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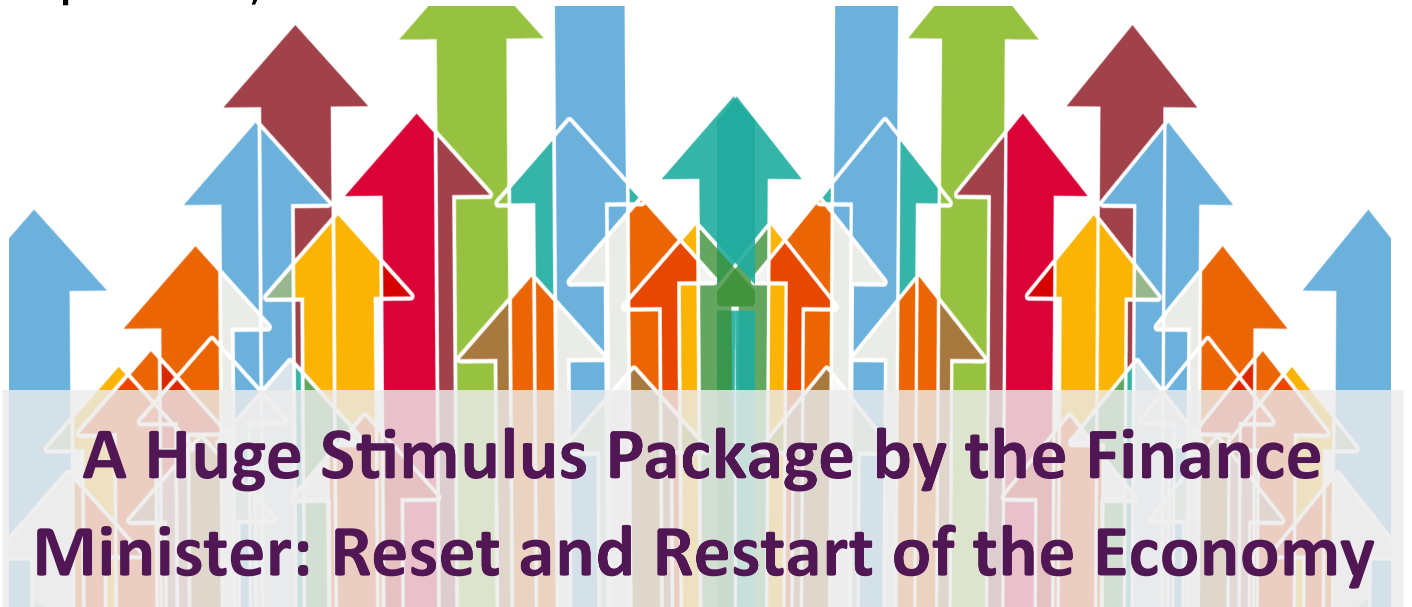
BUDGET ASSAYER : ALERT

September 23, 2019



A Huge Stimulus Package by the Finance Minister: Reset and Restart of the Economy

The recent Indian GDP growth number that was announced at 5% brought gloom all round and resulted in hectic activities amongst the 'powers to be' to find solutions to provide a kick-start to the economy and incite the 'animal spirit' of entrepreneurs. In the past 3 weeks, the Indian Finance Minister, Nirmala Sitharaman ("**FM**") has announced three sets of measures. They did not succeed in exciting the concerned section of people enough and capital markets continued to slump, resulting in erosion of significant value. On September 20, the FM announced the fourth and probably the most impactful stimulus package, inciting cheers across industry and professions. She slashed the corporate tax rate by as much as 18% for newly set up Indian manufacturing companies and by 10% for the existing companies. There are a slew of other positive measures which also brought cheer to entrepreneurs and most certainly to the capital markets. This shows the commitment of the Government to do all that is required, to take the economy to the promised 5 trillion dollar economy.

