CHAPTER 2

Tax Planning, Tax Avoidance and Tax Evasion

2.1 Introduction and Background

In the era of globalization and competition, the world has become one village. The advantages of efficiency and lower cost to run business of the person in one part of the world can be earned in any part of the world. While prices are governed by market, cost is outlook of manufacturer of goods or service provider, therefore no one can charge extra price to customer on the grounds that his cost of production or cost of provision of service is more than the others. Today, no one can operate on the theory that he can recover the entire cost from customers. At the same time he cannot sell his products below costs. If he starts selling his products below cost, the existence of the organization itself will be in danger. The earlier equation i.e. Sale price = Cost + Profit is now changed. Keeping the factors same but only by changing their places, it can be said that today Sales Price – Cost = Profit. Today sales price is dictated by the market. Profit is essential for survival and therefore always under pressure. Therefore the concept of target costing is getting importance. In target costing the price of the goods, which market can offer is a target and one has to maintain his costs below the target. Under such circumstances, cost management and cost reduction has become the most important tasks of the organizations. Due to pressure on the costs, the traditional methods of cost reduction have reached to its saturation and the organizations have to search for new and unconventional avenues for cost reduction. Since indirect taxes are part and parcel of the material cost and services, reduction in the payment
of indirect tax leads to cost saving. Therefore Tax planning in Indirect Taxes, though unconventional, has become a major source of Cost Reduction Activities.

Whether Tax planning is a legal and legitimate way of reducing tax liability? The answer to this has been given affirmative by courts in series of decisions and therefore the researcher felt it necessary to study the various aspects and avenues of tax planning in Indirect Taxes and its impact on cost.

Under Central Excise, Service Tax and Customs law, certain exemptions are being granted through notifications. Cenvat Credit Rules do help in minimizing cascading effect of taxes. Therefore, proper understanding of various rules, regulations and provisions, exemptions and procedures in taxation and application of the same in the business operations is one of the non traditional areas for cost reduction. The Industry and business, to a great extent try to reduce burden of Income Tax using various means and methods. However, in Indirect Taxes, particularly Central Excise Duty, Service Tax, Customs Duty and Vat, which play a very crucial role in cost of production, stress is given on the compliance of tax provisions to avoid stringent penalties and interest .This can be called as Tax Management. The implementation of indirect tax provisions generally rests in the hands of middle management, who is also responsible for daily routine activities. Resultantly priority is given to routine work. Also due to inadequate knowledge of the subject, lack of training and continuous up-dation of knowledge, the aspect of tax planning is being ignored. Therefore Researcher felt that the research in the area of tax planning should be undertaken.
The scope of Indirect Taxes is very wide. While law for Central Excise, Customs and Service Tax is one for the whole nation, VAT, Octroi, Entry Tax, LBT have state-wise separate provisions. The researcher has made concentrated efforts to understand various provisions related to Central Excise Duty and Service Tax, and to some extent Customs and Foreign Trade Policy, application of the same to various sectors, various exemptions thereunder, Cenvat credit provisions which are common to Central Excise and Service Tax, and effect of the same in cost reduction.

2.2 Concept of Tax Planning, Tax Avoidance and Tax Evasion.

Whenever any tax is introduced, there is always a struggle between Government and tax payers. While taxpayer always try to minimize or reduce tax liability by adopting certain measures, rightly or wrongly, the Government tries to amend the tax provisions in such a way that there is minimum scope for reducing tax burden. In spite of this, due to various economic or social reasons, certain exemptions are granted in Excise Duty, Customs or even in Service Tax. Certain deductions and abatements are provided on fulfillment of certain conditions and to extend benefits to certain sectors of the society. Sometimes, taxpayers take advantage of faulty drafting of the rules. The decisions by Supreme Court, High Courts and Tribunals become a law on the subject and are binding on taxpayers as well as Government authorities. Sometimes to overcome the decision of the Apex Court, amendments are made in the law. In such conditions Tax management and Tax planning becomes an important task of the taxpayer.
While discussing tax matters, the words tax planning, tax management, tax avoidance and tax evasion are often used. Though the ultimate objective of all four activities is to reduce tax liability, they are different concepts from legal, ethical as well as from operational point of view.

### 2.2.1 Tax Planning:

It is the duty of every citizen to pay legitimate tax but at the same time it is his right not to pay taxes which are not due.

Tax planning means reducing tax liability by taking advantage of the legitimate concessions and exemptions provided in the tax law. It involves the process of arranging business operations in such a way that reduces tax liability. If more two methods are possible to achieve an objective, select one which results in lower tax liability.

Examples of Tax Planning in Indirect Taxes
- Correct Classification of the goods.
- Claiming permissible deductions like discounts, freight etc from the assessable value.
- Determining correct cost of production of captively consumed goods.
- Availing Cenvat credit.
- Availing benefits of various exemption notifications
- Availing benefits under Foreign Trade Policy.
- Restructuring of business.
- Setting up plant the area where tax holiday is granted.
- Job Work
- Procurement from Small Scale Industries
2.2.2 Tax Avoidance:

Tax avoidance means taking undue advantage of the loopholes, lacunae or drafting mistakes for reducing tax liability and thus avoiding payment of tax which is lawfully payable. Generally it is done by twisting or interpreting the provisions of law and avoiding payment of tax. Tax avoidance takes into account the loopholes of law. Though it has a legal sanction, it means following the provisions of law in letter but killing the spirit of the law.

