsidiary company relationship – In the following situations, the inters transfers between holding-subsidiary companies shall not be considered as ‘transfer’ for purposes of levy of tax on capital gains:

(a) Any transfer of a capital asset by a company to its wholly owned Indian subsidiary company [sec. 47(iv)]; and

(b) Any transfer of a capital asset by a wholly owned subsidiary company to its Indian holding company [sec.(v)];

(c) The following points should be noted-

- Provisions under section 47(iv)/(v) are not applicable in the case of transfer of a capital asset made after February 29, 1988 as stock-in-trade.

- Section 47 (iv) and (v) covers only the immediate subsidiary company of the holding company. There is no justification for transplanting the definition of ‘holding company’ under the companies act into the provisions of section 47 automatically.

Kalindi Investment (P) Ltd. v. CIT (2002) 120 Taxman 896 (Gujarat).
(F) Planning through depreciation- Depreciation, which represents non-cash allowance in computing the taxable income, can be used as a good device for saving taxes. Some aspects concerning depreciation are mentioned hereinafter.

- W.e.f. from the assessment year 1999-2000, depreciation can be claimed on intangible assets also like know-how patent rights, copyrights, trade marks, licenses, franchises or any other business or commercial rights acquired on or after 1-4-1998.

- Depreciation can be claimed on the assets which are not only used but are ready for user;

- Depreciation can be claimed even in respect of assets that are acquired on hire purchase basis (CBDT) circular No. 9 (R-Disk No. 27(4) – IT/43 dated 23.3.1943.

- It is now mandatory to claim depreciation. If it is not claimed, it shall be deemed to have been allowed. Hence it is advisable to claim it every year.

- w.e.f. the asst. year 2002-03, there is no time limit for carry forward of unabsorbed depreciation;

- Unabsorbed depreciation can be set off against business income even if the business to which the unabsorbed depreciation relates has been discontinued.

(C) Taking assets on lessor/ownership basis- The management has to decide whether assets should be obtained on lease or ownership basis. If the asset is purchased, the assessee can claim depreciation. Besides, interest on capital borrowed to finance investment in plant and machinery can also be claimed as deduction. If however, asset is obtained on lease, deduction can be claimed in respect of lease rentals and lease management fees. The
practice of selling assets and then taking the same back on lease had been quite common. In Indian Management Advisers v. Deputy CIT (1994) 51 ITD 566 (Del-Trib) the assessee claimed depreciation on computers purchased from PCL and leased out to ‘A’ and ‘A’ sub-leased the computers to PCL. The Tribunal held that there is no legal bar for a manufacturer to sell the manufactured goods and to take them on lease from the purchaser. In Peacock chemicals (P) Ltd. v. CIT (1995) 51 TTJ (Del-Trib) 264, it was held that if asset sold and taken back on lease are entitled to depreciation in the hands of the lessor/purchaser. However, explanation 4A in section 43(1) provides that where an asset on which depreciation has been allowed is sold by assessee to another person and subsequently that asset is required by the assessee by way of lease, hire, or otherwise, the actual cost for the purpose of deduction of depreciation allowance shall be the written down value of the said asset at the time of transfer in the hands of the seller.

(D) Whether assets should be purchased on full payment basis or on installment basis:- The decision has to be of the management taking into account the situational aspects. If an asset is purchased by installments, then the taxpayer can claim depreciation under section 32. Besides interest payable on unpaid purchase price can also be claimed as deduction. In the case of obtaining an asset on hire, deduction can be claimed in respect of hire charges. By comparing present value of cash outflows a correct decision can be taken.

(i) Planning for remuneration including managerial remuneration- The planning be kept in view in the context of remuneration are to be basically two fold namely, the company should get full deduction for the payments made and the employees should be subjected to minimum tax on the amounts received. The planning will depend on the situational matrix. Tax on salaries of employees can be reduced substantially, if
salary is divided into different allowances (which are not taxable or which are partially exempt from tax) and perquisites (which are taxable at concessional rates). The optimum combination of allowances and perquisites depends upon individual requirement of each employee taking into consideration present take-home pay and future benefits of different items in salary structure.

