**Tax planning and Management /investment decisions**

Management /investment decisions are not based on tax factor alone. But it is an important factor which should be considered while taking decisions. The effect of the tax factor may be different to different course of actions. The general considerations which are applicable in the case of managerial or business decisions are given below;

1. expenses allowed as deduction
2. Year in which it is allowable
3. To what extend it is allowed
4. To what extend it can be carried forward.

While tax planning we want to see whether the expenditure is capital or revenue nature. The tax planner should consider the advantage arising out of minimizing expenditure especially in the initial years of business, so that the profits may be maximised and the assessee may be in a position to avail the various tax incentives like depreciation, tax holiday etc. Generally the deduction on expenditure on which year it is incurred. Normally deduction can be claimed by the assessee only in respect of those expenses incurred in the previous year. But there are certain exceptions to this rule. The tax planner should be aware of that. For example expenditure incurred on scientific research before the commencement of the business- capital or revenue during the three years immediately preceding the commencement of business and coming within the scope of section 35(1) (i) and 35 (1) (u) , Capital expenditure incurred prior to the commencement of business allowed as deduction in the year of commencement of business . In case capitalized under section 35 AD preliminary expenses incurred before commencement of business and coming within the scope of section·35 AD , Expenditure on prospecting for minerals coming under the scope of section 35E, are cases where the assessee can claim deduction in respect of expenditure even though the expenditure was not incurred during the previous year. Assessee should consider deduction$ available under section 35AD and 35 while tax planning. Apart from this there are deductions under sections 35 such as payment of insurance premium, interest on borrowed capital etc. But it is to be noted that any amount of interest paid in respect of capital borrowed , for acquisition of an asset (whether capitalized in the books or not) for any period beginning from the date on which capital was borrowed for acquisition of asset till the date on which such asset was put to use , shall not be allowed as deduction.

**Tax planning in respect of make or buy**

Tax planning involves planning in order to avail all exemptions, deductions and rebates provided in act. The income tax law itself provides various methods for tax planning, generally it is provided under- exemptions\_ u/s\_10, deductions u/s 80C \_to BOU and rebates and relief's. Law of Income tax has various implications on managerial decision making.

It is quite natural that every component or part of a product cannot manufactured by one company. Part manufacture involves cost, time, energy, and different kinds of technology and expertise. Therefore, in such cases company purchases parts from outside agencies. But where the cost involved in purchasing from outside market is high, and then the company might go in for in house production. Sometimes an organization wants to take decision whether a certain product should be made in the factory itself or bought from outside from a firm. For taking decision the tax laws of the country is also considered. The cost involved in making of a product involves fixed cost such as purchase of plant and variable cost such as raw materials, labour, and electricity etc. The costs involved in buying of a product from outside agency involve buying cost and inventory cost. Comparison of the above cost shall determine which decisions

.the company shall follow. But, however it should be kept in mind that while comparing cost, common cost should not be taken into account. It should also be noted that the cost incurred in making a product and buying a product, both involves incurring of revenue expenditure. Therefore, tax saved in both the cases is same. It comes into picture only when there is a need for extension or establishment of new unit to manufacture those new components.

**Tax consideration**:

1. Establishing a new unit: If the decision to manufacture a part or component involves a setting up a separate industrial unit then tax incentives available u/s 10A, ,32, BOIA and 80IB should be considered .
2. Export : If 'make or buy' decision is taken for exporting goods then tax incentives available in this case depends upon whether goods manufactured by taxpayer himself are exported or goods manufactured by others are exported by the taxpayers.
3. Sale of plant and machinery :If buying is cheaper than manufacturing and the assessee decides to buy parts or components for a long period of time, he may like to sell the existing plant and machinery. In such cases it may be liable to pay capital gain tax.
4. If the product which is produced or purchased is a capital asset, then its cost will not be allowed as deduction in computing the income. But depreciation is allowed as deduction.
5. If the product is a consumable one, then the expenses related to raw material required to replace a worn-out part at the time of repair, is treated as revenue expenditure and deductible while computing the income.

