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BBA | Semester 6 | UK6DSCMGT304

Business Tax Planning

Course Code: UK6DSCMGT304 • Module 2 Notes

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Module 2: Tax Planning for Setting Up New Business and Financing

Entity Form Selection, SEZ Section 10AA, Capital Structure Shield, and Deemed Dividends

Chapter 1: Comparative Tax Evaluation of Legal Forms of Business Organization

1.1 Strategic Importance of Entity Selection in Tax Optimization

When entrepreneurs and corporate promoters establish a commercial enterprise, selecting the legal constitution of the business entity represents the foundational strategic choice. Once selected, altering the legal form entails complex statutory reorganizations, asset transfer taxes, and regulatory clearances. The choice of entity directly dictates applicable statutory tax rates, surcharge brackets, compliance requirements, availability of profit-linked exemptions, and the tax incidence on profit repatriations to owners.

Under the Indian Income Tax Act, 1961, commercial entities are evaluated across four primary organizational categories: (1) **Sole Proprietorship**; (2) **Partnership Firm** (under the Partnership Act, 1932); (3) **Limited Liability Partnership (LLP)** (under the LLP Act, 2008); and (4) **Corporate Entity (Private or Public Limited Company)**.

1.2 Detailed Comparative Tax Matrix across Legal Forms

Analytical Tax Feature	Sole Proprietorship	Partnership Firm / LLP	Corporate Entity (Company)
Statutory Tax Rate	Individual progressive tax slabs (Nil up to 30% under Old Regime; Nil up to 30% under New Regime Section 115BAC).	Flat rate of **30%** on total taxable income.	Flat **22%** (Section 115BAA), **15%** (Section 115BAB), or **25%/30%** (Normal Regime).
Surcharge Thresholds	Progressive: 10% (above 50L), 15% (above 1Cr), 25% (above 2Cr) under Old Regime; capped at 25% under New.	Flat **12%** if total income exceeds **Rs. 1 Crore**.	10% flat under 115BAA/115BAB; 7% (1Cr–10Cr) and 12% (>10Cr) under Normal Domestic.
Health & Education Cess	4% on Total Tax + Surcharge.	4% on Total Tax + Surcharge.	4% on Total Tax + Surcharge.
Minimum Tax Threshold	Alternate Minimum Tax (AMT) under Section 115JC at 18.5% (applicable if	Alternate Minimum Tax (AMT) under Section 115JC at	Minimum Alternate Tax (MAT) under Section 115JB at 15% (exempt

Analytical Tax Feature	Sole Proprietorship	Partnership Firm / LLP	Corporate Entity (Company)
	claiming Chapter VI-A deductions).	18.5% (effective 19.24% or 21.55%).	under Sections 115BAA/115BAB).
Deduction for Owner Remuneration	Not deductible; proprietor and business are legally identical.	Allowable as business deduction to working partners under **Section 40(b)** limits.	Allowable as business deduction for reasonable director salaries under Section 36/37.
Deduction for Owner Interest	Not deductible; capital interest is not an expenditure.	Allowable up to maximum simple interest of **12% per annum** under Section 40(b).	Not allowable on equity capital; fully deductible on debentures and loans under Section 36(1)(iii).
Tax on Profit Distribution to Owners	Proprietor retains residual profits with zero additional taxation.	Share of profit received by partners is **100% Tax-Free** under Section 10(2A).	Dividends are **Taxed in the hands of shareholders** at their personal income tax slab rates.

1.3 Managerial Decision Parameters for Choosing Legal Form

- **Small-Scale Operations:** Where annual profit is projected below Rs. 15–20 lakhs, a Sole Proprietorship is optimal due to lower initial slab rates and minimal regulatory compliance overheads.
- **Professional Services & Medium Trading:** An **LLP** is highly tax-efficient: it avoids corporate dividend taxation, allows partners to withdraw residual profits 100% tax-free under Section 10(2A), permits working partner remuneration up to Section 40(b) ceilings, and incurs no dividend withholding obligations.
- **Capital-Intensive Manufacturing & High-Growth Startups:** A **Corporate Company** is indispensable: it accesses the global benchmark 15% rate under Section 115BAB (for new manufacturing) or 22% under Section 115BAA, enables institutional venture capital fundraising via equity shares, facilitates employee stock options (ESOPs), and confers full limited liability.

