Chapter 1

Recent changes in tax laws: Impact on key sectors

This article aims to:

Summarise the recent changes in tax laws for corporates along with its impact on certain sectors of the economy.

Introduction

With an objective to boost foreign investments and revive the spirit of the Indian economy amidst the continuing economic slowdown, the Government of India (GOI) introduced a slew of unprecedented measures through the Taxation Laws (Amendment) tax ordinance, 2019 (tax ordinance). The amendments of the tax ordinance have been incorporated into the Income-tax Act, 1961(IT Act) and the Finance (No.2) Act, 2019[1].

The key amendments relate to the following aspects:

- Tax concession for domestic companies
- Tax concession for new domestic manufacturing companies
- Reduction in Minimum Alternate Tax (MAT) rate and
- Buy-back of shares by listed companies.

In addition to the changes made by the tax ordinance, the Tax Act has introduced additional amendments to the IT Act and the Finance (No.2) Act, 2019.

In this article, we aim to provide an overview of the recent tax changes along with its impact on key sectors.

1. Recently, the GOI introduced the Taxation Laws (Amendment) Bill, 2019 (Tax Bill) to replace the tax ordinance. The Tax Bill received the assent of the President of India on 11 December 2019. Consequently, the Taxation Laws (Amendment) Act, 2019 (Tax Act) came into effect from 20 September 2019 i.e. from the date of issue of the tax ordinance.

Overview of the amendments

Tax concession for domestic companies

A new Section 115BAA has been inserted in the IT Act with effect from Financial Year (FY) 2019-20. Section 115BAA allows every domestic company an option to pay income-tax at the rate of 22 per cent (effective tax rate is 25.17 per cent including surcharge and cess) subject to certain specified conditions.

Key conditions to avail concessional tax rate under Section 115BAA of the IT Act

- The company will not avail any of the specified deductions/incentives under the IT Act.

  These specified deductions/incentives relate to newly established units in Special Economic Zones (SEZs), additional depreciation on new plant or machinery acquired or installed after the specified date, investment in new plant and machinery in notified backward areas in certain states, tea, coffee, rubber development account, site restoration fund, expenditure on scientific research, expenditure for specified business, agricultural extension project, skill development project or specified provisions of Chapter VI-A under the heading 'deductions in respect of certain incomes' other than the provisions of Section 80JJAA under the IT Act.

- The total income of the company should be computed in the following manner:

  a. Without set-off of any loss carried forward or depreciation[2] from any earlier Assessment Year (AY), if such loss or depreciation is attributable to any of the specified deductions.

  b. Without set-off of any loss or allowance for unabsorbed depreciation deemed so under Section 72A of the IT Act, if such loss or depreciation is attributable to any of the above-mentioned deductions.

  c. By claiming the depreciation under Section 32 of the IT Act, other than additional depreciation on new plant or machinery acquired or installed after 31 March 2005, determined in such manner as may be prescribed[3].

- Where there is a depreciation allowance in respect of a block of assets which has not been utilised prior to the AY beginning on 1 April 2020, then the corresponding adjustment should be made to the written down value of such block of assets as on 1 April 2019 in the prescribed manner.

Failure to comply with conditions

- In case a company fails to satisfy the conditions specified under Section 115BAA in any Previous Year (PY), then the option (to pay tax at the concessional rate of 22 per cent) would become invalid in respect of the AY relevant to that PY and subsequent AYs.
- When there is a failure to comply with conditions, other provisions of the IT Act would apply, as if the option had not been exercised for the AY relevant to that PY and subsequent AYs.

Effective date

- The concessional tax rate option has to be exercised by the company in the prescribed manner on or before the due date for furnishing the returns of income for any PY relevant to AY commencing on or after 1 April 2020.
- Concessional tax rate option once exercised would apply to that and subsequent AYs and it cannot be subsequently withdrawn for the same or any other AY.

