Legislative Brief

The Taxation Laws (Amendment) Ordinance, 2019

The Taxation Laws (Amendment) Ordinance, 2019 was promulgated on September 20, 2019.

The Ordinance amends the Income Tax Act, 1961 and the Finance (No. 2) Act, 2019.

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Highlights of the Ordinance

- Currently, domestic companies with annual turnover of up to Rs 400 crore pay income tax at the rate of 25%. For other domestic companies, the tax rate is 30%. The Ordinance provides domestic companies with an option to pay tax at the rate of 22%, provided they do not claim certain deductions under the Income Tax Act.
- These include deductions for: (i) newly established units in Special Economic Zones, (ii) expenditure on scientific research and skill development projects, (iii) investment in new machinery/ plant in notified backward areas, (iv) depreciation of new machinery/ plant, and (v) various other Chapter VI-A provisions.
- The Ordinance provides new domestic manufacturing companies with an option to pay income tax at the rate of 15%, provided they do not claim the deductions specified above.
- The Ordinance specifies that the provisions regarding payment of Minimum Alternate Tax (MAT) will not apply to companies opting for the new tax rates. MAT is the minimum amount of tax required to be paid, in case a company's tax liability falls below a certain limit after claiming deductions.

Key Issues and Analysis

- In 2017-18, 29% of the 8.4 lakh companies paid tax at an effective rate higher than 25%. The Ordinance allows these companies a lower statutory tax rate option of 25.17%. Note that these companies contributed 69% of the total income tax paid by all companies in 2017-18.
- In case of the manufacturing sector, the effective tax rate after deductions was 28% in 2017-18. This is much higher than the 17.16% statutory tax rate option provided under the Ordinance for new domestic manufacturing companies.
- The Ministry of Finance has estimated the revenue impact of new tax rates and other measures under the Ordinance (includes exemptions to capital gains of certain investors from increased surcharge rates) at Rs 1.45 lakh crore. This could increase the fiscal deficit for the year 2019-20 from 3.3% of GDP to 4% of GDP.
- The Ordinance specifies that the MAT provisions (Section 115JB of the IT Act) will not apply to companies opting for the new rates. It does not amend Section 115JAA, which allows companies to utilise MAT credit available with them to pay tax. After the Ordinance, the Central Board of Direct Taxes issued a circular specifying that MAT credit cannot be utilised by companies opting for the new rates. The question is whether a circular can override the MAT credit facility provided in the IT Act.

PART A: HIGHLIGHTS OF THE ORDINANCE

Context

In India, companies pay taxes on their income as per the Income Tax Act, 1961 (IT Act). Under the Act, domestic companies (i.e. companies incorporated in India) with annual turnover of up to Rs 400 crore are required to pay income tax at the rate of 25%.[1] For other domestic companies, the tax rate is 30%.[1] In addition, companies are also required to pay a surcharge on income tax and the Health and Education Cess. Including the surcharge and cess, the statutory tax rate for domestic companies ranges between 26% and 35% (see Table 1).

Table 1: Tax rate including surcharge and cess

	Turnover up to Rs 400 crore	Turnover more than Rs 400 crore
Income up to one crore rupees	26%	31.2%
Income between Rs 1 crore and Rs 10 crore	27.8%	33.4%
Income more than Rs 10 crore	29.1%	34.9%

Sources: The Finance (No. 2) Act, 2019; PRS.

In 2009, the draft Direct Taxes Code was released aiming to consolidate and simplify the IT Act and other direct tax laws, and establish an efficient and equitable tax system with minimum exemptions.[2] It proposed a uniform tax rate of 25% for all domestic companies.[2] Subsequently, the Direct Taxes Code, 2010 was introduced in Lok Sabha which proposed a 30% tax rate for domestic companies.[3] It lapsed with dissolution of the 15th Lok Sabha.

In the 2015-16 Budget Speech, the Finance Minister noted that a higher basic corporate tax rate in India (30%), in comparison to the other major Asian economies, makes the domestic industry uncompetitive.[4] On the other hand, due to excessive exemptions, the effective revenue realised by the government is at a lower rate (23%).[4] The Finance Minister proposed reducing the tax rate from 30% to 25% over a period of four years, along with rationalisation and removal of various exemptions and incentives.[4] In November 2017, the Ministry of Finance constituted a Task Force to review the IT Act and draft a new direct tax law, keeping in view the direct tax system of various countries and their best practices.[5] The Task Force submitted its report in August 2019.

