

CHAPTER IV

TAX PLANNING AND GIFT TAX ACT.

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4.1 Introduction

That tax planning, as against tax evasion is favoured by the Courts, is well established. The aim of this chapter is how to achieve tax planning through gift. A well considered act of transfer also may prove to be an effective tax planning device.

Reducing incidence of tax by adopting legal, valid and lawful methods is not only permissible but is duty of every person. It has been held by the Supreme Court that avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed, is not prohibited. It has been held by the Madras High Court that avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law and certainly not bad morality, for anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum. Justice Rand of America observed that

"Over and over again Courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as



possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than what the law demands; taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."

The entire object of preparing this chapter is to apprise how assesseees should do tax planning through gift. For that purpose it is necessary to know the aspects of tax planning.

4.2 TAX AVOIDANCE AS OPPOSED TO TAX EVASION

Tax avoidance, like tax evasion, is a worldwide phenomenon. It is not a modern device merely resulting from present day impositions, nor necessarily brought about by strong and popular resentment to taxation. Moreover, increased taxation resulting from the need to find additional revenues, merely served to intensify the practice of tax avoidance, involving, as they did and still do, the development of a large number of ingenious devices, which time and circumstances have perfected, to enable the expertly advised tax payers to pay less tax than he would otherwise have paid.

In order to distinguish tax avoidance from tax evasion, motive is an important element. A tax avoidance transaction would not be undertaken if the tax saving element had not been present. It follows, therefore, that a tax avoidance transaction is one which avoids tax, is intended for the purpose of avoiding tax by some artificial or unusual form, and is carried out lawfully, though in a way not foreseen by the legislature.

4.3 SOME ASPECTS OF TAX PLANNING

(i) Tax planning is the active device by which the tax payer seeks to reduce or waive or remove altogether his liability to tax without actually breaking the law. 'Tax evasion' is the wilful and deliberate violation of the law in order to escape payment of tax which is unquestionably imposed by the law of the taxing jurisdiction. 'Tax evasion' is sometimes loosely referred to in a broader sense to include 'tax avoidance' and the distinction is often made between 'tax planning' and 'tax avoidance' and this fact is mainly true in our country, where the tax rates are relatively higher as compared to most other countries. The concept of 'tax evasion' postulates an illegal act by the tax payer or the assessee.

(ii) 'Tax planning' does not amount to evasion of tax. It is an act of prudence and forethought on the part

of a citizen who is entitled to reduce the burden of his tax liability if it is possible under the existing laws. In support of this, it may be pertinent to quote the observations.

"Avoidance of tax is not tax evasion and it carries no ignominy with it. For, it is sound law and, certainly not bad morality. For anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum."

(iii) According to Supreme Court every person is entitled to so arrange his affairs as to avoid taxation but the arrangement must be real and genuine, and not a make believe.

(iv) Ex-Chief Justice of the Supreme Court, Shri J.C.Shah's following view on avoidance can be real guide so far 'tax planning' is concerned.

"Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed, is not prohibited. A tax payer may resort to a device to divert the income before it occurs or arises to him. Effectiveness of the device depends not upon considerations of morality but on the operation of the Gift Tax Act and other direct taxes."

(v) Thus it is always open to a person consistent with the law to so arrange his affairs that he may reduce his tax liability to the minimum permissible under the law. The fact that the liabilities to tax may be reduced by adoption of an expedient which the law permits, is wholly irrelevant in considering the validity of that expedient.

(vi) While evasion of tax by suppressing profits, inflating expenses or by any other mode should be strongly condemned, there is no reason for discouraging a tax payer from arranging his affairs in such a way as he pays the minimum but correct amount of tax which is due, so long as he does not transgress the legal provision and judicial decisions.

(vii) In a complex tax legislation there are many pitfalls. Compliance with certain procedures and formalities and that too in the prescribed form and the prescribed manner and with the prescribed time limit, has become so rigid that any omission therein might lead to unintended hardships and some times quite disastrous financial consequences and that too even in cases of most honest and co-operative tax payers. The Supreme Court on numerous occasions observed that a citizen may be entitled to some benefits conferred by a taxing statute. Hence, the subject of tax planning deserves careful consideration and attention.

