RESOURCE PAPER - 27

INDO-JAPAN CHAMBER OF COMMERCE & INDUSTRY

Tax Booster to Indian Corporates to promote 'Make in India'

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PREFACE

This issue of Resource Paper focuses on Direct Taxes. It covers the latest amendments made on the subject by the Government of India. We hope our readers would find this Ready Reckoner a useful material. Soon, we will be presenting a comprehensive material on Indirect Taxes / Foreign Trade Policy of the Government of India. As readers would know India is the 7th largest country by area with a growing population, and being a fast growing economy with ambitious plans, it makes it highly imperative to usher in reforms in the tax structure as and when required. We deem it our responsibility to highlight such significant changes for the benefit of our counterparts in Japan.

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Suguna Ramamoorthy
Secretary General

Tax Booster to Indian Corporates to promote ‘Make in India’

Background

In line with the Indian Government, to provide impetus to ‘Make-in-India’ initiative and achieving the ambitious goal of $5 trillion economy by 2025 a new provision has been inserted in the Indian tax laws Income-tax Act with effect from FY 2019-20 which allows any new domestic company incorporated on or after 1st October 2019 making fresh investment in manufacturing, an option to pay income-tax at the concessional rate of 15%. Further, to this the Indian Government has also allowed any domestic company an option to pay income-tax at the rate of 22% subject to condition that they will not avail any exemption / incentive. This is significant considering that India is always considered as a high tax rate country with a few years back tax rates for the Indian Company being almost ~35%. In addition to the tax reduction, there were also a few important changes made in the Income tax law to provide relief to the tax payer.

With this background, we would like to do thread bare analysis of the new amendments along with stipulated conditions therein.

Amendment in the Income Tax Law

A summary of revised tax rates applicable with immediate effect and would apply to taxes payable during the current financial year (2019-20) as captured in the table below:

Type of domestic company	Corporate tax rates		Minimum Alternate tax rates		Conditions
	Existing rates	Proposed rates*	Existing rates	Proposed rates*	
Existing company not availing any exemptions / incentives	25% / 30%	22%	18.5%	NIL	The company should not claim specified exemptions / incentives
Existing company availing exemptions / incentives	25% / 30%	25% / 30%	18.5%	15%	• After expiry of exemption/ expiry of holiday period, reduced rate of 22% can be availed. • Option to avail reduced rate once exercised cannot be withdrawn.
New company engaged in manufacturing activities	25% / 30%	15%	18.5%	NIL	• The company should be incorporated on or after 01 October 2019. • It should commence production by 31 March 2023. • It should not avail specified exemptions / incentives.

* with effect from Financial Year 2019-20

All tax rates are exclusive of Surcharge and Cess.

The government amended the Income-tax Act, 1961 (the Act) vide Taxation Laws (Amendment) Ordinance, 2019 (Ordinance) on 20th September 2019. The Ordinance provides certain tax concessions to domestic companies, foreign portfolio investors and other taxpayers. The amendments, inter-alia, include reduction in corporate tax rate to 22% for domestic companies which are not availing specified tax exemptions / incentives, reduced corporate tax rate of 15% applicable for new

manufacturing companies which are not availing specified tax exemptions / incentives, roll back of enhanced surcharge on capital gains and provides relief from buy-back tax in case of listed companies where public announcement of buy-back was made before 5 July 2019.

These amendments are part of various measures that the government is taking to provide impetus to the economy.

Amendments brought in by the Ordinance

Reduction of tax rate for domestic companies with effect from Financial Year 2019-20.

The government has reduced corporate tax rate (CTR) and Minimum Alternate Tax (MAT) rate for certain domestic companies.

a. Company not availing specified tax exemptions / incentives[1]

CTR *	22% (reduced from existing CTR of 25% / 30%[2])
MAT *	Not applicable (existing rate of 18.5%)
Conditions to be met	The company should not avail specified tax exemptions / incentives

The tax exemption/ incentive to be foregone for this purpose include the following:

- **Section 10AA:** Tax holiday available to Units in a Special Economic Zone
- **Section 32(1)(iia):** Additional depreciation
- **Section 32AD:** Investment in new plant or machinery in notified backward areas in certain States