Tax administration has been criticized for its aggressiveness in India. While several measures have been taken to address this criticism, the most recent announcements should give a significant impetus to addressing the pains of tax payers. With these new tax rates, India compares favorably with other developing economies, which compete with India for attracting foreign capital. India is hoping to benefit from companies shifting their manufacturing base from China in the wake of China-US trade war. The new tax rates and ensuing tax regime should add to India's attractiveness, though there are several other aspects which also need to be taken care of, notably the labour laws and the land acquisition norms etc. to improve the 'doing business in India' index. It is rumored that they are all under active review.

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September 20 Announcements

The changes in taxation rates and regime could only be brought either through an amendment to the recently enacted Finance (No. 2) Act, 2019 ("**Act**") or through a presidential ordinance when the Parliament is not in session, which is then passed by the Parliament in its next session. Therefore, these changes announced on September 20, 2019 have been brought about through an ordinance, the Taxation Laws (Amendment) Ordinance, 2019 ("**Ordinance**"), promulgated by the President of India.

Additionally, the announcement included a decision with regard to the Corporate Social Responsibility ("**CSR**") under the Companies Act, 2013 which mandates certain companies to spend, at least, 2% of their profits on CSR activities. The avenues for which it can be spent have remained ambiguous. Realising the difficulties faced by corporates, the Government has decided to increase the category of institutes and type of areas for which such funding can be used. These now include incubators funded by the State or Central Government or public funded universities, IITs, National Laboratories and Autonomous Bodies established under the Ministry of Electronics and Information Technology. Corporates are permitted to outsource their own R&D and product development activities to these institutes where they use the CSR funding. This should give a big boost to creating and developing the much needed intellectual property / innovation and creating centers of excellence as is witnessed in many developed countries.

In this news flash, we set out briefly the changes made by the Ordinance and conclude with our comments in respect of the way forward:

Lower corporate tax rates for existing companies

The Act had reduced the base corporate tax rate from 30% to 25% for domestic companies having gross receipts or turnover upto INR 4 billion. However, other companies, which did not meet this criterion continued to be taxed at the rate of 30%, resulting in a tax rate of almost 35% (including surcharge and cess). Additionally, companies are liable to Minimum Alternate Tax ("**MAT"**) at 18.5% (base rate) and such MAT is available as credit in the ensuing years for 15 years. The Ordinance slashes the base tax rate to 22% for all domestic companies, provided income of such companies is computed:

a. without claiming any relief or tax holiday available to units in special economic zone or companies engaged in power transmission; or operating in notified backward areas in certain states; or business of growing and manufacturing coffee, tea or rubber; scientific research or biotechnology; or skill development project or deductions in respect of certain specified incomes;
b. without setting off any loss carried forward from earlier years which pertains to the above deductions claimed in previous years; and
c. claiming depreciation only in the manner to be prescribed.

The base tax will be increased by surcharge at the rate of 10% and cess at 4%, leading to an effective tax rate of 25.17% ("**25% Tax Regime**"). No MAT would be payable under this regime. An existing company has the option to elect to be taxed under the 25% Tax Regime by giving up exemptions and tax holidays (as mentioned above) that it was claiming or entitled to. Alternatively, it can elect to be taxed under the 25%

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Tax Regime upon the termination of the exemptions and tax holiday. Once the company exercises the option, it cannot revert to the earlier full tax regime with exemptions / tax holidays.

Companies can opt for the 25 % Tax Regime, starting from the current financial year, i.e. April 1, 2019, this rate is available without a sunset clause.

Lower tax for companies set up for "Make in India"

To enable success of the Make in India initiative to boost employment and investment, companies set up on or after October 1, 2019 in manufacturing sector would be liable to tax at the rate of 15% if they start manufacturing on or before March 31, 2023. The surcharge on such rate is 10%, leading to an effective tax rate of approximately 17% ("**17% Tax Regime**"). To be eligible to this 17% Tax Regime, the company should meet the following conditions:

a. Such companies should not be formed by reconstruction or splitting up of existing businesses or they must not use any machinery or plant previously used for any purpose except under some specified circumstances or they must not use any building previously used as a hotel or a convention centre;
b. Such companies should not be engaged in any business other than manufacture or production of article or thing and research in relation to, or distribution of such products manufactured or produced by it; and
c. Such company shall also not claim any other exemption or tax holiday as discussed above in the 25% Tax Regime.