2.2.3 Tax Evasion:

Tax evasion means avoiding tax by illegal means. Generally it involves suppression of facts, falsifying records, fraud or collusion. It is an attempt to evade tax liability with the help of unfair means. Tax evasion is illegal and would result in punishment by way of penalty, fines and sometimes prosecution.

2.2.4 Illustration of difference between tax planning, tax avoidance and tax evasion.

The Government has issued Notifications No. 49/2003-CE, 50/2003-CE granting exemption from excise duty for ten years if industry is set up in the specified area such as Himachal Pradesh, Uttarakhand, North East India. The purpose behind these notifications is to encourage industrialization in these areas.

If a manufacturer sets up manufacturing unit in Himachal Pradesh, it is a tax planning.
However, if he sets up manufacturing facility somewhere else and brings almost ready product to Himachal Pradesh for carrying out minor operations like, testing, packing, repacking etc and sells from Himachal Pradesh, it can be said as tax avoidance, because the intention of the government to encourage industrialization in Himachal Pradesh is defeated. Thus the manufacturer follows the letter of the law but defeats the purpose of behind the law.

If a manufacturer manufactures and dispatches the goods from somewhere else and only raises invoices of sale from Himachal Pradesh to show that goods have been manufactured and sold from Himachal Pradesh, this is a tax evasion.

2.3 **Analysis and gist of important decisions on the subject.**

Since the matters pertaining to tax planning, tax avoidance and tax evasion involve legality of the particular transaction, objective behind it and methodology adopted to reduce burden of tax the researcher thought it proper to study, understand and discuss various decisions of Courts and Tribunals on the subject. The following case laws will underline the importance of tax planning and guide on certain do’s and don’ts.

Though some of the decisions pertain to direct taxes, the principles and law set by these decisions are applicable to indirect taxes also.
2.3.1 McDowell & Co. Ltd Vs CTO, reported in 1985(3)SCC 230 (SC 5 Members Bench)\(^1\)

In tax planning principle set in McDowell’s case is always referred. The principle set by Hon. Court that tax planning is permissible but not subterfuges is allocable universally to all the taxes.

**Facts of the case:** - McDowell & Co. Ltd (hereinafter referred to as the appellant) was a licensed manufacturer of Indian Liquor. Buyers of liquor used to obtain passes for release of liquor after making payment of excise duty directly to excise authorities and present said passes before appellant whereupon bill of sale was prepared by the appellant showing price of liquor but excluding excise duty. Sales tax was paid by appellant to sales tax authorities on basis of turnover but excluding excise duty. The method followed by the appellant resulted in reduction of sales tax amount on liquor. The issue before Hon. Supreme Court (5 Member Bench) was whether excise duty which was payable by appellant but had been paid by buyer was actually a part of turnover of appellant and was, therefore liable to be so included for determining liability to sales tax. In the instant case appellant followed this method to reduce burden of sales tax. The liability to pay excise duty is on the manufacturer at the time of removal of the goods from the factory, though he can recover it from the customer. However, in the instant case, the duty burden was directly transferred to buyer and the value of the excise duty, which should have been part of the taxable value for the purpose of sales tax, was not included in the taxable value. Hon. Supreme Court, on this issue, held that excise duty, which was payable by appellant but had been paid buyer was actually a part of turnover of appellant and therefore liable to be included for determining liability of sales tax.
On the other issue i.e. whether it is open to everyone to so arrange his affairs as to reduce burden of taxation to minimum and such a process does not constitute tax evasion, Hon. Apex Court held that the process will amount to tax evasion.

**Decision** :- In the said case of McDowell & Co. Ltd Vs CTO, reported in 1985(3)SCC 230 (SC 5 Members Bench), Hon. Supreme Court, observed that “ Tax planning may be legitimate if it is within the framework of law, but colorable devices cannot be part of tax planning. It is wrong to say that it is honourable to avoid payment of tax by dubious methods. It is obligation of every citizen to pay tax honestly without resorting to subterfuges”. This view was expressed in majority judgment delivered By Hon. Justice Rangnath Mishra.

However, in the separate judgment, Justice Chinnapa Reddy, expressed that “In our view, the proper view to construe a taxing statute, while considering a device to avoid tax, is not to ask whether a provision should be construed liberally or principally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax and whether the transaction is such that the judicial process may accord approval to it. - The series of transactions has to be viewed as a whole and then the court should see the real purpose of the transaction. – It is neither fair nor desirable to expect the legislature to intervene and take care of every device and scheme to avoid taxation. It is upto the court to take stock and determine the nature of the new and sophisticated devices to avoid tax and expose for what they really are and refuse to give judicial benefication”.
2.3.2  UOI Vs Azadi Bachao Andolan 2003(132)Taxman 373 (SC).²

**Facts of the case:-** By circular No.682 dt.30.03.1994 issued by Central Board of Direct Taxes in exercise of its power u/s 90 of the Income Tax Act, 1961, the Government of India clarified that capital gains of any resident of Mauritius by alienation of shares of an Indian Company shall be taxable only in Mauritius according to Mauritius Taxation Law and will not be liable to tax in India. Later because of issue of show cause notices to some FIIs functioning in India, but incorporated in Mauritius, as to why they should not be taxed on profits and dividends in India, there was a panic and to clarify the position Central Board of Direct Taxes issued circular No.789 dt.13.04.2000 clarifying that FIIs etc which are resident of Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares. The high Court quashed and set aside the circular accepting the contention that the said circular is ultra virus the provisions of sec 90 and sec 119 and also otherwise bad and illegal.