Chapter 2: Locational Tax Optimization and Special Economic Zones

2.1 Locational Strategic Choices in Corporate Tax Planning

The sovereign state frequently deploys tax policy as a tool for balanced regional development, offering substantial fiscal incentives to corporations that establish industrial production units in designated underdeveloped geographic regions, northeastern states, or export-oriented processing zones.

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2.2 The Special Economic Zone (SEZ) Regime under Section 10AA

To stimulate foreign direct investment and boost export earnings, Parliament enacted Section 10AA of the Income Tax Act. Section 10AA provides a progressive, tiered tax deduction on the export profits derived by an enterprise from the manufacture of goods or provision of services in a recognized **Special Economic Zone (SEZ)**:

$$\text{Export Profit Deductible} = \text{Profits of the SEZ Unit} \times \left(\frac{\text{Export Turnover of SEZ Unit}}{\text{Total Turnover of SEZ Unit}} \right)$$

The 15-Year Tiered Benefit Architecture:

1. **First 5 Assessment Years (Years 1 to 5): 100% Deduction** of profits derived from export of articles or services.
2. **Next 5 Assessment Years (Years 6 to 10): 50% Deduction** of such export profits.
3. **Final 5 Assessment Years (Years 11 to 15): 50% Deduction** of export profits, provided that an equivalent amount is debited to Profit and Loss and credited to a dedicated **'Special Economic Zone Re-Investment Reserve Account'**, to be utilized exclusively within 3 years for acquiring new plant and machinery.

Conditions for Section 10AA Eligibility: (a) The unit must not be formed by splitting up or reconstructing an existing business; (b) it must not be formed by the transfer of previously used machinery exceeding 20% of total plant value; (c) the audit report in Form 56F must be filed electronically prior to the return due date; and (d) export proceeds must be realized in convertible foreign exchange within the prescribed statutory period.

Chapter 3: Nature of Business and Sectoral Tax Concessions

3.1 Startup Tax Holidays under Section 80-IAC

To foster an innovative entrepreneurial ecosystem, the Government of India introduced Section 80-IAC. Under Section 80-IAC, an **Eligible Startup** is granted a **100% Tax Deduction** on its business profits for any **3 consecutive assessment years** out of a block of **10 years** beginning from the year of incorporation.

Eligibility Criteria for Section 80-IAC:

- Incorporated as a private limited company or LLP.
- Certified by the Inter-Ministerial Board of Certification (DPIIT recognition).
- Engaged in innovation, development, or commercialization of new products, processes, or services driven by technology or intellectual property.
- Annual gross turnover does not exceed **Rs. 100 Crores** in any financial year.
- Formed without splitting up or reconstructing an existing enterprise.

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3.2 Concessional Manufacturing Incentive under Section 115BAB

Newly established manufacturing companies enjoy an ultra-competitive flat baseline rate of **15%** (effective 17.16% with 10% surcharge and 4% cess). This provision positions India as an attractive global manufacturing hub alongside Vietnam and Singapore, provided the entity avoids previously used machinery and refrains from availing conflicting profit-linked exemptions.

3.3 Green Energy and Environmental Protection Deductions

Enterprises investing in renewable energy, solar power generation, and environmental pollution control equipment are entitled to accelerated depreciation at **40%** under Section 32 of the Act, significantly reducing net taxable profits in the initial years of asset deployment.

Chapter 4: Tax Planning in Capital Structure Decisions: Debt vs. Equity Financing

4.1 Theoretical Framework: The Tax Asymmetry of Capital Costs

The capital structure of an enterprise comprises a strategic blend of long-term debt capital (debentures, term loans, commercial bank borrowings) and equity capital (equity shares, retained earnings, preference shares). In corporate financial economics, the primary distinction between debt and equity financing lies in their **Asymmetric Tax Treatment** under the Income Tax Act:

- **Debt Financing (Interest Deductibility):** Under Section 36(1)(iii), interest paid on capital borrowed for the purposes of the business or profession is an **Allowable Business Expenditure** deductible from gross profits before calculating taxable income. Consequently, debt generates a substantial **Tax Shield** equal to the product of the interest expense and the marginal corporate tax rate:

> $$\text{Annual Interest Tax Shield} = I \times t$$
>
> $$\text{Effective After-Tax Cost of Debt } (K_d) = i \times (1 - t)$$
>
> **Where:** I is total interest paid, i is the contractual nominal interest rate, and t is the corporate tax rate. For example, if a company pays 10% interest under a 25% tax rate, its true economic cost of debt is only $10\% \times (1 - 0.25) = 7.5\%$.

