Analysis of ‘The Taxation Laws (Amendment) Ordinance, 2019’

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New Tax Regime

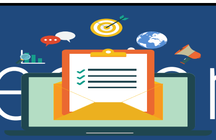
Tax Ordinance 2019

Tax rate of 22% for all domestic companies	**Tax rate of 15% for new domestic manufacturing companies**
MAT abolished in new regime. Reduction in MAT rate to 15% for old regime	**No changes in other rates like DDT, tax rates for LLPs etc**

1 On 20 September 2019, the Government has brought in the Taxation Laws (Amendment) Ordinance, 2019 that contains substantial amendments in the Income-tax Act, 1961 and the Finance (No. 2) Act 2019. Further, on 2 October 2019, the Central Board of Direct Taxes (CBDT) through a circular provided certain clarifications pursuant to Ordinance, 2019

New Tax Regime- Key Provisions

All Domestic Companies - Section 115BAA



- Option to adopt a 22% tax rate regime (ETR 25.17% including Surcharge & Cess)- to be exercised on or before filing of tax return
- However, following deductions shall not be allowed under this option
  - Section 10AA in respect of units in SEZ (Sunset clause - March 31, 2020)
  - Additional depreciation on new plant and machinery [Section 32(1)(iia)]
  - Investment in new plant or machinery installed after specified date or in notified backward areas in certain states [Section 32AD]
  - Investments in specified development accounts and funds
  - Weighted deduction for expenditure on scientific research or on specified business/projects (set to expire from AY 2021-22)
  - Chapter VI-A claims under the Heading C (except Section 80JJAA i.e., deduction for employment of new employees)
- Depreciation to be computed as per prescribed manner
- Tax Loss attributable to the above deductions not permitted to be set-off or carried forward
- No MAT applicable

Option once exercised cannot be withdrawn

New Tax Regime- Key Provisions

New Manufacturing Companies….

- Option to adopt a 15% tax rate regime (ETR 17.16% including Surcharge & Cess) for domestic companies to be exercised in *first return*
- **Conditions**
  - Company must be incorporated on or after 1 October 2019 and *has commenced manufacturing* on or before 31 March 2023
  - No other business permitted except *manufacturing or production of any article or thing* and research in relation to, or distribution of, such article or thing manufactured or produced by it
  - *No reconstruction/ splitting up* of business permitted
  - *No use of secondhand plant and machinery*, etc.(Except old plant and machinery to the extent of 20% of total value of machinery or plant used by the company)
  - No use of any building earlier used as hotel or a convention center
- Recomputing of profits from transactions with closely connected parties if they result in more than ordinary profits

New Tax Regime- Key Provisions

…….New Manufacturing Companies

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New Tax Regime- Key Provisions

Other points

- **<u>Option of claiming 15%/ 22% tax rate is at an entity level</u>** i.e. a company as a whole and not at a unit level
- MAT rate reduced from 18.5 per cent to 15 per cent (ETR 17.472 per cent) for all companies
- **Roll-back of surcharge of 25 per cent/37 per cent**
  - For non-corporate FPIs: On capital gains arising on sale of any security (including debt security) and derivatives
  - For individuals, HUFs, BOIs/AOPs: On capital gains from sale of STT paid equity shares and units of equity oriented mutual funds and business trust
- **Buy-back tax relaxation**
  - Buy-back tax rolled back for listed companies which announced buy-back before 5 July 2019
- No reduction of tax rates for individuals, partnerships and LLPs
- No reduction in AMT, DDT and Buy-back tax rates

Amendments in a nutshell

	Normal Tax Regime		Concessional Tax Regime	
Particulars	**Section 115BA of the Act**	**Others**	**Section 115BAA of the Act**	**Section 115BAB of the Act**
Applicability	AY 2017-18 onwards to all domestic companies engaged in manufacturing/ production	Any domestic company	AY 2020-21 onwards for all existing domestic companies	AY 2020-21 onwards for new domestic companies engaged in manufacturing/ production
Eligibility start date	Set up and registered on or after 1 March 2016	Not Applicable	AY 2020-21 onwards	Set up or after 1 October 2019 and commencement of manufacturing by 31 March 2023
Allowability of prescribed deduction/ loss	Not allowed	Allowed	Not allowed	Not allowed
Basic tax rate	25%	25% / 30%	22%	15%
Surcharge	7%/ 12%	7%/ 12%	10%	10%
Cess	4%	4%	4%	4%
Applicability of MAT	15%	15%	Not applicable	Not applicable
Restriction for entities formed by restructuring/ use of old plant and machinery/ use of building	No	Not Applicable	Not Applicable	Yes

Key issues

Key Issues

Issue 1 – Availability of MAT credit

– CBDT clarification: Credit of MAT paid by a domestic company exercising these options will not be available

  – Whether the circular is in accordance with the provisions of law? Whether the same can be challenged as ultra vires.