Hon. Supreme Court, in the said case of UOI Vs Azadi Bachao Andolan 2003(132) Taxman373(SC) observed that “If the court finds that notwithstanding a series of legal steps taken by the assessee, the intended legal result has not been achieved, the court might be justified in overlooking the intermediate legal, but it would not be permissible for the court to treat the intervening legal steps as non-est based upon some hypothetical assessment of the real motive of the assessee. In our view the court must deal with what is tangible in an objective manner and cannot afford to chase a “will-o’-the -wisp”.------We are unable to agree with the submission that an act which is otherwise valid in law can be treated as non-est merely on some underlying motive supposedly resulting in some economic detriment or prejudice to the national interests, as perceived by the respondents. --- The
law stated in Duke of Westminster's case has remained the same, despite the hiccups of McDowell’s case”.

In the said case, following observations of Madras High Court in the case of M.V. Valliappan Vs CIT, reported in 1988(170)ITR238 were specifically noted and approved. “The decision in McDowell’s case cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or arrangement which is perfectly permissible under the law, which has the effect of reducing tax burden of assessee, must be looked upon with disfavor”.

Thus practically, the extreme views expressed by Justice Chinappa Reddy in MCDowell’s case are no more a good law.
2.3.3 Calcutta Chromotype Ltd. Vs CCE, Calcutta-1998(99)ELT202(SC)³

Facts of the case :- Under Central Excise, where the transaction is between two related parties, separate rules are framed under Central Excise Valuation Rules. This is mainly to prevent undervaluation of goods for the purpose of excise duty payment and revenue loss. It is a common practice that assessee creates separate entities as a part of tax planning. Sometime dummy and façade entities are created.

In the instant case, manufacturer and distributor (buyer) both were limited companies with common directors and common shareholder. Manufacturer was selling goods under brand name owned by distributor. Shares of both companies were held by Sharma family and controlled by one person. In this case Hon. Supreme Court held the following.

Decision: - There is no bar on the authorities to lift the veil of the company, whether a manufacturer or buyer, to see it was not wearing that mask of not being treated as related person when, in fact, both, the manufacturer and the buyer are the same persons. Once it is found that persons behind the manufacturer and the buyer are same, it is apparent that buyer is associated with the manufacturer and then regard being had to common course of natural events, human conduct and public and private business of each other (ref Sec 114 of Evidence Act) – As to when the veil should be lifted will depend upon facts and circumstances of each case.
2.3.4 Vodafone International Holdings B.V. Vs UOI–2012 (204) Taxmann 408 (SC)².

This is a unique case throwing light on how transactions are planned internationally to avoid taxes, taking into consideration tax benefits available in different countries.

**Facts of the case :-** The Hutchison Group, Hong Kong (UK) first invested into the telecom business in India in 1992 when the said group invested in an Indian joint venture vehicle by the name Hutchison Max Telecom Ltd. (HMTL)- later renamed as Hutchison Essar Ltd. (HEL) . HEL was an Indian company in which shares were acquired by Hutchison Group of companies through a structural arrangement of holding and subsidiary companies incorporated in various foreign countries particularly in Mauritius. Hutchison Telecommunication International Ltd. (HTIL) was incorporated in Cayman Islands. HTIL and its downstream companies held interests in mobile telecommunication business in several countries including India. CGP was a 100% subsidiary of HTIL incorporated in Cayman Island as an ‘Exempted Company’ and it had a controlling interest in HEL. The appellant company, namely Vodafone International Holdings BV (VIM) , was resident for tax purposes in Netherlands. On 11.02.2007 a Sale Purchase Agreement (SPA) was entered into between appellant and HTIL under which HTIL agreed to transfer to appellant its entire issued share capital in GCP and thereby entire interest of HTIL in HEL was transferred to appellant. The issue came up for consideration was as to whether aforesaid transfer could be termed as indirect transfer of a capital asset situate in India and whether section 9(1)(i) would be attracted in such a case and consequently whether capital gain arising from such transactions could be taxed in India. The High Court held that VIH on
purchase of GCP got indirect interest in HEL, acquired controlling right in certain indirect holding companies of HEL, controlling rights through shareholder agreements which included the right to appoint directors in certain indirect holding companies of HEL, interest in the form of non compete agreement with Hutch brand in India etc. which all constituted capital asset as per section 2(14). The high Court further held that VIH by virtue of its diverse agreements had nexus with Indian jurisdiction and, hence proceedings initiated under section 201 for failure to withhold tax by VIH on payments made to HTIL could not be held to lack jurisdiction.

The matter was appealed to Hon. Supreme Court. It was noted that instant case concerned investment into India by a holding company (parent company) HTIL through a maze of subsidiaries. It was also apparent that transaction involved ‘outright sale’ between two nonresident companies of a capital asset (shares) outside India. Whether since parties to transaction had not agreed upon a separate price for CGP share and for what High Court called as ‘other rights and entitlements’ (including options, right to non compete, control premium, customer base, etc), it was not open to Revenue to split payment and consider a part of such payments for each of above items. It was further held that since there was an offshore transaction between two nonresident companies, namely HTIL and VIH, and, subject matter of transaction was transfer of CGP (another nonresident company), Indian Tax authorities had no territorial tax jurisdiction u/s 9(1)(i) to tax said offshore transaction.

