Major change in the Indian corporate tax rates – Shift to a moderate tax regime!

20 September 2019

Executive summary:

- The Indian Finance Minister ("FM") addressed a press conference on September 20, 2019 and announced several fiscal measures to promote growth and investment in India. The changes announced in the press conference shall be effective from Financial Year 2019-20.

- A significant reduction in the corporate tax rates has been announced. The corporate tax rates will be reduced from the existing 30%/ 25% to 22%/ 15% subject to certain conditions. The reduced corporate tax rates can be availed by any Indian company (foreign owned or Indian owned, listed or unlisted and irrespective of its size) which satisfies the prescribed conditions.

- Certain other changes have also been announced to stabilise the Indian capital markets.

- The Taxation Laws (Amendment) Ordinance, 2019 has been promulgated by the President of India to make relevant amendments to the tax laws to give immediate effect to the changes announced by the FM.

Summary of amendments

Proposal	Rationale	Amendment
Reduction in corporate tax rate for all companies	To promote growth and investments	• An option has been provided to all domestic companies to pay tax at the rate of 22% (effective tax rate of 25.17%), subject to the condition that they will not avail any specified incentives/ deductions[1]. Also, any carried forward losses arising on account of specified deductions claimed in the past will lapse. • Companies need to avail the option in their income-tax return within the prescribed timeline. Once the option is exercised, it cannot be subsequently withdrawn. • Companies availing the aforesaid concessional rate of tax shall not be required to pay Minimum Alternate Tax ("MAT") on book profits
Revised corporate tax rate for new manufacturing companies	To attract fresh investment in manufacturing	• An option has been provided to domestic manufacturing companies to pay tax at the rate of 15% (effective tax rate of 17.16%) subject to satisfying all the following conditions: a. Company should be incorporated on or after 1 October 2019. b. It should not be formed by splitting up or reconstruction of a business already in existence. c. It should not use any machinery or plant previously used for any purpose (second-hand imported machinery can be used subject to certain conditions); however, this condition is deemed to be satisfied if the value of second-hand machinery does not exceed 20% of the total value of the machinery. d. It should not be engaged in any business other than the business of manufacturing and research and distribution related to the manufacturing activities. e. It should not avail any specified incentives/ deductions[2]. Also, any carried forward losses arising on account of specified deductions claimed in the past will lapse. f. It should commence manufacturing on or before 31 March 2023. • Anti-abuse provisions have been introduced to check shifting of profits to such companies from closely connected persons. Transactions between closely connected persons will be subjected to transfer pricing provisions. • Companies need to avail the option in their **first** income-tax return within the prescribed timeline.

[1] SEZ unit tax holiday for exports, additional depreciation, investment allowance for investment in notified backward areas, deductions for certain specific sectors (tea, coffee, rubber, petroleum, natural gas), certain research & development related incentives, investment linked tax holiday for certain sectors, weighted deduction for agricultural extension or skill development project, any deduction specified in Chapter VI-A (other than the deduction for employment generation)

[2] SEZ unit tax holiday for exports, additional depreciation, investment allowance for investment in notified backward areas, deductions for certain specific sectors (tea, coffee, rubber, petroleum, natural gas), certain research & development related incentives, investment linked tax holiday for certain sectors, weighted deduction for agricultural extension or skill development project, any deduction specified in Chapter VI-A (other than the deduction for employment generation)

Proposal	Rationale	Amendment
		Once the option is exercised, it cannot be subsequently withdrawn. • Companies availing the aforesaid concessional rate of tax shall not be required to pay MAT
Future corporate tax rate for companies availing tax incentives	To signal a moderate tax rate post expiry of tax incentives	• Such companies shall pay tax at the pre-amendment rate i.e. 25% or 30%, as applicable. • A concessional MAT rate of 15% (excluding surcharge and cess) shall apply to such Companies. • Option has been provided to elect for concessional tax rate after expiry of tax holiday. Once opted, this cannot be subsequently withdrawn.
Exemption from Enhanced Surcharge on Capital Gains for FPIs and other investors	In order to stabilize flow of funds into Capital Markets	• Enhanced surcharge introduced by Finance Act (No. 2) 2019 (i.e. 25% and 37%) shall not apply to capital gains on sale of equity shares or units of equity oriented fund or unit of business trust (i.e. REIT or InvIT) which are liable to Securities Transaction Tax in the hands of individuals, Hindu Undivided Family, Association of Persons, Body of Individuals and Artificial Judicial Person. • The enhanced surcharge shall also not apply to capital gains arising on sale of any security (including derivatives), in the hands of Foreign Portfolio Investors ("FPIs").
Delayed introduction of buy-back tax for listed companies	Provide relief to few listed companies	• Buy-back tax shall not apply to listed companies which had announced Buy-back before the date of Budget proposals for 2019 i.e. 5th July 2019.
Expansion of scope of CSR spending	Additional avenues to spur CSR allocations	Companies can now expend their CSR funds on: • Incubators funded by Central or State Government, PSUs, any agency • Making contribution to public funded universities, IITs, National laboratories and various other bodies engaged in conducting research in science, technology, engineering and medicine aimed at improving Sustainable Development Goals.

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Our comments

- The proposal to reduce the effective corporate tax rates to 25.17%/ 17.16% and the calibrated withdrawal of MAT should bring cheer to corporates and improve India's global competitiveness in a climate of global trade tensions.
- This should also make a company structure attractive for the conduct of business since the effective tax rate arbitrage between LLPs and companies will reduce.
- Specific anti-abuse provisions have been prescribed to ensure that the concessional tax rate of 17.01% is availed only by newly formed companies making fresh investments in the manufacturing sector. Also, anti-profit shifting provisions have been introduced. Ofcourse, the tax laws anyway have a pre-existing General Anti-Avoidance Rule (GAAR) which could be invoked in suitable cases.
- There is lack of clarity on utilisation of existing MAT credit for companies who opt for the lower tax rate.
- The clarification on the non-applicability of enhanced surcharge to FPIs should provide an element of certainty and boost the capital markets. Also, the non-applicability of the enhanced surcharge on capital gains (liable for STT) is capital market friendly for other investors and re-instates the pre-budget tax position for these investors.
- The announcement made by the FM is a radical move towards addressing the long-standing demand of the industry. The changes demonstrate the proactive approach of the Government in addressing the economic downturn at a significant cost to the exchequer.

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