- **Equity Financing (Non-Deductibility of Dividends):** Dividends paid to equity or preference shareholders are treated as an **Appropriation of Post-Tax Profits**, not a tax-deductible expense. Furthermore, recipient shareholders are taxed on dividends at their applicable slab rates. Consequently, equity financing carries zero tax shield, making it significantly more expensive than debt financing in corporate capital allocation.

4.2 Thin Capitalization Rules under Section 94B

While debt offers tax advantages, excessive debt financing creates bankruptcy risks and erosion of the sovereign tax base. To curb base erosion and profit shifting (BEPS Action 4), Parliament enacted

Section 94B (Thin Capitalization Rules):

> $$\text{Maximum Allowable Interest Deduction} = 30\% \times \text{EBITDA of the Indian Company}$$
>
> **Scope of Application:** Applies where an Indian company incurs interest expenditure exceeding **Rs. 1 Crore** payable to its foreign Non-Resident Associated Enterprise (AE). Any interest exceeding 30% of EBITDA is disallowed and carried forward for set-off across up to **8 consecutive assessment years**.

Chapter 5: Corporate Distribution Strategies and Deemed Dividend Mechanics

5.1 The Deemed Dividend Framework under Section 2(22)

To prevent closely-held private limited companies from avoiding dividend taxation by distributing accumulated corporate wealth to shareholders in the disguised form of loans, capital reductions, or debentures, Section 2(22) establishes comprehensive **Deemed Dividend** provisions:

1. Section 2(22)(a): Distribution Entailing Release of Assets

Any distribution of accumulated profits by a company to its shareholders, whether capitalized or not, if such distribution entails the release of all or any part of the assets of the company, is deemed to be a dividend to the extent of accumulated profits.

2. Section 2(22)(b): Distribution of Debentures or Deposit Certificates

Any distribution to shareholders of debentures, debenture-stock, or deposit certificates, with or without interest, and any distribution of bonus shares to preference shareholders, is treated as a deemed dividend to the extent of accumulated profits.

3. Section 2(22)(c): Distribution on Liquidation

Any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation.

4. Section 2(22)(d): Distribution on Capital Reduction

Any distribution to its shareholders by a company on the reduction of its share capital, to the extent to which the company possesses accumulated profits.

5. Section 2(22)(e): Loans and Advances by Closely-Held Companies (Anti-Abuse Anchor)

The most heavily litigated deemed dividend provision in corporate tax law. Under Section 2(22)(e), any payment by a company (in which the public are NOT substantially interested) of any sum by way of **Loan or Advance** to:

1. A shareholder who is the beneficial owner of shares holding not less than **10% of the voting power**; OR

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2. Any concern (partnership firm, LLP, company, or HUF) in which such shareholder is a member or partner and possesses a **Substantial Interest** (at least 20% of share capital, voting power, or profit share); OR
3. Any person for the individual benefit of such a 10% shareholder;

is deemed to be a taxable dividend in the hands of the recipient to the extent of the **Accumulated Profits** possessed by the lending company on the date of disbursement.

Statutory Exceptions to Section 2(22)(e):

- Loans made in the ordinary course of the company's business, where the lending of money is a substantial part of the company's business (e.g., licensed NBFCs or commercial banks).
- Trade advances given in the ordinary course of commercial dealings for the supply of goods or services.

5.2 Tax Planning in Bonus Shares Issuance

Issuing **Bonus Shares** represents one of the most elegant, legally unassailable tools in corporate tax planning:

- The allotment of bonus equity shares to existing equity shareholders out of accumulated general reserves does **NOT constitute a dividend** under Section 2(22), as it entails zero release of company assets.
- Under Section 55(2)(aa), the **Cost of Acquisition** of bonus shares allotted on or after 1st April 2001 is deemed to be **Nil**.
- Tax liability is successfully deferred until the shareholder actually sells the bonus shares, at which point the gain is taxed as capital gains (short-term at 15% or long-term at 10% under Section 112A for listed shares), rather than higher immediate dividend income tax slab rates.