MAT provisions not applicable

Companies which avail the exemption under Section 115BAA of the IT Act are not required to pay Minimum Alternate Tax (MAT). Also, such companies will not be entitled to their previous MAT credit balances.

2. The loss or depreciation should be deemed to have already given full effect to and no further deduction for such loss or depreciation should be allowed for any subsequent year.

3. Refer Rule 5 and Appendix I to the Income-tax Rules, 1962.

In case of a company with a unit[4] in the International Financial Services Centre (IFSC)[5] has exercised the concessional tax rate option, then the conditions provided in the provisions should be modified to the extent that the deduction under Section 80 LA of the IT Act would be available to such a unit subject to fulfillment of the conditions.

Further, where concessional tax rate option exercised by a company under Section 115BAB (15 per cent) of the IT Act becomes invalid due to violation of certain prescribed conditions[6],then it may exercise option under Section 115BAA (22 per cent).

Tax concession for new domestic manufacturing companies

A new section 115BAB has been inserted in the IT Act with effect from FY2019-20. As per Section 115BAB, any domestic company which has been incorporated on or after 1 October 2019 and commences manufacturing or production of an article or thing on or before 31 March 2023 can choose to pay income tax at the rate of 15 per cent (effective tax rate is 17.16 per cent including surcharge and cess) subject to certain specified conditions.

Business of manufacture - Specific exclusions

The business of manufacture or production of any article or thing referred in Section 115BAB would not include business of:

a. Development of computer software in any form or in any media

b. Mining

c. Conversion of marble blocks or similar items into slabs

d. Bottling of gas into cylinder

e. Printing of books or production of cinematograph film or

f. Any other business as may be notified by the Central Government (CG) in this behalf.

Key conditions to avail concessional tax rate under Section 115BAB of the IT Act

- The company will not claim any of the specified exemption/incentive under the IT Act (same as those specified in Section 115BAA) and should commence manufacturing/production on or before 31 March 2023.
- The company is not formed by splitting up or reconstruction of a business already in existence. It does not use any plant or machinery previously used for any purpose. Also, it does not use any building previously used as hotel/convention center in respect of which deduction under Section 80-ID of the IT Act has been allowed.
- The company is not engaged in any business other than that of manufacturing or production any article or thing and research in relation to, or distribution of, such article or thing manufactured/produced by it.
- The total income of the company should be computed in a similar manner as prescribed for Section 115BAA of the IT Act[7].

4. The term 'unit' should have the same meaning as assigned to it under Section 2(zc) of the Special Economic Zones Act, 2005

5. As provided in Section 80LA(1A) of the IT Act.

6. Conditions in relation to use of old plant/machinery and building and condition that the company will not be engaged in any business other than manufacturing or production of an article or thing

7. It is to be noted that the provision allowing adjustment of unutilised depreciation allowance is not available under Section 115BAB

Failure to comply with conditions

- In case a company fails to satisfy the conditions specified under Section 115BAB in any PY, then the concessional tax rates option (to pay tax at the reduced rate of 15 per cent) would become invalid in respect of AY relevant to that PY and subsequent AYs.
- In such a case, other provisions of the IT Act would apply, as if the option had not been exercised for the AY relevant to that PY and subsequent AYs.

However, as mentioned in context of Section 115BAA, where the concessional tax rate option exercised under Section 115BAB (15 per cent) of the IT Act becomes invalid due to violation of certain prescribed conditions, then a company may exercise option under Section 115BAA (22 per cent).

Other amendments

- Where the total income of the company, includes any income, which has neither been derived from nor is incidental to manufacturing or production of an article or thing and in respect of which no specific rate of tax has been provided separately, such an income should be taxed at the concessional tax rate of 22 per cent. Further, no deduction or allowance in respect of any expenditure or allowance would be allowed in computing such income.
- The income-tax payable in respect of the income of the company deemed not at an arm's length as prescribed under Section 115BAB (including transfer pricing provisions), would be computed at the tax rate of 30 per cent.
- The income-tax payable on short-term capital gains derived from transfer of a capital asset on which no depreciation is allowable under the IT Act would be computed at the concessional tax rate of 22 per cent.
- In case of an amalgamation, the concessional tax rate option under Section 115BAB would remain valid in case of the amalgamated company if the specified conditions continue to be satisfied by such a company.