  – MAT credit written off – implications

Issue 2 – Accounting impact on Deferred Tax & MAT

– Deferred tax on account of MAT credit entitlement, brought forward losses, etc.

Issue 3 – What is 'manufacturing' and 'production' for Section 115BAB

  – Software development?

  – Incidental activities (treasury)?

  – Cost allocation of shared services?

Key Issues

Issue 4 - Potential controversies relating to losses/ depreciation

- Attribution of losses / unabsorbed depreciation
  - whether loss to be foregone should be restricted to only weighted deduction portion?
  - Unabsorbed additional depreciation foregone: implications for WDV?

Issue 5 - Issues for SEZ units

- SEZ unit: whether opting out of tax holiday (10AA) is more beneficial?
  - MAT credit unavailable
- Existing SEZ unit claiming tax holiday for 11th to 15th year (based on creation of SEZ Reinvestment Reserve) – implications of non fulfillment of conditions in subsequent years after opting for new tax regime
- Explore carving out ineligible business segment if sizable, in a separate entity ?

Sec 115BAA

Availability of MAT credit

View I

- As MAT is not applicable, tax payable under MAT is Nil
- MAT credit will be difference of tax under normal provisions and nil i.e. 25.17%-0%

View II

- As MAT is not applicable, mechanism of computing MAT credit fails
- Entire MAT credit lapses [CBDT circular]

View III

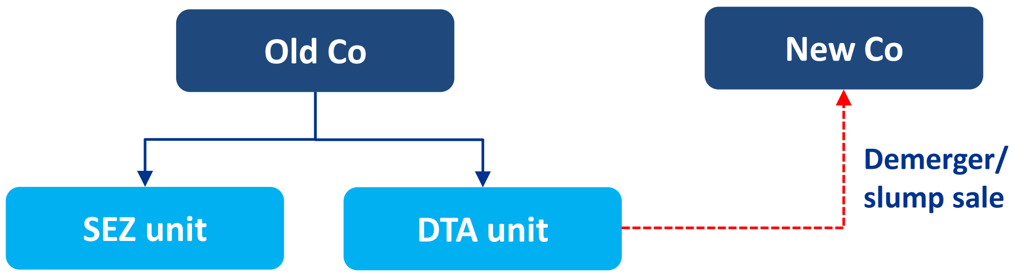
- MAT credit will be difference of tax under normal provisions and tax that would have been payable under MAT i.e. 25.17%-17.48%

Companies operating both SEZ and DTA units

Mechanics

- Incorporate a New Co
- Demerge/ slump sale DTA unit into New Co
- Continue claiming SEZ benefit in Old Co and opt for 25.17% tax in New Co
  - Applicability of GAAR?