Chapter 6: Corporate Earnings Policy: Retention vs. Distribution

Corporate financial management balances the strategic tension between retaining profits internally to finance organic expansions versus distributing dividends to satisfy shareholder expectations. The tax implications across both options are modeled as follows:

Strategic Dimension	Retention of Corporate Earnings	Distribution of Corporate Dividends
Immediate Tax Incidence	**Zero Immediate Tax** on shareholders. Profits remain invested inside the corporate entity.	Immediate tax liability triggered in shareholders' hands at their personal slab rates (up to 39%).
Wealth Creation Mode	Accelerates enterprise net worth, driving long-term corporate share price appreciation.	Provides immediate liquid cash yield to shareholders.

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Strategic Dimension	Retention of Corporate Earnings	Distribution of Corporate Dividends
Subsequent Realization Tax	Taxed as Capital Gains when shares are sold: Long-term capital gains taxed at concessionary rates (10%/12.5%).	No subsequent capital gain, but high historical income tax was paid upfront.
Optimal Strategy	Optimal for high-growth firms with abundant positive Net Present Value (NPV) investment projects.	Optimal for mature cash-cow firms with low capital requirements and institutional investors.

Chapter 7: Comprehensive Worked Numerical Problems in Business Setup and Financing Tax Planning

7.1 Worked Problem 1: Comparative Tax Liability of an LLP versus a Private Limited Company

Two industrial engineers plan to establish a technology design consultancy firm. They project an annual net business profit of Rs. 2,00,00,000 (Rs. 2.00 Crores) before any partner remuneration or director salaries. They are evaluating whether to incorporate as a **Limited Liability Partnership (LLP)** or a **Private Limited Company (opting for Section 115BAA)**.

Operational Parameters to Model:

- Both promoters work full-time in the business.
- Under the LLP, working partner remuneration will be claimed at the maximum permissible limit under Section 40(b). Residual post-tax profits are distributed 50:50.
- Under the Company, each promoter will receive a director salary of Rs. 25,00,000 per annum (total salary Rs. 50,00,000). The remaining post-tax profit is distributed in full as dividends to the two promoters.
- Both promoters have other personal income that places them in the highest 30% individual tax slab (effective personal tax rate with 15% surcharge and 4% cess = 35.88%).

Step-by-Step Mathematical Resolution:

Option 1: Tax Computation under Limited Liability Partnership (LLP):

1. Compute Maximum Allowable Partner Remuneration under Section 40(b):

> $\text{Book Profits of LLP} = \text{Rs. } 2,00,00,000$
>
> $\text{On first Rs. 3,00,000 of book profit: } 90\% \text{ of } 3,00,000 = \text{Rs. } 2,70,000$
>
> $\text{On balance Rs. 1,97,00,000: } 60\% \text{ of } 1,97,00,000 = \text{Rs. } 1,18,20,000$

> $\text{Total Permissible Remuneration} = 2,70,000 + 1,18,20,000 = \text{Rs. } 1,20,90,000$

2. Tax Liability of the LLP:

> $\text{Taxable Business Income of LLP} = 2,00,00,000 - 1,20,90,000 = \text{Rs. } 79,10,000$
>
> $\text{Baseline Tax } (30\%) = 79,10,000 \times 0.30 = \text{Rs. } 23,73,000$
>
> $\text{Surcharge: Taxable income is below Rs. 1 Crore} \implies \text{Nil } (0\%)$
>
> $\text{Health and Education Cess } (4\%) = 23,73,000 \times 0.04 = \text{Rs. } 94,920$
>
> $\text{Total Tax Payable by LLP} = 23,73,000 + 94,920 = \text{Rs. } 24,67,920$
>
> $\text{Residual Post-Tax Profit Distributed to Partners} = 79,10,000 - 24,67,920 = \text{Rs. } 54,42,080$
>
> **Tax on Share of Profit:** 100% EXEMPT in hands of partners under Section 10(2A).

3. Tax Liability on Partners' Personal Returns:

> $\text{Remuneration Received by Partners (Taxable as PGBP)} = \text{Rs. } 1,20,90,000$
>
> $\text{Tax on Remuneration (Effective } 35.88\%) = 1,20,90,000 \times 0.3588 = \text{Rs. } 43,37,892$
>
> $\text{Grand Total Tax under LLP Structure} = 24,67,920 + 43,37,892 = \text{Rs. } 68,05,812$

Option 2: Tax Computation under Corporate Company (Section 115BAA):

