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B.COM HONOURS	SEMESTER 6	CALICUT UNIVERSITY	COURSE CODE: COM6EJ302

INCOME TAX ASSESSMENT AND PLANNING

EXAM REVISION NOTES

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MODULE I

NATURE & SCOPE OF FINANCIAL MANAGEMENT

Nature, Conceptual Meaning, and Scope of Financial Management: Financial management may be defined as the operational application of general management principles to the acquisition, allocation, utilization, and conservation of financial resources within an economic enterprise.

The Evolutionary Trajectory of Financial Management: The academic discipline and corporate practice of financial management have progressed through three distinct historical epochs:

Investment Decision

Dividend Decision

Foundational Axioms of Financial Management: Modern financial theory is anchored upon several core economic axioms that dictate rational decision-making in capital markets:

The Time Value of Money

Incremental Cash Flows Count

Efficient Capital Markets

Interrelationship Between Finance and Other Functional Disciplines: Financial management does not operate in institutional isolation. It sits at the nexus of several core business and social science disciplines:

The Wealth Maximization Criterion (Value Maximization): Shareholder Wealth Maximization is universally recognized as the superior, operationally sound objective of corporate management.

- Emphasizes Cash Flows Rather Than Accounting Profits: Cash flows are objective, verifiable, and cannot be manipulated through accounting conventions.
- **Fully Incorporates the Time Value of Money:** All future cash inflows are discounted back to the present using an appropriate discount rate.
- **Accounts for Risk and Uncertainty:** Higher-risk cash flows are discounted at higher hurdle rates (k), directly penalizing reckless speculative ventures.
- **Aligns with Modern Capital Markets:** The market price of a company's shares reflects the collective, real-time assessment of informed market participants regarding future earning power and dividend sustainability.

Modern Value Metrics: Economic Value Added (EVA) and Market Value Added (MVA): To operationalize wealth maximization in internal corporate performance measurement, Stern Stewart Co. developed Economic Value Added (EVA).

The Principal – Agency Problem in Modern Corporations: In classical proprietorships and partnerships, business owners manage their own capital, aligning incentives perfectly.

Monitoring Expenditures

Residual Loss

Corporate Governance Mechanisms for Mitigating Agency Conflicts: Modern corporate governance deploys internal and external alignment mechanisms to ensure managers serve shareholder interests:

- **Incentive-Compatible Compensation Packages:** Structuring executive pay to include Employee Stock Option Plans (ESOPs), performance-vested restricted shares, and bonuses tied directly to Economic Value Added (EVA) or Total Shareholder Return (TSR).
- **Independent Board of Directors:** Maintaining robust board oversight dominated by truly independent, non-executive directors who oversee statutory Audit Committees, Nomination Remuneration Committees, and Risk Committees.
- **Active Institutional Investor Surveillance:** Mutual funds, pension funds, and sovereign wealth funds utilize their voting power to vote down excessive executive pay and challenge entrenched corporate management.
- The Threat of Hostile Takeovers (Market for Corporate Control): If management underperforms, the firm's share price falls, making the company an attractive target for hostile corporate acquirers who will immediately replace existing management.

Organisation of the Finance Function: The organizational architecture of the finance department reflects the critical strategic importance of financial resources.

- **Core Orientation:** External, market-facing, and forward-looking.
- **Cash Liquidity:** ; Reconciliation of bank accounts, invoice verification, processing payroll and accounts payable.
- **Banking Capital Markets:** ; Preparation of statutory financial statements under Ind-AS / IFRS, liaison with statutory auditors.
- **Credit Collections:** ; Recording accounts receivable ledgers, preparing bad-debt aging schedules, billing customers.

Strategic Business Partnership

Enterprise Risk Management (ERM)

Sustainable ESG Finance

Investor Relations Capital Market Signaling

MODULE II

WORKING CAPITAL MANAGEMENT

Concepts, Nature, and Factors Affecting Working Capital: In financial parlance, working capital refers to the funds committed to the day-to-day trading operations of an enterprise.