- **Section 33AB, 33ABA:** Tax incentives available in case of Tea development account, coffee development account and rubber development account;
- **Section 33ABA:** Tax incentive related to site restoration account for a business consisting of the prospecting, or extraction or production of, petroleum or natural gas or both in India
- **Section 35AD:** Deduction for capital expenditure incurred on specified businesses
- **Certain sub-sections / clauses of Section 35:** Expenditure on scientific research
- **Section 35CCC:** Expenditure on Agriculture Extension Project
- **Chapter VI-A[2]:** Specified deductions (other than section 80JJAA)

Additionally, total income of the domestic company is required to be computed without set off or any loss attributable to any of the exemptions / incentives mentioned above. Depreciation would be claimed in the manner, which will be prescribed.

b. Companies availing tax exemptions / incentives

CTR *	Existing CTR of 25% / 30% to continue
MAT*	Reduced from 18.5% to 15%
Option to avail reduced rate*	• Can opt for the reduced rate of 22% after expiry of tax holiday / exemption period • After the exercise of the option for payment of CTR @ 22%, the same cannot be subsequently withdrawn

c. New domestic company engaged in manufacturing activities[3]

CTR *	15%
MAT	Not applicable
Conditions to be met	• The company should be incorporated on or after 1 October 2019 • It commences manufacturing by 31 March 2023 • It does not avail specified tax exemption / incentive (same as mentioned in para (a) above) • The company is not formed by splitting up or reconstruction of business already in existence • The company does not, subject to certain specified conditions, use any machinery or plant previously used for any purpose • The company is not engaged in any business, other than business of manufacture/production of any article and research in relation to such article, or distribution of such article manufactured / produced

Similar provisions as in case of para (a) above relating to loss and depreciation would be applicable. Provisions related to specified domestic transactions[4] would also need to be evaluated in such cases.

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1. New section 115BAA inserted in the Act
   * plus applicable surcharge and cess
2. Under the heading 'C-Deductions in respect of certain income'
3. New section 115BAB inserted

Rollback of enhanced surcharge introduced in Finance (No.2) Act, 2019

Finance (No. 2) Act, 2019 had increased the rate of surcharge applicable to certain category of taxpayers including individuals, Hindu Undivided Families (HUF), Association of Persons (AOPs), Body of Individuals (BOIs) and Artificial Juridical Persons (AJIs). The surcharge was increased to 25% on income between INR 2 crore to INR 5 crore and to 37% on income above INR 5 crore. The Ordinance provides that increased surcharge on tax (of 25% and 37%) shall not apply on capital gains arising:

- on sale of equity share in a company or a unit of an equity oriented fund or a unit of a business trust liable for securities transaction tax, in the hands of an Individual, HUF, AOP, BOI and AJP
- on sale of any security including derivatives, in the hands of Foreign Portfolio Investors (FPIs)

Limited Rollback of buy back tax on listed companies

Finance (No 2) Act 2019 extended the levy of buy-back tax on listed companies with effect from 5 July 2019. The Ordinance has clarified that listed companies which had already made the public announcement of buy-back before 5 July 2019 will not be subject to the aforesaid buy-back tax.

Some open issues that need to be addressed

- **Would Minimum Alternate Tax (MAT) Credit lapse if lower corporate tax rate is opted**

  This is one of the biggest issues that need to be addressed by the government. This clarification is required given the fact

that there can be arguments for and against the carry over of MAT credit that an existing company may have paid in the previous years. Arguments supporting that MAT credit does not lapse:

- In substance MAT is in the nature of tax paid in advance especially after introduction of MAT Credit provisions. Therefore MAT credit should be available for carry over to the new regime and set off against the lower tax payable under the ordinance.
- No specific provision denying MAT credit has been introduced whereas specific provisions relating to lapse of loss in case of other incentives have been introduced. This implies that MAT credit should be available for carry over in absence of a clear denial.

Arguments supporting lapse of MAT credit

- The newly introduced Section 115JB(5A) stipulates MAT is no longer applicable. This is to be read with section 115JAA(2A). As this would override section 115JAA(4)/(5) which describes the carry forward of MAT credit, the availability of such carry forward cannot be inferred automatically.
- Once MAT itself is not applied on the company, it is not logical for MAT Credit to be claimed and its denial is a consequence of the shift to claim the lower tax rate.
- The benefit of taking a lower tax rate is not being thrust upon tax payers. There are two combinations available

4. Under section 92BA

* plus applicable surcharge and cess

(a) 25%/ 30% with incentives and 15% MAT (b) 22% / 15% / and Nil MAT, taxpayer can evaluate what is beneficial can choose accordingly. If taxpayers have MAT credit the same can be utilised first and then they can plan to shift to the reduced rate.