In the said judgement, Hon. Justice S.H.Kapadia discussed correctness of Azadi Bachao case and also McDowells case and held that there is no conflict between these two cases. For the ready reference, the relevant para 64 of his judgment is reproduced below
64. The majority judgment in McDowell & Co. Ltd. case (supra) held that "tax planning may be legitimate provided it is within the framework of law" (para 45). In the latter part of para 45, it held that "colourable device cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods". It is the obligation of every citizen to pay the taxes without resorting to subterfuges. The above observations should be read with para 46 where the majority holds "on this aspect one of us, Chinnappa Reddy, J. has proposed a separate opinion with which we agree". The words "this aspect" express the majority's agreement with the judgment of Reddy, J. only in relation to tax evasion through the use of colourable devices and by resorting to dubious methods and subterfuges. Thus, it cannot be said that all tax planning is illegal/illegitimate/impermissible. Moreover, Reddy, J. himself says that he agrees with the majority. In the judgment of Reddy, J. there are repeated references to schemes and devices in contradistinction to "legitimate avoidance of tax liability" (paras 7-10, 17 & 18). In our view, although Chinnappa Reddy, J. makes a number of observations regarding the need to depart from the "Westminster" and tax avoidance - these are clearly only in the context of artificial and colourable devices. Reading McDowell, in the manner indicated hereinabove, in cases of treaty shopping and/or tax avoidance, there is no conflict between McDowell and Azadi Bachao or between McDowell and Mathuram Agrawal.

In the same case Hon. Justice K.S. Radhakrishnan discussed in detail the corporate veil doctrine.
In para 75 and para 76 Hon. Court observed that Lifting the corporate veil doctrine can be applied in tax matters even in absence of any statutory authorization to that effect. Principle is also being applied in cases of holding company – subsidiary relationship – where in spite of being separate legal personalities if the facts reveal that they indulge in dubious methods for tax evasion. For the ready reference, the relevant paras are reproduced below.

75. Lifting the corporate veil doctrine is readily applied in the cases coming within the Company Law, Law of Contract, Law of Taxation. Once the transaction is shown to be fraudulent, sham, circuitous or a device designed to defeat the interests of the shareholders, investors, parties to the contract and also for tax evasion, the Court can always lift the corporate veil and examine the substance of the transaction. This Court in CIT Vs Sri Meenakshi Mills Ltd., AIR 1967 SC 819 held that the Court is entitled to lift the veil of the corporate entity and pay regard to the economic realities behind the legal facade meaning that the court has the power to disregard the corporate entity if it is used for tax evasion. In Life Insurance Corporation of India v. Escorts Ltd. (1986) 1 SCC 264, this Court held that the corporate veil may be lifted where a statute itself contemplates lifting of the veil or fraud or improper conduct intended to be prevented or a taxing statute or a beneficial statute is sought to be evaded or where associated companies are inextricably as to be, in reality part of one concern. Lifting the Corporate Veil doctrine was also applied in Juggilal Kamlapat v. CIT AIR 1969 SC 932, wherein this Court noticed that the assessee firm sought to avoid tax on the amount of compensation received for the loss of office by claiming that it was capital gain and it was found that the termination of the contract of managing agency was a collusive transaction. Court held that it was a collusive device,
practised by the managed company and the assessee firm for the purpose of evading income tax, both at the hands of the payer and the payee.

76. Lifting the corporate veil doctrine can, therefore, be applied in tax matters even in the absence of any statutory authorization to that effect. Principle is also being applied in cases of holding company - subsidiary relationship - where in spite of being separate legal personalities, if the facts reveal that they indulge in dubious methods for tax evasion.

Further, the Court discussed Tax avoidance and tax evasion. He observed the following.

(B) Tax Avoidance and Tax Evasion:

Tax avoidance and tax evasion are two expressions, which find no definition either in the Indian Companies Act 1956 or the Income Tax Act 1961. But the expressions are being used in different contexts by our Courts as well as the Courts in England and various other countries, when a subject is sought to be taxed. One of the earliest decisions which came up before the House of Lords in England demanding tax on a transaction by the Crown is Duke of Westminster (supra). In that case, Duke of Westminster had made an arrangement that he would pay his gardener an annuity, in which case, a tax deduction could be claimed. Wages of household services were not deductible expenses in computing the taxable income; therefore, Duke of Westminster was advised by the tax experts that if such an agreement was employed, Duke would get tax exemption. Under the Tax Legislation then in force, if it was shown as gardener's wages, then the wages paid would not be deductible. Inland Revenue contended that the form of the transaction was not acceptable to it and the Duke was taxed on the substance of the transaction, which was that payment of annuity, was treated as a payment of salary or wages.
Crown's claim of substance doctrine was, however, rejected by the House of Lords. Lord Tomlin's celebrated words are quoted below:

"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."

Lord Atkin, however, dissented and stated that "the substance of the transaction was that what was being paid was remuneration."

The principles which have emerged from that judgment are as follows:

(1) A legislation is to receive a strict or literal interpretation;

(2) An arrangement is to be looked at not in by its economic or commercial substance but by its legal form; and

(3) An arrangement is effective for tax purposes even if it has no business purpose and has been entered into to avoid tax.