1. Corporate Tax Liability:

> $\text{Gross Profit} = \text{Rs. } 2,00,00,000$
>
> $\text{Less: Director Salaries Claimed as Expense} = \text{Rs. } 50,00,000$
>
> $\text{Net Taxable Corporate Income} = 2,00,00,000 - 50,00,000 = \text{Rs. } 1,50,00,000$
>
> $\text{Corporate Tax under Section 115BAA } (25.168\%) = 1,50,00,000 \times 0.25168 = \text{Rs. } 37,75,200$
>
> $\text{Post-Tax Corporate Profit Distributed as Dividends} = 1,50,00,000 - 37,75,200 = \text{Rs. } 1,12,24,800$

2. Personal Tax Liability of Promoters under Corporate Structure:

> Tax on Director Salaries (Rs. 50 Lakhs @ 35.88%) $= 50,00,000 \times 0.3588 =$ Rs. $17,94,000$
>
> Tax on Dividend Income in Hands of Promoters (Effective 35.88%) $= 1,12,24,800 \times 0.3588 =$ Rs. $40,27,458$
>
> Grand Total Tax under Corporate Structure $= 37,75,200 + 17,94,000 + 40,27,458 =$ Rs. $95,96,658$

Executive Decision Synthesis:

> Net Annual Tax Savings by Adopting LLP $= 95,96,658 - 68,05,812 =$ Rs. $27,90,846$
>
> **Strategic Recommendation:** If the promoters intend to extract all annual earnings for personal consumption, the **LLP structure saves nearly Rs. 28 Lakhs per year** in taxes because residual profit withdrawals are 100% exempt under Section 10(2A), completely escaping the double taxation of corporate dividends.

7.2 Worked Problem 2: Capital Structure Optimization and Interest Tax Shield

Titan Heavy Machineries Ltd. requires an additional capital investment of Rs. 10,00,00,000 (Rs. 10 Crores) for an automated robotic expansion line. The projected annual Earnings Before Interest and Tax (EBIT) is Rs. 2,50,00,000 (Rs. 2.50 Crores). The corporate tax rate is 25.168% (Section 115BAA). Management is evaluating two alternative financing proposals:

- **Proposal 1 (100% Equity Financing):** Allot 1,00,00,000 new equity shares of Rs. 10 each.
- **Proposal 2 (Debt-Equity Mix):** Raise Rs. 6,00,00,000 through 11% long-term corporate debentures and Rs. 4,00,00,000 through 40,00,000 new equity shares of Rs. 10 each.

Required: Calculate Earnings Per Share (EPS) and the annual Interest Tax Shield under both proposals.

Step-by-Step Mathematical Resolution:

Financial Metric	Proposal 1: 100% Equity	Proposal 2: Debt-Equity Mix
Earnings Before Interest and Tax (EBIT)	Rs. 2,50,00,000	Rs. 2,50,00,000
Less: Debenture Interest (11% on Rs. 6 Crores)	Nil	(Rs. 66,00,000)
Earnings Before Tax (EBT)	**Rs. 2,50,00,000**	**Rs. 1,84,00,000**
Less: Corporate Tax (25.168%)	(Rs. 62,92,000)	(Rs. 46,30,912)

Financial Metric	Proposal 1: 100% Equity	Proposal 2: Debt-Equity Mix
Profit After Tax (PAT)	**Rs. 1,87,08,000**	**Rs. 1,37,69,088**
Number of Equity Shares Outstanding	1,00,00,000 shares	40,00,000 shares
Earnings Per Share (EPS = PAT / Shares)	**Rs. 1.87 per share**	**Rs. 3.44 per share**

Analysis of the Interest Tax Shield:

$$\text{Annual Interest Tax Shield} = 66,00,000 \times 25.168\% = \text{Rs. } 16,61,088$$

$$\text{Effective After-Tax Cost of Debt} = 11\% \times (1 - 0.25168) = 8.23\%$$

$$\text{EPS Expansion} = \frac{3.44 - 1.87}{1.87} \times 100 = 83.96\%$$

Financial Leverage Synthesis: Introducing 60% debt capital saves **Rs. 16.61 Lakhs annually in corporate tax**, driving an extraordinary **84% increase in Earnings Per Share** (from Rs. 1.87 to Rs. 3.44), proving the decisive power of debt interest tax deductibility.