(viii) In order to minimise both tax evasion and tax avoidance the reasons for their existence must be carefully examined and understood by the administrators and advisors who are responsible for prescribing the cure. The tax authorities and the tax collection machinery should be geared up and the loopholes in tax laws should be effectively plugged to curb large scale violation and avoidance of tax. The government should be more responsive to the needs and aspirations of the society. The existence of tax laws that are fairly administered go a long way to provide the basic prerequisites for curbing tax evasion.

(ix) Till the time these steps are taken, the constant battle of wits shall continue to take place between the tax payers on the one hand seeking the means of escape and the revenue on the other hand, devising attempts at blocking it.

(x) In the present state of affairs prevailing in our country, one wonders how 'tax planning' can succeed when we are surrounded by a jungle of laws, some of which are ill-conceived whereas the others are being altered and amended every now and then on one or the other pretext and in some cases even from retrospective effect. The recent trend is to complicate the existing tax structure in the

name of simplification and rationalisation of our tax laws. This complication depends when a new provision is introduced to plug a loophole with a view to checking evasion of tax. In this attempt, our tax laws with innumerable sections, sub-sections, provisions and explanations have become unstable that any 'tax planning' falls before the fruits of such planning are actually reaped.

(xi) In modern complex society, one cannot expect a simple tax system. In a socialistic society financial needs and obligations of the State are considerable. There is a planning commission to prepare the plans for the nation's economic development and well being. Planning is also advocated and necessitated even in the strictly personal and private affairs of a man by way of family planning.

(xii) Planning of one's affairs so as to suffer least burden of taxes is not a crime. Tax planning becomes necessary because in matters of taxation, good citizenship does not consist in good intentions.

(xiii) It is in the light of the above cannon of interpretations and administration of tax laws that tax planning at once becomes a duty and necessity.

(xiv) The importance of tax planning becomes more evident when we consider the doctrine of form and substance in the interpretation of taxing statutes.

(xv) In a socialistic pattern of society, it is a

patriotic duty of every citizen, whether he carries on business or as a sole proprietor or a big government corporation to contribute his humble mite towards increased production and national wealth. It is the patriotic duty of every citizen to see that he conserves the resources - whether human, material or financial - allotted to him and generated by him, for better performance of the duties undertaken by or assigned to him. It is, therefore, the patriotic duty of every citizen to put the best use of the limited financial resources allotted to him.

4.4 TAX PLANNING THROUGH GIFTS

(a) WILLS AND TAX PLANNING

Will can be made in favour of any person and a legatee can, therefore, be a society, trust, company, individual, association of persons and a Hindu Undivided Family or combination of any one or more of them. Any testator whether a male or female can so plan and devise his or her bequest in a manner which can be beneficial from the tax angle so as to attract the minimum amount of tax or even avoiding the incidence of tax altogether in the hands of the legatees. Properties can thus be passed on to a trust enacted under the will, for the benefit of the specified beneficiaries. With ascertained shares, it can also be fruitfully passed on to the Joint Hindu Family of

the sons of the testator, thus providing each of them a separate assessable entity, for the purpose of Gift Tax Acts. In a case where the testator's sons are already existing assesseees in their capacity as an individual as well as Joint Hindu Family, the testator can bequeath partly to the grandsons and partly to the wives of the sons, the result being that after the testator's death a number of additional entities come into existence for the purpose of assessment to tax as separate and distinct assessable units under Gift Tax Act.

It will thus be seen that passing of the properties under a will can be fruitfully used as a tax planning measure. As gift under a will is exempt under Section 5 of the Gift Tax Act, there cannot be a readymade formula which may suit all persons. The bequest is to be devised, according to the specific circumstances of each case and tax planner has to take into consideration the composition of the testator's family, the nature of the properties to be bequeathed and the wish of the testator.