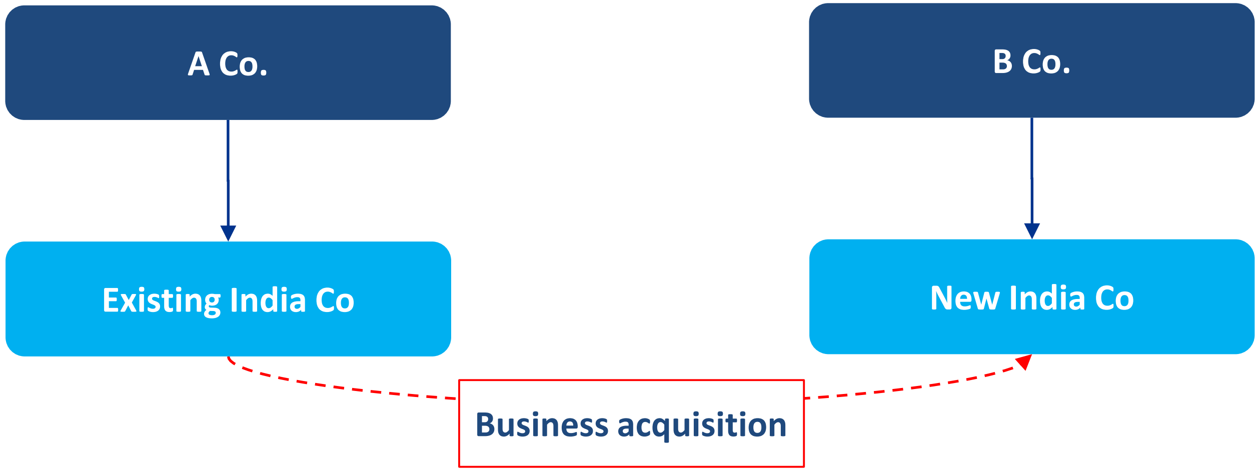
Proposed Option



Sec 115BAB

Formation condition

Illustration 1



Scenario 1

New India Co acquires business:

- Condition applies to the company or unit?
- Business already in existence?

Scenario 2

New India Co to scale up business substantially after 2 years

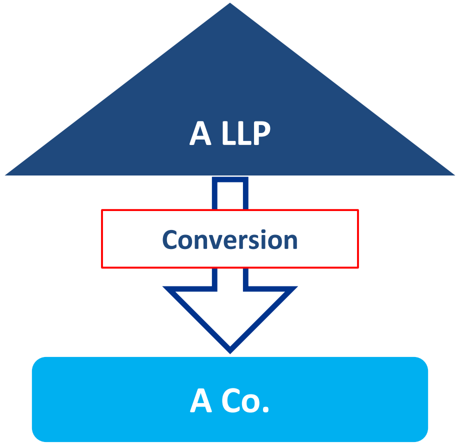
- Eligible or not for 17.16% tax regime?
- Eligible after 2 years?

Scenario 3

Business scaled up in different company (i.e. New India Co 2):

- Both companies to share common CEO, key management personnel's

Illustration 2



Conversion

Whether A Co is formed by splitting up or reconstruction?

Plant & Machinery usage condition

Plant & Machinery criteria

- Plant & machinery means?
- Condition to be tested on formation or at any point of time during the year?
- What does ‘ total value’ as used in explanation 2 of section 115BAB(2)(a)(ii) means?
  - Anomaly – refer adjacent illustration

Depreciation	Particulars	Year 1	Year 2
15%	P&M (used)	20	17
40%	Computers (new)	80	48
	Total	100	65

Value means:

- Fair market value?
- Tax WDV? If so, value of old P&M exceeds more than 20% in year 2
- Book value?
- Purchase price?

Miscellaneous (1/2)

Option to exercise 17.16% & 25.17% tax regime

- Should17.16% tax option be exercised before the due date for furnishing first return of income?
- 25.17% tax option be exercised during any previous year before the due date for furnishing return of income?
- Option exercised:
  - Year 1 – 17.16% tax
  - Year 2 – 25.17% tax
  - Year 3 - ?

Interpretation of 'has commenced' as per section 115BAB(2)(a)(i)

- Company is set up and registered after 1 October, 2019 but manufacturing has not commenced by 31 March, 2020
- Earned interest income during FY20.
- Whether 17.16% tax applies on interest income?

Sectors – does 17.16% tax apply?

- Software development
- Power generation
- Data processing
- Real estate
- Restaurant

Miscellaneous (2/2)

Conversion of LLP into Company

- Not lucrative for companies owned by foreign companies
- DDT timing benefit
- Lucrative for companies owned by individual Indian residents

Merger of loss making entity into 25% entity

- Lucrative as there is no MAT
- Section 72A conditions to be fulfilled

Capital gains tax

- Capital gains tax rate for companies opting for 17.16% tax or 25.17%?

