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REVOLUTIONARY TAX REFORMS ANNOUNCED TO BOOST THE INDIAN ECONOMY

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From having admitted the slowdown in the economy to announcing back to back measures to stabilise and improve the growth, the Government of India today defied all the criticism by announcing big bang tax reforms vide Taxation Laws (Amendment) Ordinance dated 20 September 2019 promulgated by the Hon'ble President of India (Ordinance). The tax reforms announced primarily pertain to significant reduction in corporate tax and capital gains tax rates to provide an impetus to manufacturing, employment and investment in India.

Snapshot of tax reforms

1 *Existing companies: Corporate tax rate of 22% with no Minimum Alternate Tax (MAT)*

Presently the Indian companies are taxed at a base rate of 30% / 25% for financial year (FY) 2019-20 if the turnover of such company in FY 2017-18 did not exceed INR 400 crores. It has now been provided that all the Indian companies may opt to pay tax at a base rate of 22% (plus surcharge of 10% and health and education cess of 4%) without availing any tax incentive /exemption as specified for such companies. Companies opting for 22% base tax rate shall not be subject to MAT which is presently levied at 18.5%. Such option once exercised shall not be withdrawn.

Further, Indian companies availing tax incentive/exemption may opt for the concessional tax rate of 22% on expiry of such tax incentive/exemption period. Such option once exercised shall not be withdrawn.

2 *New companies: Corporate tax rate of 15% with no MAT*

Under the existing provisions of the Income Tax Act, 1961 (IT Act), manufacturing entities set-up on or after 1 May 2016 may avail the option of offering income to tax at 25% base rate subject to waiver of certain tax deductions. In order to assist the ailing manufacturing sector having a consequential impact on employment rate, it is provided that the Indian companies incorporated on or after 1 October 2019 for investment in manufacturing, may avail concessional corporate tax rate of 15% (plus surcharge of 10% and health and education cess of 4%) with no liability on account of MAT. Such companies would need to comply with domestic transfer pricing provisions.

The lowest corporate tax rate is available subject to (a) company not availing specified incentive/exemption (b) commencing production on or before 31st March 2023 and (c) not undertaking any business other than business of manufacture of an article of thing and research in relation to or distribution of such article or thing manufactured by it.

3 *Reduction in MAT rate:*

The tax rate under MAT has been reduced to 15% from current rate of 18.5%.

4 *Relaxation from enhanced surcharge on capital gains*

Vide Finance Act 2019, the surcharge rate for individuals, Hindu Undivided Family, Association of Persons, Body of Individuals and Artificial Juridical Persons was increased to 25% and 37% on income exceeding INR 2 crores and INR 5 crores respectively. This led to a huge uproar amongst the high net-worth individuals and Foreign Portfolio Investors (FPI) and consistent sell off of securities on the market.

In order to revive the sentiment of the investors, it has been provided the aforesaid surcharge of 25% and 37%, as applicable, shall not be levied on capital gain income earned on sale of equity shares and equity oriented fund liable to securities transaction tax in the case of individuals, Hindu Undivided Family, Association of Persons, Body of Individuals and Artificial Juridical Persons.

Further, while FPIs earlier were provided relief from this enhanced surcharge only on certain transactions (please see our newsflash dated 26 August 2019 on earlier relief provided to FPIs), it has now been provided that such enhanced surcharge shall not be applicable to sale of any security by such FPIs including derivatives.

5 *Buy-back tax on listed shares made prospective*

Prior to the Union Budget 2019 announced on 5 July 2019, while buy-back of unlisted shares was taxable in the hands of the Company, buy-back of listed shares was exempt. To bring in parity, provisions under the IT Act were amended to tax the buy-back of listed shares on or after 5 July 2019. The said amendment brought in an ambiguity as to whether buy-back tax on listed shares would be applicable for the offers that were announced/launched prior to 5 July 2019.

The Government have addressed the aforesaid concern by providing that the buy-back tax on listed shares shall not be applicable to buy-back of listed shares where public announcement is made prior to 5 July 2019.

Comments

The high voltage tax reforms are a welcome move and would make India an attractive investment destination for the global as well as domestic investors. These reforms would reinforce the belief that the Government of India is committed towards acknowledging the difficulties faced by the Indian economy and is willing to provide the much-needed support. It would have been a complete package if the tax rates for individuals would also have been rationalized to leave more money in the hands of the consumer thereby increasing their purchasing power capacity. In particular, the following aspects are of importance:

- Concessional tax rate is made applicable only for Indian companies and not for other taxpayers including Limited Liability Partnerships. Given that regulations for foreign investment in LLPs are being brought at par with those of corporates, parity may be provided under tax laws as well.

- Exemption from MAT is a big thumbs-up especially for the companies staring at huge tax cost on book profit arising on settlement of liabilities under Insolvency and Bankruptcy Code, 2016 and Investment holding companies.

- While under erstwhile provisions Indian manufacturing companies opting for concessional tax rate of 25% were subject to MAT, for new manufacturing companies incorporated on or after 1 October 2019 opting for concessional tax rate of 15% would not be subject to MAT.

- Under the existing provisions, surcharge was levied at 7% for taxable income exceeding INR 1 crore and 12% for taxable income exceeding INR 10 crores resulting into effective tax rate of 33.38% / 34.94% and 27.82% /29.12% for companies whose turnover in FY 2017-18 did not exceed INR 400 crores. However, for companies opting for concessional tax rates of 22% and 15% pursuant to the Ordinance, the thresholds have been done away with and the surcharge for such companies would be levied at 10% irrespective of the amount of taxable income resulting into effective tax rate of 25.17% and 17.16% respectively.

- As regards relaxation from enhanced surcharge for FPIs, in absence of an express tax pass through status of a Category III Alternative Investment Funds (unlike in case of Category I and II Alternative Investment Funds except in relation to their business income) and tax consequences of a trust earning business income as well as certain practical challenges, enhanced rates of surcharge could continue to apply.

- On companies availing the option of concessional tax rate along with MAT exemption, whether the existing MAT credit would continue is a question and hence, needs clarification.

- Lastly, companies would need to evaluate their tax cost considering tax incentives/exemption are continued to be availed and the tax cost if option for the concessional tax is availed to determine their effective tax rates with and without tax incentives/exemptions.

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