TAX PLANNING IN RESPECT OF OWN OR LEASE

Assets may be purchased or taken on lease. Apart from tax angle, other factors also are important in taking lease or buy decisions like rate of change in technology, production methods etc. . There are advantages or disadvantages of leasing. Leasing avoids ownership and with its accompanying risk of obsolescence and terminal value losses. In leasing immediate payment of capital cost can be avoided. But at the same time there will be fixed rental obligations. There are many factors which are required to be considered before making own or lease decisions. Cost of asset to be owned, rent of the asset to be taken on lease, source of financing the asset, risk involved in the alternatives, impact of tax concessions such as depreciation, tax holiday etc. are the important factors.

A lease is a long term agreement to rent equipment, land, buildings, or any other asset. In return for most-but not all-of the benefits of ownership, the user (lessee) makes periodic payments to the owner of the asset (lessor). The lease payment covers the original cost of the equipment or other asset and provides the lessor a profit.

**Advantages when assets are taken on lease:** If the asset is taken on lease, the entire rental payment can be claimed as deduction as revenue expenditure. If the rate of tax is 30% then the effective rent obligation can be reduced to that extent. The lease rent may be split into three components- the recovery of principal, cost and the interest chargeable to and an element of profit. The lessee can claim tax benefit on even the principal investment in the equipment. However depreciation cannot be claimed since assets are not owned by the assessee. Another tax advantage of lease is that the life of the lease can be shortened compared to the depreciable life otherwise allowed if the assessee purchased the asset.

**Advantage when assets are purchased**: Depreciation on specified assets can be claimed as deduction u/s 32. The assets may be purchased out rightly or may be taken on loan. Where the asset is taken on Joan interest amount an either be claimed as revenue expenditure or can be capitalized . But where interest is paid after the asset is first put use, the deduction on account of interest shall be claimed as revenue expenditure, i.e. Such interest cannot be capitalized.

The following factors are considered while taking a decision regarding whether asset

is acquired on lease or own.

1. Finance position: If a person has sufficient cash or can get loan at a minimum rate, then he can purchase the asset on cash or by instalment system or hire purchase system. He can claim depreciation on asset purchased. The interest to be paid on loan for purchasing an asset can be claimed as a deduction. If he has no sufficient cash or loan on easy terms, he can acquire the asset through lease. The lease rent can be deducted while computing his total income.
2. Depreciation: U the asset is purchase<! or acquired through hire purchase or installment system, depreciation can be allowed as deduction. When the asset IS taken on lease no depreciation is allowed as deduction. It will enhance the tax liability of the lessee.
3. 0bsolescence: When an asset become obsolete, it can be replaced from depreciation fund partly and through finance. In die case of lease it is the duty of the lessor to replace that asset.
4. Scrap value: U an asset has large residual value, it is better to purchase it.
5. Profit margin: U the profit margin is low, it is better to purchase the asset.
6. Profit after tax: It is better to consider profit after tax in tax planning. The assessee should follow a method of purchasing asset which will reduce tax liability and profit after tax is greater.

The following steps are required to take decision;

1. Assets purchased by utilizing loan
2. Compute repayment of loan and interest on loan spread over a number of years
3. Work out cash outflow ( repayment of loan plus interest) spread over a number of years
4. Calculate depreciation on asset spread over a number of years
5. Work out tax saved on deduction claimed (interest and depreciation) spread over a number of years.
6. Compute adjusted cash flow ( ii - iv)
7. Compute present value of adjusted cash flow

2.Asset is leased

i. Work out one time processing fees in zero year.

ii. Compute lease rental spread over number of years.

iii. Calculate cash outflow ( processing fees plus lease rental) spread over a number of years

iv. Workout tax saved on deduction claimed ( processing fees plus lease rental) spread

over a number of years

v. Compute adjusted cash flow (ill - iv)

vi Compute present value of adjusted cash flow

REPAIR OR REPLACE

The main tax consideration which one has to keep in mind is whether expenditure on repair, replacement or renewal is deductible as revenue expenditure u/s 30, 31 or 37(1). If the expenditure is deductible as revenue expenditure under these sections, then cost of financing such expenditure is reduced to the extent of tax saved. On the other hand if such expenditure is not allowed as deduction u/s 30, 31 or 37(1) then it may capitalized and on the amount so capitalized depreciation is available if certain conditions are satisfied.