The House of Lords, during 1980's, it seems, began to attach a "purposive interpretation approach" and gradually began to give emphasis on "economic substance doctrine" as a question of statutory interpretation. In a most celebrated case in W.T. Ramsay Ltd. (supra), the House of Lords considered this question again. That was a case whereby the taxpayer entered into a circular series of transactions designed to produce a loss for tax purposes, but which together produced no commercial result. Viewed that transaction as a whole, the series of transactions was self-canceling, the taxpayer was in precisely the same commercial position at the end as at the beginning of the
series of transactions. House of Lords ruled that, notwithstanding the rule in 
Duke of Westminster's case (supra), the series of transactions should be 
disregarded for tax purposes and the manufactured loss, therefore, was not 
available to the taxpayer. Lord Wilberforce opined as follows:

"While obliging the court to accept documents or transactions, found to be 
genuine, as such, it does not compel the court to look at a document or a 
transaction in blinkers, isolated from any context to which it properly belongs. 
If it can be seen that a document or transaction was intended to have effect as 
part of a nexus or series of transactions, or as an ingredient of a wider 
transaction intended as a whole, there is nothing in the doctrine to prevent it 
being so regarded; to do so in not to prefer form to substance, or substance to 
form. It is the task of the court to ascertain the legal nature of any transaction 
to which it is sought to attach a tax or a tax consequence and if that emerges 
from a series or combination of transactions intended to operate as such, it is 
that series or combination which may be regarded." [Emphasis supplied]

House of Lords, therefore, made the following important remarks concerning 
what action the Court should consider in cases that involve tax avoidance:

(a) A taxpayer was only to be taxed if the Legislation clearly indicated 
that this was the case;

(b) A taxpayer was entitled to manage his or her affairs so as to reduce 
tax;

(c) Even if the purpose or object of a transaction was to avoid tax this did 
not invalidate a transaction unless an anti-avoidance provision 
applied; and

(d) If a document or transaction was genuine and not a sham in the 
traditional sense, the Court had to adhere to the form of the 
transaction following the Duke Westminster concept.
Thereafter he also discussed as to whether McDowells case calls for reconsideration. He observed that -

**McDowell - Whether calls for Reconsideration:**

107. McDowell & Co. Ltd. case (supra) has emphatically spoken on the principle of Tax Planning. Justice Ranganath Mishra, on his and on behalf of three other Judges, after referring to the observations of Justice S.C. Shah in CIT v. A. Raman & Co. AIR 1968 SC 49, CIT v. B.M. Kharwar AIR 1969 SC 812, the judgments in Bank of Chettinad Ltd. v. CIT (1940) 8 ITR 522 (PC), Jiyajeerao Cotton Mills Ltd. v. CIT and Excess Profits Tax AIR 1959 SC 270; CIT v. Vadilal Lallubhai (1973) 3 SCC 17 and the views expressed by Viscount Simon in Latilla v. IRC. (1943) AC 377 stated as follows:

"Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."

108. Justice Shah in A. Raman & Co. (supra) has stated that avoidance of tax liability by so arranging the commercial affairs that charge of tax is distributed is not prohibited and a tax payer may resort to a device to divert the income before it accrues or arises to him and the effectiveness of the device depends not upon considerations of morality, but on the operation of the Income Tax Act. Justice Shah made the same observation in B.M. Kharwar (supra) as well and after quoting a passage from the judgment of the Privy Council stated as follows :-
"The Taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of the relationship. But the legal effect of a transaction cannot be displaced by probing into the "substance of the transaction".

In Jiyajee Rao Cotton Mills Ltd. (supra) also, this Court made the following observation:

"Every person is entitled so to arrange his affairs as to avoid taxation, but the arrangement must be real and genuine and not a sham or make-believe."

109. In Vadilal Lallubhai (supra) this Court re-affirmed the principle of strict interpretation of the charging provisions and also affirmed the decision of the Gujarat High Court in Sankarlal Balabhai v. ITO (1975) 100 ITR 97, which had drawn a distinction between the legitimate avoidance and tax evasion. Lalita’s case (supra) dealing with a tax avoidance scheme, has also expressly affirmed the principle that genuine arrangements would be permissible and may result in an assessee escaping tax.

110. Justice Chinnappa Reddy starts his concurring judgment in McDowell as follows:

"While I entirely agree with my brother Ranganath Mishra, J. in the judgment proposed to be delivered by me, I wish to add a few paragraphs, particularly to supplement what he has said on the "fashionable" topic of tax avoidance." [Emphasis supplied]
Justice Reddy has, the above quoted portion shows, entirely agreed with Justice Mishra and has stated that he is only supplementing what Justice Mishra has spoken on tax avoidance. Justice Reddy, while agreeing with Justice Mishra and the other three judges, has opined that in the very country of its birth, the principle of Westminster has been given a decent burial and in that country where the phrase “tax avoidance” originated the judicial attitude towards tax avoidance has changed and the Courts are now concerning themselves not merely with the genuineness of a transaction, but with the intended effect of it for fiscal purposes. Justice Reddy also opined that no one can get away with the tax avoidance project with the mere statement that there is nothing illegal about it. Justice Reddy has also opined that the ghost of Westminster (in the words of Lord Roskill) has been exorcised in England. In our view, what transpired in England is not the ratio of McDowell and cannot be and remains merely an opinion or view.