MAT provisions not applicable

Companies which avail the concessional tax rate under Section 115BAB of the IT Act are not required to pay MAT.

If any difficulty arises in fulfilment of conditions, the Central Board of Direct Taxes (CBDT) may with the approval of the CG issue guidelines for the purpose of removing the difficulty and to promote manufacturing or production of article or thing using new plant and machinery. Further, guidelines issued by the CBDT would be laid before each house of parliament and would be binding on the company and the income-tax authorities.

Companies that continue to avail tax exemptions

A company which does not opt for the concessional tax rates and avails the tax exemption/incentive should continue to pay tax at the pre-amended rate (25 or 30 per cent as the case may be)[8]. However, such companies can opt to pay tax at the concessional rate of 22 per cent after the tax holiday/exemption period is over. The option once exercised cannot be subsequently withdrawn.

The rate of MAT for companies which continue to avail exemptions/incentives has also been reduced from 18.5 per cent to 15 per cent.

Minimum Alternate Tax (MAT)

With effect from 1 April 2020 (FY2019-20), following amendments have been made with respect to MAT and MAT credit:

- MAT rate has been reduced to 15 per cent from 18 per cent.
- MAT provisions will not apply to a company that exercises the option to avail the concessional tax rate of 22 per cent or 15 per cent to new manufacturing companies.
- MAT credit provisions will not apply to a company that exercises the option to avail the concessional tax rate of 22 per cent.

Buy-back of shares by listed companies

Listed companies which have already made a public announcement of buy-back of shares before 5 July 2019 are not required to pay tax on buy-back of shares.

Impact on key sectors

Typically, the decision as to whether a company should shift to the new concessional tax regime, and the timing thereof, would be based on a detailed impact analysis of the tax effect under the existing tax regime (with deductions/incentives) versus tax effect under the new concessional tax regime (without deduction/incentives). This would include factoring the quantum and duration of existing tax incentives, business projections for forthcoming years, quantum and status of loss carry forwards and MAT credits, etc.

The companies that opt for concessional tax rate would need to assess the impact on the financial statements of FY2019-20 as there would be a change in provision for tax. Additionally, the Effective Tax Rate (ETR) as calculated as per Ind AS 12, *Income Taxes* would also change.

The carrying amount of deferred tax assets and liabilities would change if a company opts for concessional tax rates as provided in the IT Act and would impact statement of profit and loss. Companies following Ind AS may carry large deferred tax balances, for example, certain deferred tax assets and liabilities are recognised at the time of a business combination, on transition to Ind AS and adoption of new Ind AS standards. Due to change in tax law, there would be remeasurement of deferred tax balances and generally the impact would be accounted through statement of profit and loss. In certain cases, remeasurement impact may relate to items previously recognised in Other Comprehensive Income (OCI) or directly in equity and this impact may be recognised in OCI or equity. The entities should evaluate the principles of Ind AS 12 carefully while recognising the impact due to remeasurement of deferred tax assets and liabilities.

Additionally, cash flows of the companies opting for reduced tax rates would be impacted and such companies should consider this impact while analysing impairment assessment of non-financial assets.

In some case, the impact may be easy to calculate. In other cases, in applying the new provisions of the IT Act, a company will make its best estimate and may revise that estimate in future periods as a result of new or better information, clarifications of the application of tax laws and/or more experience. Management's intention is relevant to determine which tax rates would apply to measure current tax and deferred tax balances. In all cases, the financial statements should include appropriate disclosures under Ind AS 12, including relevant information about major sources of estimation uncertainty in applying the new provisions of the IT Act.