Therefore, a company set up on or after October 1, 2019 which starts manufacturing before March 31, 2023, may choose to be taxed under the existing tax exempt regime available to registered 'start-up'. A business which is set up on or after October 1, 2019 which commences manufacturing on or before March 31, 2023, is registered as a start-up and has taken exemption from tax for three consecutive years out of seven years, can also opt for 17% Tax Regime post completion of the tax holiday period. However, in this situation, it will not be able to claim set off of losses (if any) accumulated during the tax holiday period.

These companies, qualifying for 17% Tax Regime would also need to transact with their parent or related party existing companies on an arm's length basis and comply with transfer pricing regulations in terms of maintaining documentation and filing of forms with the tax department.

Once a company qualifies for 17% Tax Regime, starting from the current financial year, i.e. April 1, 2019, this rate is available without a sunset clause.

Companies can opt for the 17 % Tax Regime starting from the current financial year, i.e. April 1, 2019.

Reduction in MAT

The MAT for the existing companies who otherwise pay tax at net rate of almost 35% has been reduced from 18.5% to 15%. MAT would not be attracted in case of domestic companies which opt to be taxed under the 25% Tax Regime or the 17% Tax Regime. An existing company which is paying tax at the rate of 35% and is subject to MAT, may need to consider the election to the 25% Tax Regime after ensuring that the existing MAT credit is utilised.

The reduced rate of MAT will apply with effect from the current financial year, i.e. April 1, 2019.

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Grandfathering of Buy-Back Tax in case of listed shares

The Act had brought the buy-back of shares by listed companies under the buy-back tax net effective July 5, 2019. This tax was earlier applicable to unlisted companies. This created a lot of flutter in the market since buy-back is a long drawn process. Companies which had already announced buy-back as on July 5, 2019 would have been subjected to this onerous tax and were caught unawares. To reduce difficulties faced by such companies, it is now provided that the buy-back tax will not be applicable in cases where the listed companies had announced buy-back before July 5, 2019.

Cheers for Foreign Portfolio Investor and Domestic Investors

The Act had enhanced the surcharge on all tax payers in the category of Individuals, Hindu Undivided Family, Association of Persons, Body of Individuals etc. when their income exceeded INR 20 million but was less than INR 50 million to 25% and to 37% when the income exceeded INR 50 million. This enhanced tax, by implication, also became applicable to Foreign Portfolio Investors ("**FPIs**") which were not organised as corporates. In addition to the hue and cry from FPIs, this enhancement of tax on income derived from sale of securities in the stock market negatively impacted the investor sentiment and it encouraged the 'bear market' operators to beat the market down substantially. The Ordinance has made amends to this by exempting all capital gains income realised by FPIs, from the application of enhanced surcharge. Similar exemption is also provided in case of capital gains realised by domestic investors from sale of shares and securities where 'securities transaction tax' is paid. Securities for this purpose are equity shares, units of equity oriented funds and units of business trusts.

Concluding Remarks

The huge reduction in tax rates is estimated to result in a tax revenue loss to the Government to the tune of INR 1.45 lakh crores (as per news reports). The expectation and hope are that the increased spur in economic activities will give rise to better tax realisation and the lower rates would improve compliances, thereby result in better collections. The abolition of tax exemptions and holidays should help remove distortions as well as reduce disputes arising from denial by tax officers to give the exemptions. Nil cash outflow on MAT and reduced litigation should free up the resources of businesses to focus on their excellence and outreach to far off domestic and export markets as also improve their competitiveness in the global scenario.

Disclaimer

This alert has been sent to you for information purposes only. The information and/or observations contained in this alert do not constitute legal advice and should not be acted upon in any specific situation without appropriate legal advice. Should you have any queries please feel free to reach out to following:

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