111. Confusion arose (see Paragraph 46 of the judgment) when Justice Mishra has stated after referring to the concept of tax planning as follows:

"On this aspect, one of us Chinnappa Reddy, J. has proposed a separate and detailed opinion with which we agree."

112. Justice Reddy, we have already indicated, himself has stated that he is entirely agreeing with Justice Mishra and has only supplemented what Justice Mishra has stated on Tax Avoidance, therefore, we have go by what Justice Mishra has spoken on tax avoidance.
113. Justice Reddy has depreciated the practice of setting up of Tax Avoidance Projects, in our view, rightly because the same is/was the situation in England and W.T. Ramsay Ltd. case (supra) and other judgments had depreciated the Tax Avoidance Schemes.

114. In our view, the ratio of the judgment is what is spoken by Justice Mishra for himself and on behalf of three other judges, on which Justice Reddy has agreed. Justice Reddy has clearly stated that he is only supplementing what Justice Mishra has said on Tax avoidance.

115. Justice Reddy has endorsed the view of Lord Roskill that the ghost of Westminster had been exorcised in England and that one should not allow its head rear over India. If one scans through the various judgments of the House of Lords in England, which we have already done, one thing is clear that it has been a cornerstone of law, that a tax payer is enabled to arrange his affairs so as to reduce the liability of tax and the fact that the motive for a transaction is to avoid tax does not invalidate it unless a particular enactment so provides (Westminster Principle). Needless to say if the arrangement is to be effective, it is essential that the transaction has some economic or commercial substance. Lord Roskill’s view is not seen as the correct view so also Justice Reddy's, for the reasons we have already explained in earlier part of this judgment.

116. A five Judges Bench judgment of this Court in Mathuram Agrawal (supra), after referring to the judgment in B.M. Kharwar (supra) as well as the opinion expressed by Lord Roskill on Duke of Westminster case (supra) stated that the subject is not to be taxed by inference or analogy, but only by the plain words of a statute applicable to the facts and circumstances of each case.
117. *Revenue cannot tax a subject without a statute to support and in the course we also acknowledge that every tax payer is entitled to arrange his affairs so that his taxes shall be as low as possible and that he is not bound to choose that pattern which will replenish the treasury.* Revenue's stand that the ratio laid down in McDowell is contrary to what has been laid down in Azadi Bachao Andolan case (supra), in our view, is unsustainable and, therefore, calls for no reconsideration by a larger branch.

**Present Status of the case:** To nullify the effect of the decision of Hon. Supreme Court, Government passed amendment with retrospective effect.

The Company filed appeal in the international court. Now efforts are being made to settle the issue out of court since it will have long-term effect on the foreign investment and technology in India.

Apart from the abovementioned decisions, there are many decisions on validity and legality of tax planning. Gist of some other important decisions on Tax Planning Vs Tax Evasion is given below.
Direct Taxes

2.3.5 CIT Vs Walford Share & Stock Brokers P. Ltd. 2010(192) Taxmann211 (SC)².

Hon. Supreme Court observed that a citizen is free to carry on its business within four corners of law. Thus mere tax planning without any motive to evade taxes through colorable devices is not frowned upon even by the judgment of this court in McDowell & Co. Ltd case. In this case, it was held that mere use of provision of the Act cannot be called as ‘abuse of law’. Even assuming that the transaction was pre-planned, there is nothing to impeach the genuineness of the transaction.

2.3.6 Banyan and Berry Vs CIT -1996(84)Taxmann 515(Guj HC DB)²,

It was held that “Not all legitimate act of taxpayer can be branded of questionable character on the anvil of McDowells. We are unable to read in that aforesaid decision that any act of an assessee which results in reduction in his tax liability or expectation of tax benefit in future amounts to a colorable device, a dubious method or subterfuge to avoid tax and can be ignored....... The principle cannot be read as laying down the law that a person is to arrange his affairs so as to attract maximum tax liability , and every act which results in tax reduction or not attracting tax authorized by law is to be treated as device of tax avoidance.”
2.3.7  CGT Vs Satya Nand Munjal -2003(128) Taxmann 892 (P&H HC DB)^2.

It was observed that if on account of lacuna in the law or otherwise, the assessee is able to avoid payment of tax within the letter of law, it cannot be said that the action is void because it is intended to save payment of tax, So long as the law exists in its present form, the taxpayer is entitled to take its advantage.
Indirect Taxes

2.3.8 CCE Chandigarh Vs Pyara Rexine Pvt. Ltd. 2010(259)ELT 692 (HP HC)\(^3\).

In the said decision, it was held that Avoidance of tax by Tax Planning is not illegal.

2.3.9 Motiram Tolaram Vs UOI – 1999(112) ELT 749(SC)\(^3\)

Sometimes notifications are worded in such a way so that certain class of assessee should not get benefit of the same. In the said case, Hon. High Court observed that normally it is the assessee who does tax planning but in the case of countervailing duty leviable on imported polyvinyl alcohol under exemption Notification 185/83-CE, one finds that it is the revenue which has done tax collection planning. The notification was deliberately worded in such a way that imported polyvinyl alcohol did not get the concessional excise rate.

2.3.10 Union of India Vs Playworld Electronics Pvt. Ltd. 1989(41)ELT368(SC)\(^3\)

Hon. Supreme Court held that “It is true that tax planning may not be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage to avoid the payment of tax by dubious methods. It is also true that in order to create the atmosphere of tax compliance taxes must be reasonably collected, should be utilize in proper expenditure and not wasted.
2.3.11 CCE, Mumbai Vs Fiat India Ltd. 2012(283) ELT161(SC)³.