Remodeling structures

Break even point

Particulars	Concessional Tax Regime (in INR)	Normal Tax Regime (in INR)
Pre-deduction Income	100.00	100.00
Less: deductions/ incentives • 10AA • 32AB • 32(1)(iia) • Chapter VI-A (Except 80JJAA) • B/F Loss & Depreciation • Others	Not Applicable	27.96
Profit before Tax	100.00	72.04
Tax Rate	25.17%	34.94%
Tax in INR	25.17	25.17

Assumption: Company is not liable to pay tax under MAT/ no MAT credits are available

01 If aggregate *deductions/ incentives is less than 28%* – Concessional tax regime beneficial

02 If aggregate *deductions/ incentives* are more than 28% - normal tax regime beneficial

Scenarios for Manufacturing entities – Section 115BAB

Scenarios covering Capital WIP expenditure incurred in an entity with a view to commence production

Scenario 1

Company incorporated on or after 01st October, 2019

Company A

Manufacturing

Intends to commence production on or before 31st March, 2023

ETR	Whether to opt for concessional tax regime u/s 115BAB @ ~17%

Scenario 2

Company incorporated on or after 01st April, 2019 but before 01st October, 2019

Company A

Incorporated on 1 April 2019, not commenced operations

CWIP

Transfer

New Company

Incorporated on or after 1st October, 2019

Possible GST implications on transfer of CWIP

ETR	Whether to opt for concessional tax regime u/s 115BAB @ ~17%

Scenario 3

Company incorporated before 01st October, 2019 intending to expand mfging

Company A

Incorporated on 1 April 2001 and operating