(ii) Planning through company entering into partnership- A corporate entity is presently capable of entering into partnership as an individual partner. The tax chargeable from the partnership firm is 35 percent. In the case of a domestic private limited company the corresponding rate is also 35 percent.

The company may hold upto 95 percent share in the partnership firm. The directors of the company may be made the employees of the partnership firm. They will then be entitled to all the privileges in terms of salary and perquisites which they could have derived as the directors of the company as also standard deduction because they would be deriving remuneration from the partnership firm as employees and not in the capacity of partners. The company will derive simple interest @ 12 percent per annum from the partnership firm on its capital contribution to the partnership firm.

Entering into partnership with a firm is otherwise also beneficial for companies as the share income from the firm would be exempt under section 10(32) and the company can also circumvent section 115JB in respect of such share income.

(iii) Planning for MAT- If a sum is debited in profit and loss account then it will not be subject to any disallowance for computing 'book profit' even though such claim is not allowable under section 37 or under any other
Some Tips for Corporate Planning Tax

The following tips for corporate planning tax can be useful:

1. The tax incidence of a company can be reduced, by increasing the number of directors & the total remuneration pay out to them. This is however subject to individual tax structure prevalent. Directors are entitled to claim standard deduction u/s 16 from salary or remuneration received from Company. This benefit is not available in the case of a partnership firm.

2. As perquisites extended to directors are allowable as deduction in the hands of the company, these should be provided to them. The perquisites provided to the directors in turn would be subjected to tax in accordance with provisions of section 17 and rule 37.

3. Depreciation occupies a very important place in the Profit & Loss account of any business. Investment should be made in depreciable assets. Further as of late it is not a matter of choice whether to claim depreciation or not. The same has to be availed as a mandatory regulation. In this regard the necessary provisions of the Income Tax Act, 1961 along with the provisions of the Companies, Act 1956 should be kept in abeyance.
4. Interest on capital borrowed by an existing company up to the period when asset is first put to use can be either claimed as a deduction under section 36(1) (iii) or alternatively it can be capitalized and added to the actual cost of the asset under section 43(1). In this regard the following table will ease the understanding process.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rate of Depreciation is 100%</th>
<th>Rate of Depreciation is not 100%</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Put to use for at least 180 days in the year in which acquired.</td>
<td>Not put to use for at least 180 days in the year in which acquired.</td>
</tr>
<tr>
<td>Capitalize Claim u/s 36(1) (iii)</td>
<td>Equal benefit</td>
<td>Not beneficial</td>
</tr>
</tbody>
</table>

5. Exporting of goods will entitle the Company to enjoy numerous tax advantages under the tax laws.

6. Operating from a FTZ, SEZ or North Eastern Region or as 100% EOU are options worth weighting as section 10 offers tax holidays to these set ups.

7. A company is entitled to claim deduction under Chapter VIA of the Income Tax Act at a higher rate as compared to Firm or any other entity.

8. Though directors are personally liable to pay Income Tax demands of the company in case company fails to pay the demand, but as far as commercial and business liabilities are concerned, the liability of directors of the company is limited and cannot be recovered from directors personally.
7.4 Other Methods

The provisions of sections 60 to 64 of the Income-Tax Act related with the avoidance of tax. As per these sections, in certain cases incomes of some other persons shall be deemed to be the income of assesssee and their income shall be included in the income of the assesssee.

7.4.1 Meaning of Clubbing Income:- The income of other persons mentioned in sections 60 to 64 are included in total income of an assesssee. As per provisions of Income Tax Act, this process is called 'Clubbing of Income'. Such these incomes are as follow:-

- **Transfer of income without transfer of the assets (section 60):**
The assesssee transfers the income of any assets to another person but have the ownership of that asset with him. The income of such asset shall be the income of the transferor. This income shall be included in the taxable income of the transferor.

- **Revocable transfer of asset (section 61):** All income arising to any person by virtue of a revocable transfer of assets shall be chargeable to income tax as the income of the transferor and shall be included in his total income.