The Central Excise Act, 1944 was amended w.e.f. 1-7-2000 to provide that if goods are sold to unrelated buyer and price is the sole consideration, transaction value is the basis of Assessable Value for purpose of payment of excise duty; therefore cost of production is not relevant for purpose of excise duty payment.

In CCE Vs Guru Nanak Refrigeration Corporation-2003 (153) ELT 249 (SC), Hon. Supreme Court upheld the decision of the CEGAT in the case of Guru Nanak Refrigeration Corporation Vs CCE-1996( 81) ELT 290 (CEGAT 3 member bench), wherein it was held that if there is no allegation of flow-back of money from buyer to assessee, if price is the sole consideration and if dealings between assessee and buyer are at arm’s length, Assessable Value will be decided on basis of selling price, even if it is below manufacturing cost.

However, In CCE Vs Fiat India P Ltd. 2012(283) ELT 161 (SC), it has been held that if goods are sold below the cost of production, the price would not be ‘normal price’. The price charged would not be ‘sole consideration’. Intention to penetrate the market or meet the competition would be the additional consideration. In that case, excise duty will be payable on the basis of cost of production plus profit and not on basis of transaction value (selling price). Thus the decision of the Supreme Court in the case of CCE vs Guru Nanak Refrigeration Corpn. 2003(153) ELT249 was distinguished.
The Fiat case was mainly in relation to provisions of section 4 of Central Excise Act 1944, as existing upto 1-7-2000, where ‘normal wholesale price of such goods’ was the basis of Assessable Value. However, part of the period covered in the case also covers period after 1-7-2000 i.e. covered under new section 4 of the Central Excise Act, 1944.

**Facts of the case**

Many automobile manufacturers from out of India started entering Indian market after liberalization of economic policies in 1991. Existing manufacturers also started introducing new models. Fiat India Pvt. Ltd also started manufacturing of its new model namely Fiat Uno in India. Initially most of the major components and parts were imported in SKD or CKD form and were assembled in India.

Till 1991, the foreign exchange rates were controlled artificially by Reserve Bank of India. There was always a difference between official foreign exchange rate as determined by RBI and the market rate. As a part of liberalization, the control over foreign exchange rate was removed. The foreign exchange rate was to be determined by market forces. As a result, foreign exchange rates became adverse, due to which cost of imported articles became very high.

In the instant case, Fiat India Pvt Ltd. (Hereinafter referred to as Assessee) had to import car components at very high price. Their main competitors like Maruti Udyog Ltd. had started indigenization much earlier and most of the parts were manufactured within India where cost was low. Hence, their cost of production was much lower than that of Fiat. Though cost of procurement of raw material and components was very high as compared to the competitor, it
was not possible for assessee to sale their cars at such high price and recover full cost. Therefore, assessee had no option but to sell their cars at a price below their cost of production, to remain in the market. This continued for a period of more than five years.

The cost of production was Rs 398585/-, whereas assessable value based on sale price was Rs 185400/-. The assessee had entered into spin off agreement vide Deed of Assignment dt.30.03.1998, whereby Fiat India Pvt. Ltd would be liable for any excise liability accruing from 29.09.1997 onwards, in respect of the cars in issue. Such ‘loss making price’ continued for five years.

Assessee contended that there was no financial flow back. Assessee was forced to sale below cost of production due to increased cost of imported components. As the process of indigenization would increase, cost would come down. It was submitted that the low price was to penetrate the market, to meet competition in the market and to sustain in business. Department contended that the price at which the cars were sold is not ‘normal price’ and therefore the assessable value needs to be worked on the basis of cost of production. A special audit u/s 14A of the Central Excise Cat was ordered and the Cost Accountant to ascertain the correctness of the price declared by the assessee. The cost accountant, vide his report dt. 31.03.1999 submitted that cost of production of the Fiat Uno model was Rs. 504982/-

Hon. Supreme Court, decided the civil appeal Nos. 1648-1649 on 29.08.2012. The summery of the decision of Supreme Court is as follows-

(1) ‘Loss making price’ which continued for five years cannot be treated as ‘normal price’. (para 70)
There could be instances where manufacturer may sale below cost, like switching manufacturing activity or goods could not be sold in a reasonable time. These instances are only illustrative, not exhaustive. (para 50).

When assessee was selling goods at a loss, price was not sole consideration. ‘Penetrating market’ was the additional consideration (para 43, 50, 51, 60, 61).

Consideration means something which is of value in the eyes of law. It means reasonable equivalent or other valuable benefit passed on by promisor to promisee or transferor to transferee. ‘Sole consideration’ means it should be sufficient and valuable having regard to the facts, circumstances and necessities of the case. (para 53, 58)

This principle would apply even under new section 4, if price is not the sole consideration. ‘Penetrating the market’ can be additional consideration.

Mere fact that correct interpretation of law may lead to hardship would not be a valid consideration for distorting the language of statutory provision. (para 27).

The judgment is being interpreted by department to mean that transaction value of a product cannot be below cost of a product. Even if selling price is below the cost, excise duty will be payable on basis of cost plus profit basis only.
The decision of the Supreme Court, now compel manufacturers to pay duty on the value, which cannot be less than cost of production. The decision has put tremendous pressure on manufacturers to reduce cost of production, and thereby selling price to remain in the market. This will lead the manufacturers to explore every possibility of cost reduction, by using conventional or unconventional method. On this background researcher felt that the concept of tax planning in Indirect Taxes will get more importance.