If a product stops working it requires repair. It can be done by replacing certain parts. After repair, it can be put to use for further production. Replacement is different from repair. Replacement is occupying a new one by dumping or selling old one. The replacement of a section in a series of machines which are interconnected, in a segment of the production process, may in some circumstances, be regarded as repair when without such replacement that unit in that segment will not function. That logic cannot be extended to the entire manufacturing facility from the stage of raw material to the delivery of the final finished product.

If expenditure is incurred to bring a new asset into existence or to obtain a new or fresh benefit then it is considered as replacement or renewal. The replacement may be of defective parts or replacement of entire machinery or a sizeable part of the entire machinery, If replacement is part only, the expenditure for such replacement is deductible while computing the income. But if the replacement is of whole machinery with view to bring a new asset into existence, the expenditure will not be deductible because it is capital in nature. In this case depreciation is allowed as per section 32.

"Current repair" implies the expenditure must have been incurred to 'conserve and maintain' an already existing asset and the object of the expenditure must not be to bring a new asset into existence of for obtaining a new gain.

Repairs to building can be capital or revenue, depending on nature of change to be occurred : If the repair does not bring an additional advantage or benefit of lasting nature or change the nature, character or the Identity of the building itself, the expenditure must be regarded as a revenue expenditure. On the other hand, if change occurs it will be in the nature of a capital expenditure. Replacement of assets as a whole is not considered as 'repair': Where extensive repairs are carried out in order to put to use an existing asset, the same could be termed as revenue expenditure. But where there is replacement 'as a whole', it amounts to reconstruction and not repairs. It is relevant that the asset in its old form must continue to exist. Then only we can say that the expenditure involved in improving the assets is revenue expenditure. Where replacement takes place and a new asset comes into existence and then expenditure involved would become a capital expenditure.

Repairs for converting godown into administrative office : Where the assessee incurred expenditure on repairs to a godown used for business purpose so as to convert it into administrative office, the expenditure was allowable as revenue expenditure since the business asset has retained its character and only its use had changed, and the use at both points of time . Ie, Before and after the expenditure was incurred, related to the business of the assessee without there being any addition to or expansion of the profit making apparatus of the assessee

**TAX PLANNING IN THE CASES OF REPAIR OR REPLACEMENT OR RENEWAL**

We want to consider the following points while taking a decision to repair or replace an asset for reducing tax liability.

1.If income is less in the relevant assessment year it is better to slow down the pace of repair and renewal in such a manner that it is spread over a number of years. If the income is high, it is better to fasten the process.

2. It is better to replace a part of the asset instead of entire asset. If there is replacement of the asset, then the cost of replacement may be allowed as deduction for income for tax purposes. On the other hand we can treat the cost of replacement as a capital expense.

**SHUT DOWN OR CONTINUE DECISION**

If the total deductible expenses for our business are greater than its income then it will have a loss for tax purposes. The business will not have to pay tax and the loss can generally be used to reduce income in future income years.

A shutdown point is a concept in managerial economics that suggests a business should at least temporan1y stop production and close its doors because it's no longer profitable to sustain operations. There are number of reasons why the business is incurring a loss and facing shut down. It may be low demand of the product, mismanagement, financial problems, change in technology, high rate of taxes, etc.

If a business suffers loss continuously the management should take a decision whether to continue or shut down the business. Where a part of a business is discontinued or a business is continued with reduced level of activity then it is not considered as discontinued business. While taking decisions tax implication in this respect is to be considered.

1.Business loss: If the business has a discontinued loss, it can be carried forward and

set off against profits and gains of business or profession.

2.Unabsorbed depreciation: If a business has discontinued, unabsorbed deprecation

can be

.i. Set off against income from business or profession under any other head

ii. Carried forward and set off for indefinite period whether business is carried on or discontinued.

1) Where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year for the assessment year up to the date of such discontinuance may, at the discretion of the income tax officer, be charged to tax in that assessment year.

2. the income of each completed previous year included in such period shall be chargeable to tax at the rate in force in that assessment year, and separate assessment shall be made in respect of each such completed previous year or part of any previous year.

3) Any person discontinuing any business or profession shall give to the income­ tax officer a notice of such discontinuance within fifteen days thereof.

4) Where any profession is discontinued in any year on account of the cessation of the profession by, or the retirement or death of, U1e person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the aforesaid person had it been received before such discontinuance.