The Taxation Laws (Amendment) Ordinance, 2019 was promulgated on September 20, 2019 to amend the IT Act and the Finance (No. 2) Act, 2019.[6] It provides lower tax rate options to domestic companies to promote growth and investment and attract fresh investment in the manufacturing sector.[7]

Key Features

New income tax rate option for domestic companies

- Currently, for domestic companies with annual turnover of up to Rs 400 crore, the income tax rate is 25%. For other domestic companies, the tax rate is 30%. The Ordinance provides domestic companies with an option to pay income tax at the rate of 22%, provided they do not claim certain deductions under the IT Act. These include deductions provided for: (i) newly established units in Special Economic Zones (SEZs), (ii) investment in new plant or machinery in notified backward areas, (iii) expenditure on scientific research, agriculture extension, and skill development projects, (iv) depreciation of new plant or machinery (in certain cases), and (v) various other provisions in the IT Act under Chapter VI-A.
- The Ordinance provides new domestic manufacturing companies with an option to pay income tax at the rate of 15%, provided they do not claim certain deductions (as specified above). These new companies must be set up and registered after September 30, 2019, and start manufacturing before April 1, 2023. New manufacturing companies will not include companies: (i) formed by splitting up or reconstruction of an existing business, (ii) engaged in any business other than manufacturing or production, and (iii) using any plant or machinery previously used in India (except under certain specified conditions).

Provisions for companies opting for the new tax rates

- A company can choose to opt for the new tax rates in the financial year 2019-20 (i.e. assessment year 2020-21) or in any other financial year in the future. Once a company exercises this option, the chosen provision will apply for all subsequent years.
- Domestic companies pay surcharge at 7%, if income is between one crore rupees and Rs 10 crore, and at 12%, if income is more than Rs 10 crore. Companies opting for the new rates have to pay a 10% surcharge.

Minimum Alternate Tax

- Minimum Alternate Tax (MAT) is the minimum amount of tax required to be paid by a company, in case its tax liability after claiming deductions falls below a certain limit. This limit is calculated as a certain percentage (i.e. MAT rate) of the company's book profit (subject to certain adjustments). The Ordinance reduces the MAT rate from 18.5% to 15% with effect from the financial year 2019-20.
- The Ordinance specifies that the provisions regarding payment of MAT under the IT Act will not apply to companies opting for the new tax rates.

PART B: KEY ISSUES AND ANALYSIS

Impact of lower tax rate options provided to domestic companies

Ordinance: Section 4

The Ordinance provides that domestic companies can opt for the 22% tax rate and new domestic manufacturing companies can opt for the 15% tax rate, provided they do not claim certain deductions. Including surcharge and cess, companies opting for these tax rates are statutorily required to pay tax at the rates of 25.17% and 17.16%, respectively. Before the Ordinance, the statutory tax rates for domestic companies ranged from 26% to 35% (Table 1); however, they could reduce their effective tax rates by claiming deductions under the IT Act. In the following section, we examine the effective rates at which companies pay taxes (after claiming deductions) to understand how many companies could opt for the new tax rates and the likely fiscal impact of lower tax rates.

Table 2 provides data on the effective tax rates for 8.4 lakh companies that filed income tax returns for the financial year 2017-18. These rates are the actual tax rates at which these companies paid tax in 2017-18. About 29% of the 8.4 lakh companies paid tax at an effective rate that was higher than 25%. The Ordinance allows these companies a lower statutory tax rate option of 25.17%. Note that these companies contributed 69% of the total income tax paid by all companies in 2017-18.

For instance, in case of the manufacturing sector, the effective tax rate after deductions was 28% in 2017-18. This is much higher than the 17.16% statutory tax rate option under the Ordinance for new domestic manufacturing companies.[8]

Table 2: Effective tax rates after deductions (2017-18)

Effective tax rate after deductions	Proportion of companies	Share in total tax paid
Less than zero and zero	45%	1%
0% to 20%	10%	8%
20% to 25%	5%	22%
25% to 30%	19%	16%
30% to 33%	6%	42%
More than 33%	4%	11%
Zero profit before taxes	11%	0%

Note: Effective tax rate is calculated as tax paid after deductions divided by profit before tax. Data is for both domestic and foreign companies.
Sources: Statement of Revenue Impact of Tax Incentives, Receipt Budget, Union Budget 2019-20; PRS.

We analysed the latest quarterly filings (Q2 2019-20) submitted by the BSE100 companies to see how many of them are opting for the new tax rates under the Ordinance. Of the 99 companies that have submitted their filings till date, 47 companies have opted for the new tax rates for the financial year 2019-20.[9] The 52 other companies have not given a clear indication on opting for the new tax rates for 2019-20.

The fiscal impact of companies opting for the lower tax rate options would depend on: (i) the number of companies opting for these options, and (ii) the difference between their new and old effective tax rates. The Ministry of Finance has estimated the revenue loss in providing the lower tax rates and other measures under the Ordinance (includes exemptions to capital gains of certain investors from increased surcharge rates) at Rs 1.45 lakh crore.[7] This is equivalent to 5.2% of the government's revenue estimate in 2019-20. If all other parameters remain the same, this could increase the fiscal deficit for the year 2019-20 from 3.3% of GDP to 4% of GDP.