- The intent is that companies continue to pay at least 15% tax in all cases, either as MAT or as normal rate (which without incentives is closer to MAT). Intent is not to reduce it further by allowing a carry forward of the MAT credit.
- Computation mechanism for determining MAT credit fails
- If hypothetically computed, there are two possible numbers to compare for quantification of credit (a) Normal tax @25% / 30% with 15% MAT or (b) Tax @ 15% / 22% without incentives and with 0% MAT. Too many assumptions to be made to claim the MAT credit and therefore it is not the intention of the government to extend the MAT credit for the new tax rates.

- **Deferred tax asset -** In case a view is taken that MAT credit shall lapse, MAT credit would be required to be written off. Impact to Indian companies has to be considered before any decision is taken.

- **Losses pertaining to specified deductions (Section 32(1)(iia), 32AD, 33AB, 33ABA, 35CCC, 35CCD, etc) from losses B/F from previous year.** The new sections 115BAA and 115BAB provide that loss to be carried forward

with respect to these specified sections would be deemed to be fully set-off. Existing domestic companies opting for the reduced tax rates would therefore need to bifurcate any brought forward losses into loss originating from specified sections and other loss.

The core issue that needs to be addressed is that there is no method to apportion the brought forward loss prescribed by the ordinance. A clarification with respect to apportioning the loss on a reasonable basis would be required.

Also, in case of companies which have claimed additional depreciation under section 32(1)(iia) the amount representing the unabsorbed depreciation would comprise normal depreciation and additional depreciation. Accordingly, the unabsorbed depreciation would need to be further bifurcated into unabsorbed ordinary depreciation and unabsorbed additional depreciation. The above issued may not arise with respect to new domestic companies set up for manufacturing business but would be applicable to existing companies that want to migrate to the lower rate.

- **Change in rate of Depreciation -** The Ordinance provides that CBDT would prescribe the manner in which tax depreciation shall be computed by companies which opt for the lower tax rates. The manner of claiming depreciation to be prescribed as the consolidated depreciation has been reduced from the block in earlier years and may need segregation.

  The issue that this throws up is that until the depreciation method is prescribed, companies will not be able to evaluate

the impact under the existing vs. lower tax rates. Any evaluation would have to factor in depreciation computed as per existing method, which could be misleading.

- **What amounts to business of 'manufacture' for the purpose of section 115BAB -** The new section 115BAB is applicable to a domestic company engaged in the business of 'manufacture' or production of any article or thing **and** research in relation to, or distribution of, such article or thing manufactured or produced by it. The term 'manufacture' has not been defined u/s 115BAB. Definition of manufacture is provided in the Act under section 2(29BA)

  The issues around this is that there has been a plethora of litigation in the past on what amounts to 'manufacture' for the purpose of claiming various incentives/ deductions under the Act. Any impact of this definition vis-à-vis judicial precedents is necessary before deciding on availability of the lower tax rate. Prima facie, availability of the lower tax rate in case of contract manufacture and cases involving (a) Principal to Agent relationship or (b) Principal to Principal relationships will raise the issue of who would be the entity which can claim the lower tax rate or whether both can claim the lower rate. There is some inconsistency with the recent changes under the FDI policy on what constitutes manufacturing under FDI policy.

- **Impact of violating any of the conditions for availing lower tax rate -** What if conditions to avail lower tax rate by a manufacturing company is violated in future, what would be the impact and options before taxpayer?

Does defaulting on any condition prescribed for new manufacturing companies present a planning option to companies to opt out of the reduced tax rate regime and fall back into the existing tax rate with incentives / deductions even though it is provided that they cannot opt out. This would not have been intended by government and needs to be clarified.

Conclusion:

The reduction in corporate tax rates had been the long-standing demand by the Indian corporate sector and aligns the rates with those of several developed economies. The reduced rate of 22% for existing domestic companies and 15% for new companies engaged in manufacturing activities is expected to revive investments and business sentiments. Roll back of enhanced surcharge on capital gains is also a welcome step that will address the concerns of domestic and foreign investors. The change in tax rates for domestic companies, however further widens the gap between the tax rates for such companies' vis-a-vis the foreign companies (40%) and LLPs (30%). Existing domestic companies would be required to decide on opting for the reduced tax rates before the due date for filing of tax return. Accordingly, they would now need to evaluate their tax liability under both options, i.e. the reduced tax rates vis-a-vis existing tax rates while factoring possible partial lapse of losses and MAT credit.

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