8. Domestic companies with a total turnover or gross receipt (in PY2017-18) of less than INR400 crore are required to pay corporate tax at the rate of 25 per cent of the total income and domestic companies with a total turnover or gross receipt of INR400 crore or more are required to pay corporate tax at the rate of 30 per cent of the total income.

The impact of the new provisions on key sectors is highlighted in the section below.

Power sector

The Indian power sector is a regulated sector and is a beneficiary of various tax incentives largely due to its capital-intensive nature and inherent public service. The power companies in India have enjoyed profit-linked tax holidays (Section 80-IA) and accelerated depreciation (Section 32) under the IT Act.

Companies in power sector, where the vintage of their operations in India is 5 to 8 years, have significant unutilised MAT credits due to Section 80-IA tax holiday period. The decision to avail concessional tax rates would be based on the benefit analysis of specified deductions/incentives versus the concessional tax rates. However, in our experience, companies may opt for concessional tax rate given the benefits of time value of money on account of lower tax payments. Also, utilisation of MAT will take a long time and until then companies will have to pay taxes at higher rates.

Further, the amendment wherein companies would be able to adjust the written down value of the block of fixed assets for tax purposes in cases where depreciation allowance in respect of such block of asset has not been given effect to has been a welcome relief to companies in this sector.

The Tax Act has not specifically excluded the business of power generation out of business of manufacturing for the purpose of lower tax rate of 15 per cent. Unless specifically excluded, power generation should fall within the purview of manufacturing for the purpose of Section 115BAB of the IT Act.[9] In the past also, companies in the power sector have been availing tax benefits available for manufacturing companies, for instance, investment allowance under Section 32AC of the IT Act. Accordingly, power companies incorporated after 1 October 2019 and planning to commence operation prior to 31 March 2023, can avail the benefit under Section 115BAB of the IT Act.

Pharmaceutical sector

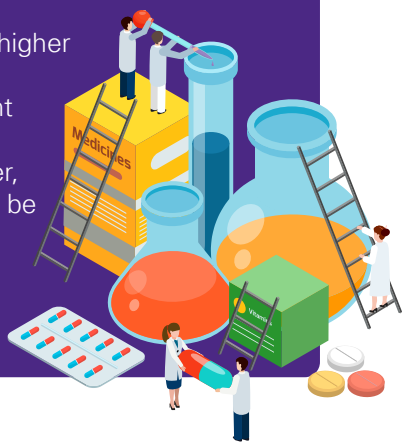
Currently pharmaceutical sector enjoys various benefits/deductions, for example:

- Weighted deduction of expenditure (revenue and capital) on scientific research
- Profit from business eligible under Chapter VI-A claims under the Heading C
- Section 10AA in respect of units in SEZ.

Considering various deductions/benefits available, their current ETR is lower which leads them to pay tax under MAT provisions. Post amendments due to the tax ordinance, several companies in the sector may not be inclined to forgo their past MAT credit entitlement. However, given the reduction in the MAT rate from 18 per cent to 15 per cent (ETR), we expect that companies covered by the MAT provisions may see an accelerated utilisation of MAT credit on account of increase in the difference between the MAT rate and normal tax rate.

Companies may evaluate to opt out of old tax regime, once all the benefits are utilised or cease to flow to such companies, since option to opt for concessional tax rate once exercised cannot be withdrawn. Also the companies need to forecast time period until which they shall continue under old tax regime. Accordingly, once they move to concessional tax regime, the carrying amount of deferred tax assets and liabilities would change.

The companies where ETR is higher than the concessional tax rate and that do not have significant MAT credit may opt for the concessional tax rate. However, we expect this assessment to be based on quantification of the benefits expected.