Classification by Time Horizon: Permanent vs. Temporary Working Capital: From an operational standpoint, working capital requirements fluctuate dynamically throughout the financial year:

Temporary (Variable) Working Capital

Determinants of Working Capital Requirements: The quantum of working capital required by an enterprise is determined by multiple operational and environmental parameters:

- **Nature and Type of Business:** Public utility companies (railways, electricity grids) operate on a cash-only basis with negligible inventories, requiring minimal working capital.
- **Length of Production / Operating Cycle:** The longer the span of time required to convert raw materials into saleable finished goods, the larger the quantum of capital locked in work-in-progress inventory.
- **Sales Turnover and Scale of Operations:** Higher sales volumes inherently require larger investments in inventory, higher receivables balances, and greater cash reserves.
- **Credit Policy Extended to Customers:** , 90-day credit terms) inflates accounts receivable balances, requiring higher working capital compared to a conservative cash-on-delivery (COD) policy.
- **Credit Terms Availed from Suppliers:** , 60 days), the firm finances its inventory through trade credit, reducing external working capital needs.

Cash Budgeting: Receipts and Disbursements Method: The primary analytical instrument for managing corporate cash is the Cash Budget—a forward-looking statement estimating monthly cash inflows and outflows over a specified planning horizon.

- **Opening Cash Balance:** INR 2,00,000; INR 2,80,000; INR 1,50,000
- **Cash Sales:** INR 3,00,000; INR 3,50,000; INR 4,00,000
- **Collections from Debtors:** INR 5,00,000; INR 4,20,000; INR 6,00,000

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- **Total Cash Available (A):** INR 10,00,000; INR 10,50,000; INR 11,50,000

Mathematical Models of Cash Optimization: To determine the optimal transaction cash balance that minimizes the combined costs of holding cash and converting marketable securities, corporate finance relies on two benchmark quantitative models:

Receivables Management: Objectives and Credit Policy Design: Trade credit is granted as a competitive marketing tool to stimulate sales volume and expand market share. However, credit sales lock up capital and introduce default risks.

Credit Standards (The 5 Cs of Credit)

Monitoring: Days Sales Outstanding (DSO)

Aging Schedule of Receivables

Float Management, Operating Cycle, and Cash Conversion Cycle: In modern treasury operations, the acceleration of cash velocity is a direct determinant of corporate profitability.

Collection Float (Disadvantageous)

Disbursement Float (Advantageous)

Working Capital Financing Strategies Regulation of Bank Credit: How should current assets be funded? , bank cash credit, trade payables) or long-term capital (equity, debentures, retained earnings).

Regulation of Bank Working Capital Credit in India: The Reserve Bank of India (RBI) historically regulated bank credit through expert committees to prevent corporate diversion of funds:

Advanced Analytical Dimensions and Applied Commerce Casework (Analytical Division 1): The concepts, statutory provisions, operational accounting rules, and quantitative models detailed in this module carry critical implications for enterprise governance, audited disclosure standards, and executive fiscal decision-making.

Empirical Casework: Forensic Analysis, Audit Trail Verification, and Internal Controls: Empirical accounting investigations across modern industrial enterprises illustrate that financial distortion, fraud, and misstatement rarely occur as isolated incidents; rather, they stem from structural vulnerabilities within accounting workflows, segregation-of-duties lapses, or inadequate internal audit scrutiny.

- **Ledger amp; Voucher Integrity:** ; Companies Act (Sec.
- **Revenue amp; Cost Allocation:** ; Ind AS 115 (Revenue from Contracts with Customers) amp; CAS 1 to 24 Cost Accounting Standards.
- **Fiscal Risk amp; Tax Compliance:** ; GST Law Section 16/36 Rules amp; Income Tax Act Transfer Pricing Provisions.
- **Working Capital Governance:** ; Tandon amp; Chore Committee Norms for Bank Working Capital Credit Appraisal.