7.2 Worked Problem 2: SEZ Export Unit Profit Exemption under Section 10AA and Reinvestment Reserve Mechanics

Kochi TechPark Electronics Pvt. Ltd., an eligible undertaking operating in a notified Special Economic Zone (SEZ), commenced commercial manufacturing operations on 1st April 2019. The company has completed its initial 5 consecutive assessment years of 100% export profit deduction and is currently operating in its 7th assessment year (Assessment Year 2026-27), falling within the second 5-year block where deduction under Section 10AA is restricted to 50% of export profits.

The financial records of the company for the previous year reveal the following figures:

- **Total Business Turnover:** Rs. 12,00,00,000 (Rs. 12.00 Crores).
- **Export Turnover:** Rs. 9,00,00,000 (Rs. 9.00 Crores, fully brought into India in convertible foreign exchange within the prescribed statutory period of six months).
- **Domestic Sales:** Rs. 3,00,00,000 (Rs. 3.00 Crores).
- **Freight, Telecommunication, and Insurance charges:** Incurred outside India amounting to Rs. 60,00,000 (included in export turnover).
- **Profits of the Business:** Rs. 2,40,00,000 (Rs. 2.40 Crores) before any Section 10AA deductions.
- **Amount credited to SEZ Re-Investment Reserve Account:** Rs. 45,00,000.

Step-by-Step Resolution:

Step 1: Statutory Adjustments to Export Turnover and Total Turnover
Under Section 10AA, freight, telecommunication charges, and insurance attributable to the delivery of

goods outside India must be deducted from both Export Turnover and Total Turnover to ensure mathematical symmetry.

$$\text{Adjusted Export Turnover} = 9,00,00,000 - 60,00,000 = \text{Rs. } 8,40,00,000$$

$$\text{Adjusted Total Turnover} = 12,00,00,000 - 60,00,000 = \text{Rs. } 11,40,00,000$$

Turnover Symmetry Rule: Total turnover and export turnover are adjusted downward by Rs. 60.00 Lakhs for foreign freight and transmission charges to calculate eligible export proportions.

Step 2: Computation of Export Profits Eligible for Section 10AA Deduction
The statutory formula for Section 10AA deduction is applied as follows:

$$\text{Eligible Export Profit} = \text{Profits of Business} \times \left(\frac{\text{Adjusted Export Turnover}}{\text{Adjusted Total Turnover}} \right)$$

$$\text{Eligible Export Profit} = 2,40,00,000 \times \left(\frac{8,40,00,000}{11,40,00,000} \right) = \text{Rs. } 1,76,84,211$$

Formula Breakdown: Business profit (Rs. 2.40 Crores) multiplied by export turnover ratio (73.684%) results in eligible export earnings of Rs. 1.768 Crores.

Step 3: Determination of Permissible Deduction for Years 6 to 10
Since the unit is in its 7th year, the statutory deduction is limited to 50% of the export profit, subject to the condition that an equal or greater amount is transferred to the Special Economic Zone Re-investment Reserve Account:

$$50\% \text{ of Export Profit} = 50\% \times 1,76,84,211 = \text{Rs. } 88,42,105$$

$$\text{Actual Reinvestment Reserve Created} = \text{Rs. } 45,00,000$$

$$\text{Allowable Deduction under Section 10AA} = \min(88,42,105, 45,00,000) = \text{Rs. } 45,00,000$$

Critical Limitation Note: Because the company only credited Rs. 45.00 Lakhs to the Re-Investment Reserve, the allowable deduction under Section 10AA is strictly restricted to Rs. 45,00,000 rather than the theoretical maximum of Rs. 88.42 Lakhs.

Step 4: Computation of Net Taxable Income and Total Corporate Tax Liability

Particulars	Amount (Rs.)
Business Profits before Section 10AA	2,40,00,000
Less: Deduction under Section 10AA (Restricted to Reserve)	(45,00,000)
Total Taxable Income (Normal Provisions)	**1,95,00,000**
Income Tax at 30% (assuming normal corporate regime)	58,50,000

Particulars	Amount (Rs.)
Add: Surcharge at 7% (Taxable income between Rs. 1 Cr and Rs. 10 Cr)	4,09,500
Subtotal Tax and Surcharge	62,59,500
Add: Health and Education Cess at 4%	2,50,380
Total Corporate Tax Payable under Normal Provisions	**65,09,880**

Managerial Tax Finding: Had the management created a Re-Investment Reserve of Rs. 88,42,105 instead of Rs. 45,00,000, the company would have saved an additional Rs. 15,17,046 in corporate taxes. This illustrates the decisive necessity of aligning financial accounting entries with statutory tax reserve requirements.