9. There are judicial decisions to support that power generation qualifies as manufacture/production of goods.

Healthcare sector

Hospitals

In our experience, many of the large hospitals in India are not likely to opt for concessional tax rates for FY2019-20, even though these hospitals are not in SEZ/tax holiday period, as current ETR is lower than the concessional tax rate. The current ETR is lower because these hospitals generally have huge accumulated losses and large MAT credit balances. Further, many hospital chains are currently in expansion phase and the losses are expected to continue in near future.

Medium-size hospitals with turnover/gross receipts less than INR400 crore are currently taxed at 25 per cent (exclusive of surcharge and cess). Such hospitals may opt concessional tax rates upon evaluation of benefits on a case-to-case basis.

Diagnostic centers

Many of the diagnostic centers in India are generally making profits. Therefore, upon election of concessional tax rates, their ETR will reduce resulting in a lower current tax. The impact of the same can be envisaged in the results of certain listed companies for the period ended 30 September 2019 wherein they have elected the concessional tax rate and taken the impact in the said quarter.

Medical equipment companies

Many of the medical equipment companies in India are profitable and have an ETR higher than the concessional tax rate. Hence, their ETR will reduce resulting in lower current tax charge, upon election of concessional tax rates.

Medical equipment manufacturing companies would need to evaluate the benefits of Section 115BAB on a case-by-case basis

Building, Construction and Real Estate (BCRE) sector

Large companies in real estate sector would need to evaluate the impact of adoption of concessional tax rates and may plan to avail the corporate tax rate reduction after utilisation of existing MAT credit and brought forward business losses.

However, real estate companies with gross receipts/ turnover less than INR400 crore are currently paying income taxes at the rate of 25 per cent (exclusive of surcharge and cess). Therefore, they are unlikely to be additionally benefited by opting for the concessional tax rates.

Real estate companies have a significant gestation period unlike other sectors, wherein during the construction phase certain companies may incur book losses and may not pay taxes under the MAT provisions of the IT Act. Companies are likely to have brought forward losses, and therefore, future tax liability is expected to be lower than the concessional rate of tax.

Many real estate companies (in the commercial real estate sector with leasing model) also avail the benefit of deductions of SEZ, IT parks, etc. These companies enjoy tax holiday period for 10 years (though pay MAT and avail MAT credit). Based on the tax holiday period and the projections of the taxable profits and utilisation of MAT credit, such companies would need to determine the timing of transition to the concessional rate of tax.

In our experience, many of the companies in this sector may not want to forgo MAT credit asset, since it would be a cash loss to the company. Further based on the quantum of the carry forward losses and the construction phase of the project, combined with the market outlook, companies might elect to continue with existing tax regime, resulting in liability payable under MAT rules (which is lower than the concessional tax rate).

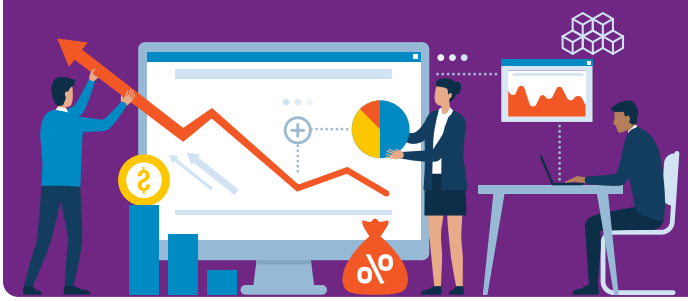
Financial services sector

Banks/NBFCs (including HFCs)

In our experience, many of the banks and Non-Banking Financial Companies (NBFCs) (including Housing Finance Companies (HFCs)) are likely to opt for the concessional tax rates as they will benefit from a lower tax charge in comparison to their current ETR.

Banks and NBFCs, in general, have higher loan loss provisions in the books of account (in accordance with the Reserve Bank of India (RBI) norms and/or Ind AS provisioning requirements, as applicable) as compared to tax books (where provisions are deductible on the basis of actual write-offs) resulting in future tax-deductible timing differences on loan loss provisions.