Executive Synthesis, Governance Policy, and Continuing Professional Mastery: To conclude, mastery of the concepts examined throughout this module empowers students and commerce executives to evaluate complex fiscal data with precision, independence, and analytical clarity.

Advanced Analytical Dimensions and Applied Commerce Casework (Analytical Division 2): The concepts, statutory provisions, operational accounting rules, and quantitative models detailed in this module carry critical implications for enterprise governance, audited disclosure standards, and executive fiscal decision-making.

Comparative Regulatory and Practical Implementation Standards: A rigorous examination of corporate commercial practice highlights the indispensable role of standardized accounting principles.

MODULE III

FINANCE AND INVESTMENT DECISIONS

The Time Value of Money: Compounding and Discounting Principles: The Time Value of Money (TVM) is the foundational cornerstone of modern financial economics. The principle states that a Sum of of money in hand today possesses greater economic worth than the identical monetary Sum of promised at a future date.

- **Reinvestment Earning Power:** Capital available today can be deployed in productive assets or invested in financial securities to generate compound interest or dividends.
- **Inflationary Loss of Purchasing Power:** In an inflationary economy, price levels rise over time, eroding the real basket of goods and services that a fixed nominal rupee amount can command in the future.
- **Future Uncertainty and Default Risk:** Realization of future cash flows is inherently probabilistic, carrying credit, operational, and macroeconomic default risks.

Practical Applications: Annuities, Perpetuities, and Loan Amortization: Corporate cash flows rarely occur as isolated lump Sum of s; they typically manifest as recurring cash flow streams.

Perpetuity Growing Perpetuity

Comprehensive Numerical Application: Loan Amortization Schedule: A corporation borrows INR 10,00,000 to finance plant automation, repayable in 4 equal annual installments at an annual interest rate of 12% per annum on the reducing balance.

- **Year 1:** 45
- **Year 2:** 58
- **Year 3:** 69
- **Year 4:** 28

Systematic Risk vs. Unsystematic Risk: The CAPM Framework: Modern portfolio theory bifurcates total corporate risk into two distinct components:

Systematic (Market / Undiversifiable) Risk

Cost of Capital Weighted Average Cost of Capital (WACC): The Cost of Capital is the minimum rate of return that an enterprise must earn on its investments in order to satisfy the required returns of its debt holders, preference shareholders, and equity investors, thereby preserving the market value of the firm's equity shares.

Comprehensive Numerical Illustration: WACC under Book Value vs. Market Value: Consider Apex Global Ltd. with the following capital structure and specific costs of capital (Corporate tax rate = 30%):

- **Equity Capital (INR 10 par):** 600
- **Retained Earnings:** 200 | MV: -
- **10% Preference Shares:** 080
- **12% Debentures:** 320

Leverage Analysis: Operating, Financial, and Combined Leverage: Leverage refers to the employment of an asset or source of funds for which the firm pays a fixed operational cost or fixed financial charge.

Financial Leverage (DFL)

EBIT-EPS Indifference Analysis: The EBIT-EPS Indifference Point represents the specific level of Operating Profit (EBIT) at which two competing financing structures generate the exact identical Earnings Per Share (EPS):

Capital Budgeting Decisions and Techniques: Capital budgeting is the corporate process of planning, evaluating, and selecting long-term capital investments whose cash flows extend beyond one fiscal year.

Summary Synthesis

- **Time Value of Money:** ; Essential for bond pricing, loan amortization schedules, and capital budgeting.
- **Risk and Return:** ; Calibrates the hurdle rate reflecting asset market beta risk.
- **Cost of Capital (WACC):** ; Acts as the corporate benchmark discount rate; minimized by optimal capital structure.
- **Leverage Analysis:** ; Governs EBIT-EPS volatility and establishes the financial indifference point.

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Advanced Analytical Dimensions and Applied Commerce Casework (Analytical Division 3): The concepts, statutory provisions, operational accounting rules, and quantitative models detailed in this module carry critical implications for enterprise governance, audited disclosure standards, and executive fiscal decision-making.

