

EY Tax Alert

Government slashes corporate tax rates for domestic companies

Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

Executive summary

This Tax Alert summarizes the Taxation Laws (Amendment) Ordinance, 2019 (Ordinance) promulgated by the President of India on 20 September 2019 to make certain amendments to the Income Tax Act, 1961 (ITA) and the Finance (No. 2) Act, 2019. The Ordinance provides for a major reduction in corporate tax rates for existing and new domestic companies. The Ordinance also implements the withdrawal of higher surcharge for non-corporates on certain capital market transactions announced earlier on 24 August 2019 as also provides relief from buy-back tax for listed companies in respect of buybacks which were publicly announced prior to Budget announcement on 5 July 2019.

Background

Amidst the backdrop of a slowing economy and a clamour from the industry for fiscal stimulus, Finance Minister (FM) Nirmala Sitharaman had made a series of announcements starting from 23 August 2019 on various fiscal and non-fiscal measures being adopted to boost the economy. On the direct tax front, some of the measures announced were withdrawal of 'angel tax' for registered start-ups, withdrawal of higher surcharge for non-corporates on certain capital market transactions, additional depreciation on motor vehicles and administrative measures to remove harassment of taxpayers.

Continuing with such measures, on 20 September 2019, the Government promulgated the Ordinance containing various fiscal measures to further promote growth and investment through the following amendments.

Taxation Laws (Amendment) Ordinance 2019

► Reduction of corporate tax rates for domestic companies

- a) Prior to the Ordinance, existing domestic companies were liable to tax at basic rate of either 25% or 30%. The effective tax rate ranged from 26% to 34.94% after considering surcharge of 7%/12% and health & education cess of 4%.

The tax rate of 25% was applicable to two types of domestic companies viz. (a) those having turnover or gross receipts not exceeding INR4b in tax year 2017-18; and (b) new domestic manufacturing companies set up and registered on or after 1 March 2016 fulfilling specified conditions.

- b) With effect from tax year 2019-20, domestic companies^[1] shall have an option to pay income tax at the rate of 22% plus 10% surcharge and 4% cess taking the effective tax rate (ETR) to 25.17%, subject to the condition that they will not avail specified tax exemptions or incentives under the ITA. Such option once exercised cannot be subsequently withdrawn. Companies exercising such option will not be required to pay Minimum Alternate Tax (MAT).

^[1] i.e. defined in the current Indian tax law to mean Indian company or any other company which, in respect of its income liable to tax in India, has made prescribed arrangements for the declaration and payment, within India, of the dividends (including dividends on preference shares) payable out of such income

Domestic companies claiming any tax exemptions or incentives shall also be eligible to exercise such option after the expiry of the tax incentive period.

- c) Further, new domestic manufacturing companies, incorporated on or after 1 October 2019 and commencing manufacturing on or before 31 March 2023, making fresh investments in manufacturing will have an option to avail an even lower tax rate of 15% plus 10% surcharge and 4% cess taking the ETR to 17.16%^[2]. Companies exercising such option will not be required to pay MAT. However, such new domestic manufacturing company should fulfil, *inter alia*, following conditions:

(i) It is not formed by splitting-up/ reconstruction of a business already in existence^[3];

(ii) It should not use the following assets:

- Any plant or machinery previously used in India in value exceeding 20% of total value of plant or machinery;
- Any building previously used as a hotel/ convention centre;

(iii) It should not claim any specified tax incentive;

(iv) It should exercise option to claim the benefit of lower tax rate in the first of the returns to be filed by it and such option once exercised cannot be withdrawn.

The benefit of lower tax rate is also subject to anti-avoidance provision in terms of which the Tax Authority has power to apply the lower tax rate to a reasonable level of profits, if it appears to the Tax Authority that transactions with closely connected or other persons produces more than ordinary profits which might be expected to arise and for this purpose, the company shall also be liable to domestic transfer pricing provisions.