CWIP

Transfer

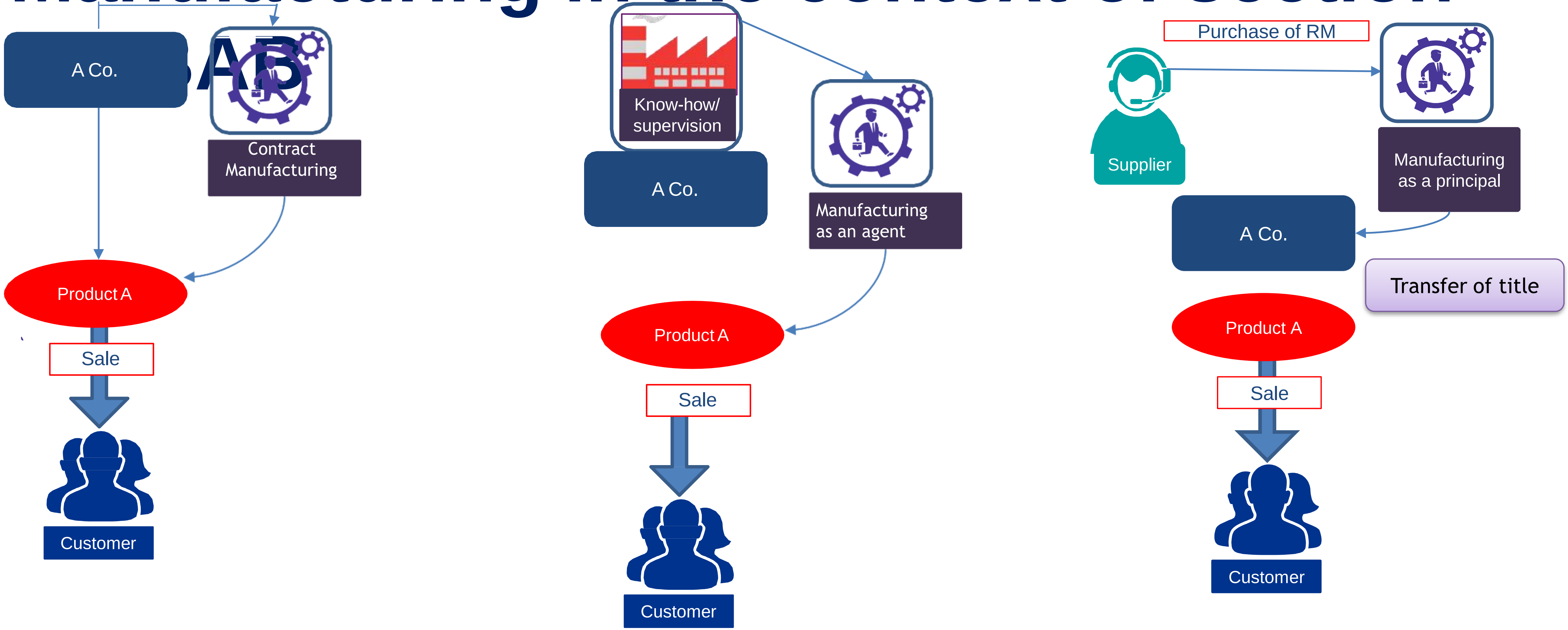
New Company

Incorporated on or after 01st October, 2019

Possible GST implications on transfer of CWIP

ETR	Whether to opt for concessional tax regime u/s 115BAB @ ~17%

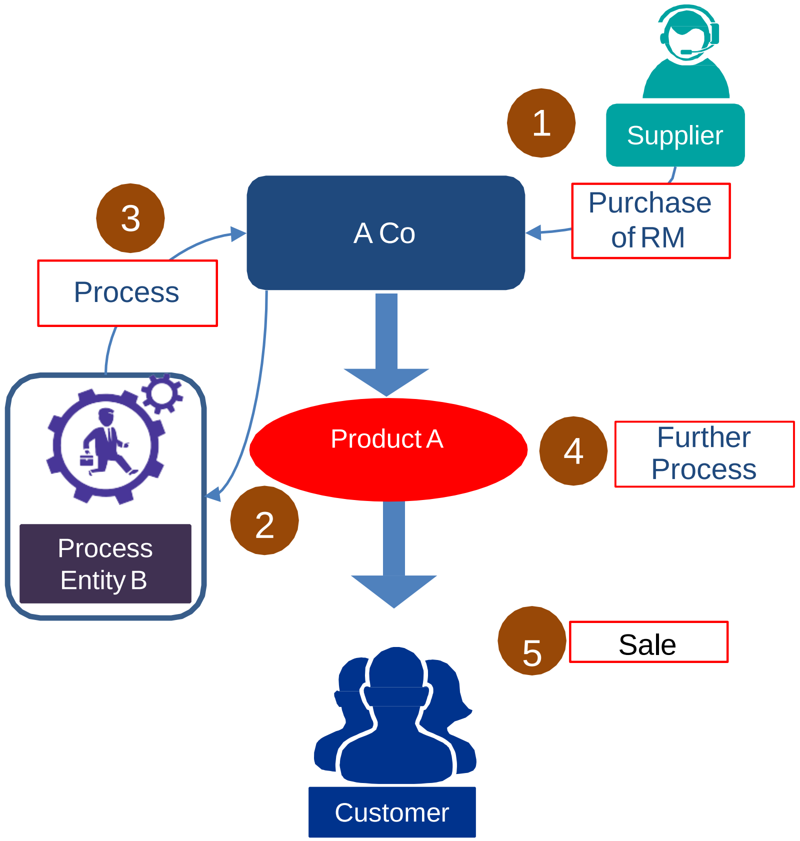
Different Scenarios in Contract Manufacturing in the context of section



Who will be eligible to claim the concessional rate under section 115BAB?

Toll manufacturing in the context of section 115BAB

Scenario



Can both A Co. & Process Entity B avail concessional tax rate as specified u/s 115BAB?

Possible alternatives for migration- Entities operating in SEZ

Scenario 1

Continue on As-Is Where-Is basis

Company A

SEZ Business | Manufacturing | Non-SEZ Business

ETR	Higher of 34.94% on taxable profits or 15% on book profits

Who would opt to continue?

- Entity with current ETR of less than 25.17% (on account of deduction, c/f losses & MAT credit)
- Entities with only profitable SEZ business

Scenario 2

Opt for Concessional Tax Regime

Company A

SEZ Business | Manufacturing | Non-SEZ Business

ETR	25.17%

Who would opt for concessional tax regime?

- Entities with higher proportion of non-SEZ business
- Eligible deductions have already been availed or are approaching the expiry period
- Comparative ETR after utilization of MAT credit & b/f SEZ losses are higher than concessional rate

Scenario 3

Opt for Concessional Tax Regime for non-SEZ business by splitting up the existing structure