The resultant Deferred Tax Asset (DTA) (relating to loan loss provision) on the balance sheet will get remeasured at the reduced rate resulting in a charge to the statement of profit and loss in FY2019-20.



Further upon election of new tax rates, banks with offshore banking units will lose benefit of deduction under Section 80LA[10] of the IT Act.

Insurance companies

Life insurance companies are unlikely to opt for the concessional tax rates as their current ETR is lower than the concessional tax rate offered. While the general insurance companies would need to evaluate the concessional tax rates in comparison to the specified deductions/incentives availed.

Mutual funds

There will be no impact of the recent tax amendments on the mutual funds as the income generated by mutual funds are exempt from tax.

Venture Capital Funds (VCFs) and Alternate Investment Funds (AIFs)

Funds are generally registered as trusts. Hence, the concessional tax rate benefit does not apply to them.

Other companies

Impact on other companies in financial services sector (i.e. asset management, advisory and broking companies) will depend on evaluation of benefits provided by the tax concessions on a case-by-case basis.

Technology sector

In our experience, many of the large companies in the technology sector have not availed concessional tax rate for the FY2019-20 as their ETR is currently lower than the concessional tax rates of 22 per cent. This is largely due to tax exemptions under Section 10AA[11] of the IT Act for revenue from SEZs.

They may evaluate to avail the benefit of the concessional tax rate after two to three years from now when the SEZ benefits would not be available.

For companies that have not availed the concessional tax rate, a scenario could arise where the revised MAT rate (17.47 per cent) increases the quantum of MAT assets that can be adjusted against future tax liability, since the gap between the current tax and MAT has now increased. Companies may be able to recognise previously unrecognised MAT assets, which due to their inability to utilise MAT credit had not been recognised.

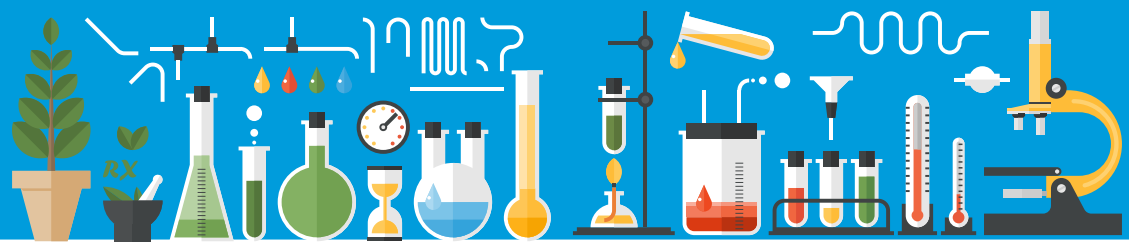
10. Available to a bank incorporated by/under the laws of the country outside India with an offshore banking unit in SEZ or to a unit of an IFSC.

11. The tax exemption varies from 100 per cent of profits for the first five years of operations to 50 per cent for the next five, and 50 per cent for a further five years where the profits are credited and utilised for investment in the prescribed manner

Chemical sector

Currently, companies operating in chemical sector enjoy certain tax breaks under the IT Act. These, *inter alia*, include deduction under Section 10AA, Section 35(2AB) and Section 80-IA.

In our experience, companies have considered the impact of the above tax benefits and the availability of unutilised MAT credit and brought forward losses before deciding on moving into the new tax regime and many companies have concluded that deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc. are not significant enough for these companies to continue with the old tax regime, and are opting for the new concessional rate.



Automotive, telecom and Transport, Leisure and Sports (TL&S) sector

With respect to the adoption of the concessional tax rate by the companies in the automotive, telecom and TL&S sector, there is a mixed reaction. This is mainly on account of the tax holiday benefit and carry forward of MAT.

While assessing the options under the IT Act, companies are required to evaluate the potential loss of MAT and tax benefits such as deductions under Section 80-IA, Section 80-IB and Section 35D.