(b) TAKING OUT LIFE INSURANCE POLICIES
UNDER MARRIED WOMEN'S PROPERTY ACT,

1874

No part of the premium paid towards a Life Insurance policy effected under the Married Women's Property Act can

be treated as 'Gift' for the purpose of the Gift Tax Act and further no premium paid by the deceased for effecting or keeping in force a policy taken out under the Married Women's Property Act is to be regarded as a gift for the purposes of Section 9 of the Estate Duty Act. The other main advantages of a policy effected under the Married Women's Property Act is that on the death of the husband, though the proceeds of the policy become chargeable to Estate Duty it will not be aggregated with the other estate of the deceased, but it will be regarded as an estate by itself. However, the Estate Duty Act has been inoperative since the year 1985.

(c) TRANSFER BEFORE MARRIAGE

Transfer of asset by way of gift by an individual to his prospective wife or by an individual to his prospective daughter-in-law shall be out of the clutches of the provision of Section 4 of the Gift Tax Act and also Wealth Tax Act, because the enumerated relationship in the deeming provisions should subsist not only on the date of giving or valuation date, but also at the time of gift. Therefore, the deeming provisions would not apply in such cases if the donee was not the wife or daughter-in-law of the individual when the gift was made.

(d) TAX PLANNING BY CREATING NEW
HINDU UNDIVIDED FAMILY THROUGH
GIFT

New Hindu Undivided Family can still be brought into existence through gifts. A gift has to be made, with a clear, categorical and unequivocal declaration to the effect that it is being made for the benefit of the family. However, in order to escape from it, it is necessary that the gift to the H.U.F. is made by an outsider and not by a member of the Hindu Undivided Family, as otherwise the provisions of Gift Tax Act will be attracted.

(e) TAX PLANNING VIA STATUS

(i) Tax planning in the case of the individuals mainly consists of splitting of property between several tax payers.

(ii) Selection about the status under which an assessee has to carry on his business is very important for tax planning because by selecting an appropriate status one can plan to pay a minimum amount of tax and thus save himself from levy of interest and penalties as far as possible without much inconvenience.

(iii) An assessee can carry on business either as

a sole proprietor or in the status of a firm. The business can also be carried on in the status of an Hindu Undivided Family, a company or through a private family trust.

(f) GIFTS TO DEFRAUD REVENUE

If the gift to daughter-in-law or minor grandchildren by an assessee is found to have been made with the object of defrauding the Revenue, notwithstanding the levy of Gift Tax on the property by the Gift Tax authorities, the transfer could be regarded as void under Section 281 of the Income-tax Act and consequently the transferor could be deemed to continue to be the owner of the property gifted by him. Accordingly, the transferor would also be liable to tax in respect of the income from the property gifted as well as the value of such property. Care should, therefore, be taken to ensure that the object of the transfer is not to defraud the Revenue and that Section 281 of the Income-tax Act is not attracted because if the transfer attracts Section 281, the liability to Income-tax would still continue besides the liability to Gift Tax and Wealth Tax and still further the object of the transfer would be defeated.

(g) MARRIAGE EXPENSES

The Court has held where the expenditure on the

occasion of marriage is estimated out of necessity, as the factual position is not correctly stated voluntarily by the assessee and the replies given are inadequate and evasive, the explanation given by the assessee is that a part of the expenditure on marriage is met from gifts and presents and balance is met by withdrawals from the firm after marriage but the same is not accepted, the amount of unexplained expenditure on the occasion of marriage, reception and gifts to bride and bridegroom could be regarded as undisclosed income liable to tax in the hands of the assessee. Care should, therefore, be taken to see that there is proper disclosure so that the provisions for subjecting to tax anything as explained income or expenditure do not get attracted as these are as important as the clubbing provisions since the consequences of such additions in respect of income from undisclosed sources would be more serious.

To sum up the planning of tax and financial affairs in the context of diversion of income at source is of utmost importance not only to individuals but also to other categories of tax payers including companies, government undertakings, co-operative societies, partnership firm and trusts or Hindu Undivided Family. It is in the interest of every tax payer to ascertain as far as practicable the legal consequences even before the transfer as planned is implemented so that one does not have to repent or regret later.