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MODULE IV

CAPITAL STRUCTURE AND DIVIDEND DECISIONS

Capital Structure: Conceptual Meaning, Attributes, and Determinants: In corporate financial architecture, a rigorous distinction is drawn between three related structural terms:

- **Financial Structure:** Represents the entire right-hand side of the corporate balance sheet, encompassing all long-term capital sources as well as all short-term current liabilities.
- **Capital Structure:** Refers exclusively to the permanent, long-term financing mix of the enterprise—consisting of shareholders' equity (equity share capital, retained earnings, reserves) and long-term debt (debentures, term loans, bonds, preference capital).
- **Asset Structure:** Represents the composition of the left-hand side of the balance sheet—the proportionate allocation between fixed tangible assets, intangible assets, and current operational assets.

Key Determinants of Corporate Capital Structure: Designing an appropriate capital structure requires synthesizing internal financial parameters and external capital market conditions:

Cash Flow Ability Debt Service Capacity

Nature of Business Business Risk

Asset Structure Tangibility

Theories of Capital Structure: Classical and Modern Approaches: The core theoretical debate in corporate finance asks: Can a firm alter its total market value or lower its overall cost of capital simply by changing its financing mix of debt and equity?

Numerical Demonstration: Net Income vs. Net Operating Income Approach: Consider a firm with Operating Profit (EBIT) of INR 2,00,000. 10).

- **Operating Profit (EBIT):** INR 2,00,000; INR 2,00,000
- **Less: Interest on Debt (I):** Plan 1: INR 0 | Plan 2: INR 50,000; Plan 1: INR 0 | Plan 2: INR 50,000
- **Earnings for Equity (NI):** Plan 1: INR 2,00,000 | Plan 2: INR 1,50,000; Plan 1: INR 2,00,000 | Plan 2: INR 1,50,000
- **Market Value of Equity (S):** Plan 1: INR 16,00,000 | Plan 2: INR 12,00,000; Plan 1: INR 16,00,000 | Plan 2: INR 11,00,000 (V - B)

Static Trade-Off Theory

Pecking Order Theory (Myers Majluf, 1984)

Types of Corporate Dividend Policies: Enterprises generally adopt one of three structured dividend policies:

- **Stable Dividend Policy:** Highly favored by institutional investors.
- **Fluctuating / Irregular Dividend Policy:** Dividends fluctuate wildly with annual accounting profits.
- **No Dividend / Residual Policy:** Zero cash dividends paid; all net earnings are reinvested into high-growth R D and expansion projects (standard for early-stage technology enterprises).

Corporate Actions: Stock Splits, Reverse Splits, and Share Buybacks: Modern corporate finance utilizes specialized capital restructuring actions to optimize market liquidity and capital efficiency:

Stock Split

Buyback of Shares (Share Repurchase)

Strategic Rationale for Buybacks

Regulatory Framework for Share Buybacks in India: In India, share buybacks are strictly regulated under Sections 68, 69, and 70 of the Companies Act, 2013 and the SEBI (Buy-Back of Securities) Regulations:

- **Permissible Sources:** Buybacks can be financed exclusively from (a) Free reserves, (b) Securities premium account, or (c) Proceeds of any fresh issue of shares (other than identical shares).
- **Statutory Ceilings:** Total buyback in any financial year cannot exceed 25% of the aggregate paid-up equity capital and free reserves.
- **Debt-to-Equity Covenant:** The ratio of secured and unsecured debt owed by the company after the buyback must not exceed 2:1 relative to paid-up capital and free reserves.
- **Capital Redemption Reserve (CRR):** If buyback is funded from free reserves or securities premium, a Sum of equal to the nominal value of repurchased shares must be transferred to the Capital Redemption Reserve Account.
- **Extinguishment of Shares:** Repurchased securities must be physically or electronically extinguished within 7 days of completion, and the firm cannot issue fresh equity shares for 6 months post-buyback (except bonus shares).

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