Chapter 8: Thin Capitalisation Rules (Section 94B) and Interest Deduction Caps

8.1 Statutory Framework of Section 94B

To curb base erosion and profit shifting (BEPS) through excessive interest deductions, the Finance Act introduced **Section 94B** in alignment with OECD BEPS Action 4 recommendations. Section 94B imposes a statutory cap on the deductibility of interest expenses incurred by an Indian company or a permanent establishment of a foreign company in respect of debt issued or guaranteed by a non-resident **Associated Enterprise (AE)**.

8.2 Operational Conditions and Safe Harbour Thresholds

The interest limitation rules under Section 94B apply exclusively when the following statutory conditions are concurrently satisfied:

- **Borrower Entity:** The borrower is an Indian company or an Indian permanent establishment of a foreign corporation.
- **Lender Status:** The debt is issued by a non-resident Associated Enterprise, or guaranteed by a non-resident AE, or where the AE provides an implicit deposit or letter of comfort.
- **De Minimis Threshold:** Total interest or similar financial consideration paid or payable exceeds **Rs. 1,00,00,000 (Rs. 1 Crore)** in the relevant previous year. If interest is Rs. 1 Crore or less, Section 94B does not apply.
- **Exempted Sectors:** Section 94B explicitly exempts banking companies and insurance corporations from its restrictive provisions.

8.3 Mathematical Formula for Interest Disallowance

The deductible interest is legally capped at 30% of earnings before interest, taxes, depreciation, and amortisation (EBITDA). The excess interest is disallowed and added back to taxable income:

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$$\text{Excess Interest Disallowed} = \text{Total Interest Paid to AE} - (30\% \times \text{EBITDA})$$

Formula Definition: Any interest paid to a foreign associated enterprise exceeding 30% of operating EBITDA is disallowed under Section 94B.

8.4 Carry Forward and Set-off of Disallowed Interest

The disallowed interest under Section 94B is not permanently lost. The statute allows the disallowed sum to be carried forward for up to **8 consecutive assessment years** immediately succeeding the assessment year for which the disallowance was first made. In subsequent years, this carried-forward interest can be deducted against business profits, subject to the overall 30% EBITDA cap in those respective future years.

Chapter 9: Strategic Tax Decision Framework for Startup Incorporation and Financing

9.1 Master Comparative Matrix for Entity Form Selection

The following comprehensive matrix synthesises all primary tax and operational variables across Sole Proprietorships, LLPs, and Private Limited Companies:

Strategic Parameter	Sole Proprietorship	Limited Liability Partnership	Private Limited Company
Statutory Tax Rate	Graduated slab rates (5% to 30%)	Flat 30% (+ Surcharge & Cess)	Flat 22% (Sec 115BAA) or 25% (Sec 115BA)
Minimum Alternate Tax / AMT	AMT at 18.5% if claiming special deductions	AMT at 18.5% applicable	Exempt from MAT under Section 115BAA
Owner Compensation	Proprietor drawings non-deductible	Partner salary deductible under Sec 40(b)	Director salary fully deductible as business expense
Profit Distribution	Tax-free personal drawings	Tax-free partner share under Sec 10(2A)	Taxable as dividend in shareholder hands (slab rates)
Tax Audit Requirement	Section 44AB turnover thresholds apply	Section 44AB turnover thresholds apply	Statutory audit mandatory under Companies Act
Angel Tax & Capital Gains	Not applicable	Not applicable	Angel tax abolished; investor exit subject to Sec 112

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9.2 Managerial Action Checklist for Capital Structure Planning

Financial executives must adhere to the following sequence when optimising corporate capital structures:

- **Step 1: Interest Coverage & EBITDA Analysis:** Assess whether planned debt obligations will violate the 30% EBITDA ceiling under Section 94B if borrowing from foreign affiliated lenders.
- **Step 2: Section 115BAA Election Verification:** Verify that opting for the 22% corporate tax rate does not sacrifice valuable unabsorbed MAT credits or pending Section 35AD / Chapter VI-A deductions.
- **Step 3: Remuneration vs. Dividend Optimization:** Establish optimal executive salary structures to absorb corporate operating profit into individual slabs, mitigating double taxation.
- **Step 4: Advance Inter-Corporate Loan Safeguards:** Rigorously monitor shareholding patterns and lending terms to prevent inadvertent deemed dividend exposure under Section 2(22)(e).

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