2.4 Conclusion

From the above discussions, it can be seen that tax planning is legal but colourable device cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods.

Tax planning is the exercise carried out by a taxpayer to meet his legal obligations in proper and systematic manner by availing all permissible benefits under tax laws including benefit of various notifications. Planning does not mean reduction in tax liability always but is done with the intention to avoid litigations and penalties. Planning various statutory returns on time, compliance of provisions of law and avoiding penalties, interest and unwarranted litigations is an efficient tax management. Tax management may not result in reducing tax liability but it certainly helps in saving penalties and interest and thus can be treated as a part of tax planning. Tax planning is incomplete without tax management.

The objective of tax management is to comply with law and statutory provisions. It is an ongoing activity and includes maintenance of proper records, filing of proper returns, assessments, review of the procedures
followed by the taxpayer. It also includes compiling and preserving data and supporting documents, timely payment of tax, responding to the notices received from tax authorities etc. Tax management has a limited scope and results in avoiding penalties, penal interest and prosecution.

The scope of Tax planning is much wider. It aims at reducing tax liability to the minimum. Though it is an ongoing activity, it is futuristic in its approach and results in substantial benefits over a period. It includes availing concessions and reliefs permissible under the law and arrange business activities in the manner which will minimize the incidence of tax.

Tax planning under Central Excise, Customs and Service Tax helps in taking decisions in the following activities.

- Reducing cost of raw material, packing material and capital goods.
- Make or buy.
- Own or lease.
- Export or domestic sale.
- Shifting / starting business at new locations where concessions are available.
- Merger / demerger.
- Valuation of excisable goods and reduction in tax liability.
- Making product competitive in the market and increase market share.

The Government has powers to amend tax provisions by amending the law or even by issuing notifications. Benefits and exemption in tax laws are given with specific intention. Many a times these are misused by the trade and industry. Sometimes government also plays mischief to block the legitimate right or to deprive certain organizations from such legitimate benefits.
In this study report, an attempt has been made to find out whether tax planning is possible in Indirect Taxes and if done whether and how much cost reduction is possible. Emphasis has been given to study the various provisions and cases resulting in tax planning in Indirect Taxes. Stress has been given upon Central Excise and Service Tax. Cases of how government has taken away right of tax planning by amending the laws are also studied and references have been made to it.

Tax planning in Direct Taxes helps in reducing tax liability and increase in income. It has very little bearing on cost. However, Indirect Tax is a cost, tax planning ultimately results in reduction in cost of production or cost of goods sold. Tax planning in Central Excise brings down cost of material and tax planning in service tax reduces cost of utilities and overheads. Thus, even keeping the price of the goods same, the profit can be improved.

There are many instances where tax planning was failed. Study of some failed tax planning is also done. It has helped in determining “Does and Don’ts”. In fact, McDowell’s case is the example of failed tax planning.

Proper understanding of various provisions and procedures in taxation, application of the same in the business operations is one of the non traditional areas for cost reduction activities. The Industry and Business, to a great extent try to reduce burden of Income Tax by using various means and methods. Enough literature is available on tax planning in direct taxes. However, Indirect Taxes, i.e. Central Excise, Customs, and Service Tax in the case of Central Government and Vat in the case of State levies, the concept of cost reduction through proper tax planning has not been explored so far by the Industry. Efforts are taken on compliance of tax provisions to save penalties,
but the aspect of proper planning and achieving cost reduction is generally ignored. The implementation of various provisions rests in the hands of middle management, who are also responsible for daily routine activities. Resultantly priority is given to routine work and many a times provisions are overlooked. Inadequate knowledge and lack of training also affects the cost reduction activities. The proper planning in the area of indirect taxes is one of the important areas where cost reduction is possible. Cost reduction in indirect taxes requires understanding of law and application of the same in the given situation.

Central Excise and Service Tax constitute approx 25 % value of the total turnover. The impact is twofold. Duties and taxes on inputs, input services, capital goods on one hand and on the other hand duties and taxes on final product and output services, duties on intermediate products.

In the present era, one cannot expect to manufacture all the goods, inputs, intermediate products under one roof. Even for manufacturing a single product also some activities are outsourced. To get benefit of specialization and effective utilization of resources the product passes through the hands of many agencies and players in the stream. Therefore, there is cascading effect and impact of taxation on incoming goods and services. Also the goods and services are liable to various duties and taxes like Central Excise Duty, Service Tax, and Vat etc. Therefore proper understanding of various tax provisions and making effective use of the same helps in achieving cost reduction.
Keeping in mind this aspect, the researcher conducted a study of the avenues available for tax planning in Indirect Taxes. The cases selected are all real and genuine. An attempt has been made to analyze various tax provisions, rules, notifications etc keeping in mind the objective of cost reduction. The principle of KAIZEN i.e. continuous improvement process (CIP), is also kept in mind. Therefore a possibility of small saving in certain areas is also considered for this purpose.

The landmark decisions in the area of tax planning have provided the basis of framework in indentifying the issues, gaps leading to formulation of research questions. Besides this, exhaustive review of literature has been carried out by the researcher which is presented in the subsequent chapter of the study.
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