Company A

SEZ Business | Manufacturing | Non-SEZ Business

Post Segregation of the business

Existing Company – SEZ Business

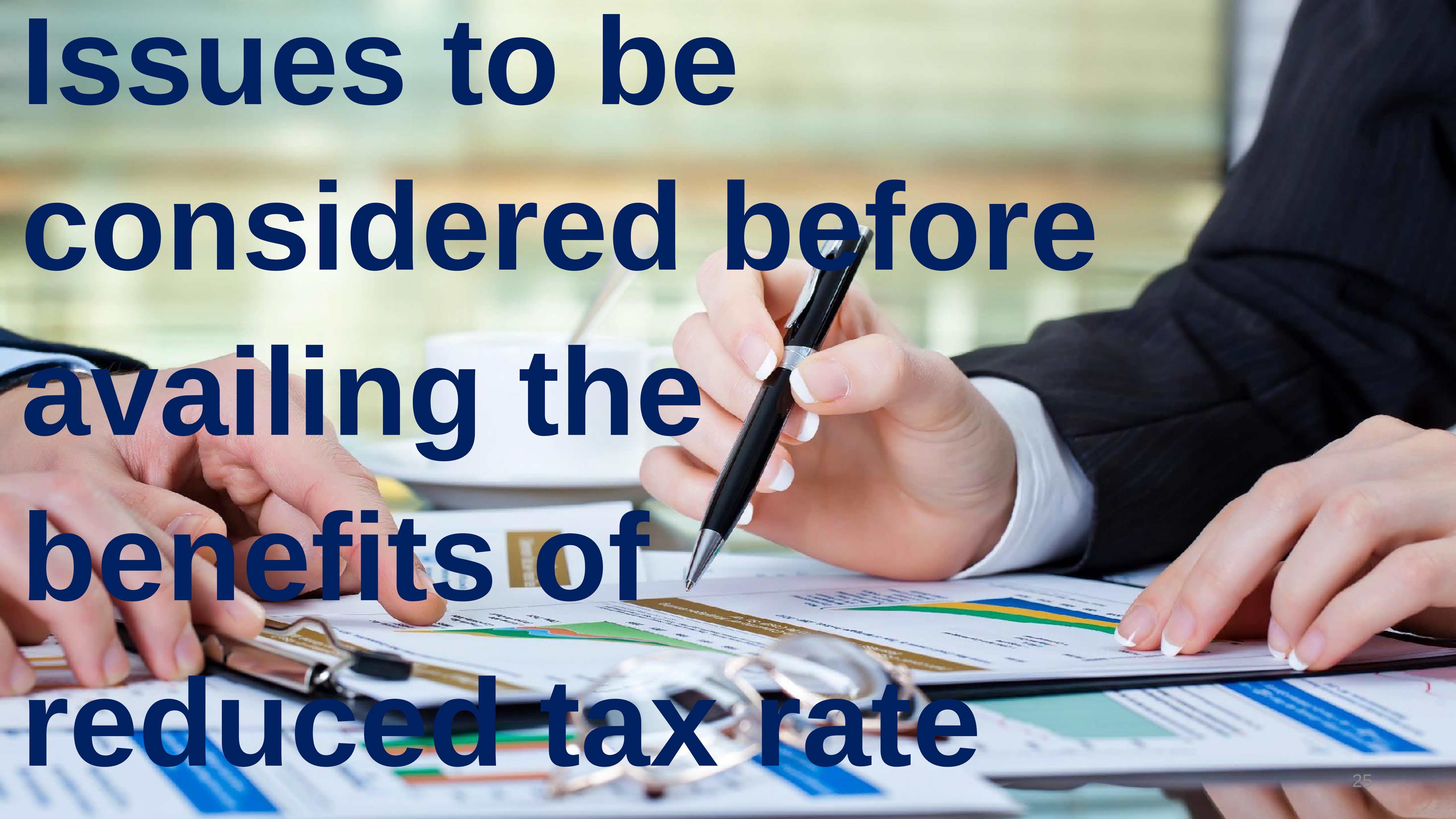
ETR	Normal Tax / MAT

New Company – Non-SEZ Business

ETR	25.17%

This may result in reduction of ETR to less than 25.17%
(SEZ would pay MAT & non-SEZ would pay under concessional rate)

Issues to be considered before availing the benefits of reduced tax rate



Issues to be considered before

1. What happens if the conditions for claiming reduced tax rate is violated in one year?

2. Undertaking a detailed impact analysis of available MAT credit from previous years

1. Evaluate effect of unutilised amount in SEZ reinvestment reserves and tax impact u/s 10AA(3)?

2. Assess impact on deferred tax assets/ deferred tax liabilities recognized in the financial statements

1. What happens to the GST credit on transfer of CWIP?

2. Evaluate possibility of potential FTC leakage

1. Undertake a feasibility study of proposed expansion / restructuring under both tax regimes (including evaluation of specific anti-abuse and GAAR provisions)

Questions

&

Answers

Than k you

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