Deductions under the Income Tax Act

The Ordinance specifies certain deductions under the IT Act which cannot be claimed by companies opting for the new tax rates. Table 3 shows the major deductions claimed under the IT Act in terms of their revenue impact (i.e. revenue foregone by the government in allowing the deduction). The total revenue impact of these deductions was Rs 1.2 lakh crore in 2017-18. Table 3 also classifies deductions depending on whether they can be claimed with the new tax rates. Note that the Ordinance notifies only certain components under accelerated depreciation, export profits of SEZ units, and expenditure on scientific research which cannot be claimed by companies opting for the new tax rates. The revenue impact data for these specific components is not available.

Companies presently availing deductions, which cannot be claimed with the new rates, may decide to continue with the existing system for some time. They may do so till the benefits from deductions are more than those from lower rates. Note that companies can opt for the new rates in 2019-20 or in any other year in the future.

Table 3: Major deductions for companies under the IT Act and their revenue impact in 2017-18

Deductions that cannot be claimed	Revenue impact	Deductions that can be claimed	Revenue impact
Accelerated depreciation	Rs 58,326 crore*	Donations to charitable trusts and institutions	Rs 1,860 crore
Export profits of SEZ units	Rs 20,918 crore*	Employment of new employees	Rs 738 crore
Profits of power sector undertakings	Rs 13,157 crore	Contributions to political parties	Rs 133 crore
Expenditure on scientific research	Rs 6,832 crore*		
Profits of undertakings set-up in Sikkim	Rs 2,321 crore		
Profits of undertakings set-up in Uttarakhand	Rs 1,798 crore		
Various other deductions	Rs 13,986 crore		

Note: * Certain deductions under these categories can be claimed with the new rates. Data not available separately for these components.
Sources: Statement of Revenue Impact of Tax Incentives, Receipt Budget, Union Budget 2019-20; PRS.

Utilisation of MAT credit by companies opting for the new tax rates

Ordinance: Section 5(b)

Act: Section 115JAA, 115JB

Minimum Alternate Tax (MAT) is the minimum amount of tax required to be paid by a company, in case its tax liability falls below a certain rate after claiming deductions under the IT Act. A company paying MAT in excess of its normal tax liability (as per the other provisions of the Act) is provided MAT credit, equivalent to the amount of additional tax it had to pay. The company can use this credit to pay tax in the future (within a 15-year period). For example, a company with Rs 100 crore book profit is required to pay a minimum tax of Rs 15 crore (assuming 15% MAT rate). If its normal tax liability after claiming deductions is Rs 10 crore (less than MAT), it is required to pay MAT of Rs 15 crore, and can use MAT credit of Rs 5 crore to pay tax in the future.

The Ordinance specifies that the MAT provisions (Section 115JB of the IT Act) will not apply to companies opting for the new tax rates. This implies that such companies are not required to pay the minimum amount of tax set by MAT. However, it does not amend Section 115JAA of the IT Act, which allows companies to utilise MAT credit available with them to pay tax. After the Ordinance, the Central Board of Direct Taxes issued a circular specifying that MAT credit cannot be utilised by companies opting to pay tax at the new rates, as MAT is not applicable to such companies.[10] It also states that since there is no timeline within which a company can opt for the new rates, a company may choose to do so after utilising its MAT credit, if it so desires. The question is whether a circular can override the MAT credit facility provided in the IT Act.

Corporate tax rates in other countries

The table below gives a comparison of the corporate tax rates across major countries during the year 2018.

Table 4: Comparison of corporate tax rates across major countries (2018)

Asia	Tax rate (in %)	Europe	Tax rate (in %)	Other countries	Tax rate (in %)
Hong Kong	16.5	United Kingdom	19	USA	25.8*
Singapore	17	Russia	20	Canada	26.8*
Thailand	20	Switzerland	21.1*	South Africa	28
Vietnam	20	Spain	25	New Zealand	28
Malaysia	24	Netherlands	25	Australia	30
Indonesia	25	Italy	27.8*	Mexico	30
China	25	Germany	29.8*	Argentina	30
South Korea	27.5*	France	34.4	Brazil	34
Japan	29.7*				
India#	**35**				

Note: *Tax rate includes corporate tax rates levied by state governments in these countries. #In case of India, the tax rate reflects the highest applicable tax rate (including surcharge and cess). Including the dividend distribution tax, the tax rate would come out to be 48.3%.
Sources: OECD Corporate Tax Statistics 2018; PRS.

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