^[2] The Press Note issued by Government refers to ETR of 17.01%

^[3] Except in case of rehabilitation of existing business disrupted by natural or other specified calamity

d) The comparative effective tax rates before and after exercise of option are as follows: -

Sr	Nature of domestic company	Current ETR (%)	ETR on Exercise of Option (%)	Reduction in tax liability
1	Total turnover or gross receipts \leq INR4b during FY 2017-18 or new manufacturing companies incorporated between 1 March 2016 and 30 September 2019			
	o Income < INR 10m	26%	25.17%	0.83%
	o Income > INR10m, but <INR100m	27.82%	25.17%	2.65%
	o Income > INR100m	29.12%	25.17%	3.95%
2	Optional tax rate for new manufacturing companies incorporated on or after 1 October 2019			
	o Income < INR 10m	26%	17.16%	8.84%
	o Income > INR10m, but <INR100m	27.82%	17.16%	10.66%
	o Income > INR100m	29.12%	17.16%	11.96%
3	Other domestic companies			
	o Income < INR 10m	31.2%	25.17%	6.03%
	o Income > INR10m, but <INR100m	33.38%	25.17%	8.21%
	o Income > INR100m	34.94%	25.17%	9.77%

▶ **Reduction of MAT rates**

The rate of MAT for other companies (including domestic companies continuing to avail tax incentives) is reduced from base rate of 18.5% to 15% (before application of surcharge and cess).

▶ **Withdrawal of enhanced surcharge on capital gains**

The Finance (No. 2) Act, 2019 had increased surcharge for an individual, HUF^[4], AOP^[5], BOI^[6] and artificial juridical person to 25% (for total income between INR 2 crore to INR 5 crore) and 37% (for total income exceeding INR 5 crore) from the earlier rate of 15%. Subsequently, the FM in her press conference on 23 August 2019 announced a partial roll back of the enhanced surcharge for:

- a) Individuals, HUFs, AOPs, BOIs and Artificial Juridical Persons on capital gains income arising on transfer of listed equity shares, units of equity-oriented fund and business trust, which are liable to Securities Transaction Tax; and
- b) Foreign Portfolio Investors (FPIs^[7]) on capital gains income arising on transfer of above referred capital assets as also on derivatives (which are deemed to be capital assets in their hands).

There was lack of clarity on withdrawal of enhanced surcharge to FPIs in respect of capital gains arising on securities other than those referred above (e.g. debentures, government securities, etc).

The Ordinance implements the withdrawal of enhanced surcharge as announced earlier. Further, it also clarifies that, in case of FPIs, the enhanced surcharge shall not apply to capital gains on any 'securities'.

▶ **Transitional relaxation on tax on buy-backs by listed companies**

Prior to amendment by Finance (No.2) Act 2019, tax on income distributed by a company to its shareholders by way of buy-back of shares applied only to unlisted companies. The Finance (No.2) Act 2019 extended it even to listed companies with effect from 5 July 2019. This created hardships for listed companies who had publicly announced buy-backs before 5 July 2019 but not completed it by that date. The Ordinance relaxes the applicability in respect of buy-backs by listed companies in respect of which public announcement of buyback as per regulatory norms has been made before 5 July 2019. Thus, the buy-back tax will apply in case of listed companies where public announcement of buy-back is made on or after 5 July 2019.

Other announcement made in the Press Note^[8]

▶ **Scope of Corporate Social Responsibility (CSR) spending expanded**

In addition to the above, the Government has decided to widen the scope of mandatory CSR spending of 2% under the Companies Act, 2013 to permit expenditure on incubators funded by Government or public sector companies or contributions to public funded universities, Indian Institutes of Technology, National Laboratories and other autonomous bodies engaged in conducting research in science, technology, engineering and medicine aimed at promoting sustainable development goals.

^[4] Hindu undivided family

^[5] Association of Persons

^[6] Body of individuals

^[6] aka Foreign Institutional Investors (FIIs)

^[8] Issued by the Ministry of Finance dated 20 September 2019

Comments

The reduction in corporate tax rates for domestic companies is a bold and radical measure implemented by the Government to tackle the slow-down in the economy. All domestic companies across all sectors will stand to benefit from the reduction if they opt to sacrifice the tax incentives.

The special concessional effective tax rate of 17.16% for new domestic manufacturing companies will make India more competitive when compared to some of the other emerging markets and give a boost to 'Make in India' policy of the Government.

The non-applicability of MAT in above cases and reduction in MAT rate in other cases ensure that the reduction in corporate tax rates is truly effective.

The withdrawal of buy-back distribution tax for listed companies in respect of buy-backs which were already publicly announced prior to 5 July 2019 will provide relief to those listed companies who were caught unawares by the Union Budget 2019 and make the levy on listed company buy-backs truly prospective in nature.

The expansion of the scope of CSR to payments made to Government-funded/ recognized R&D institutions provides opportunity to corporates to avail dual benefit of CSR compliance under corporate law as well as tax benefit under the ITA provided such corporate does not opt for lower rates as introduced by the Ordinance.

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