**Revocable transfer:** As per section 63 (a), a transfer shall be deemed to be revocable if:-

1. It contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to be transferor; or
2. It gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income of assets. The transfer of the assets includes any settlement, contract, trust or arrangement.
Income of spouse to be included in the income of an individual
[Section 64]

(a) Remuneration of spouse received from a concern in which the
spouse has Substantial Interest [Section 64(1) (ii)]. Any salary,
commission, fees or any other type of remuneration is received
directly or indirectly by a spouse in which other spouse has
substantial interest, such remuneration shall be included in the
total income of that spouse who has substantial interest in that
institution.

If the payment of salary, commission, fees etc. is made to spouse
on account of his technical and professional abilities, then such
remuneration shall not be included in the income of that individual
but this remuneration shall be personal income of the spouse. If
husband and wife both have substantial interest in that institution
and both get remuneration, the remuneration of both shall be
included in the income of that person whose income is more.
[Circular No. 258, dated 14-6-1979]

(b) Income from assets transferred to spouse [Section 64(1) (IV)].
If any property (except house property) is transferred by spouse
(from husband to wife or from wife to husband) without adequate
consideration, the income of this property shall be included in the
income of transferor.

Income from asset transferred to daughter-in-law [section 64(1) (vi)].
If an assessee (father-in-law or mother-in-law) transfers his property
to daughter in law without any adequate consideration on or after 1st
June, the income of such property shall be included in the income of
transferor.
Transfer of asset to any person or Association of Persons for the benefit of spouse [Section 64 (1) (vii)]. If an assessee transfers any property to any person or association of persons for the benefit of spouse (husband or wife), the income from this property to the extent of benefit of the spouse shall be considered the income of transferor and shall be included in the income of the transferor.

Transfer of asset to any person or Association of Persons for the benefit of daughter-in-law [Section 64 (1) (viii)]. If this transfer is made on or after 1ST June, 1973 the income shall be included in the income of the transferor.

Income of Minor Child [Section 64 (1A)]. Incomes earned by minor child shall be included in the income of his parents (wherever has greater income). In the case, if the marriage relations are not maintained the income of minor child shall be included in the income of those parents (father or mother) that has looked after the child in the previous year.

Income from Converted Property [Section 64 (2)]. If a member of Hindu undivided family converts his own earned property to H.U.F. on or after 1ST January, 1970, this is called converted property. The income of such converted property will be the income of the transferor and not of the family. Hence such income shall be taxable in the hands of transferor. But if such transferred property is divided amongst the members of the family, the share in that property to that extent shall be included in the income of transferor.
The above discussion makes it clear that the provisions of Income Tax Act have been such that, it gives maximum loopholes for tax avoidance to the charitable trust, private company, HUF and other deemed incomes. The trust could avail the opportunity of tax avoidance in the income earned from the business and also capital gains from the transfer of capital assets held for the charitable trust. The Indian Companies Act is encouraging the formation of private or closely held company by giving them certain privileges and exemptions.

HUF is a separate assessee under the Income Tax Act, the members of HUF try to divide the HUF into many separate combinations like, father and sons, grand father and grand sons etc. By such partitions the total income of HUF is divided into several small pieces of income, thus providing the privilege of tax avoidance in the form of no tax or lesser rates of tax.

Formation of firm is advantageous from the point of view to avoid the tax liability. If a firm is unregistered, there are little chances for tax avoidance because unregistered firm is to be taxed as an individual. On the other hand, the firm which is registered has good deal of opportunity of tax avoidance because the partners of a registered firm are allowed to carry forward the share of firm’s losses for some years to be deducted out of their income. The rates of taxation for a registered firm are very low as compared to the rates applicable to the individuals. Thus, by these advantages the partners of registered firm are able to avoid taxation to a considerable extent.
Deemed incomes also facilitate the avoidance of tax. According the Income Tax Provisions there are certain circumstances in which the income of other persons is to be included e.g., the income of minor children is to be included in the income of the father, in case of a firm, salary paid to the spouse who is already having income from other sources, will be clubbed with the income of the individual and will not be treated as the income of the spouse. So these provisions lead to avoidance of income tax in a negative way, the assessee may try to show a loss incurred by the other person whose income is to be clubbed with his income. This way the income of the assessee will be reduced by the amount of loss of the other person. So, way the tax liability of the assessee will be reduced.