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Direct Tax Alert

November 27, 2019

The Taxation Laws (Amendment) Bill, 2019

Background

The Taxation Laws (Amendment) Bill, 2019 (hereinafter referred to as 'the Bill') was introduced in the Lok Sabha on November 25, 2019. The Bill once passed will replace the Taxation Laws (Amendment) Ordinance, 2019 (hereinafter referred to as 'the Ordinance') which was promulgated on September 20, 2019[1]. The Bill gives effect to the Ordinance, with a few additional clarifications and amendments which are discussed below.

Amendments proposed to Section 115BAA of the Income-tax Act, 1961 (concessional tax rate of 22% for existing domestic companies)

The Ordinance introduced a new section 115BAA in the Income-tax Act, 1961 ('the Act') which provided a concessional tax rate of 22% (plus surcharge of 10% and cess of 4%) for all domestic companies subject to fulfilment of specified conditions. It was also provided that companies opting for this concessional tax regime will not be subject to Minimum Alternate Tax ('MAT'). The clarifications/amendments provided in the Bill are as under:

Clarification/Amendment proposed in the Bill	Dhruva comments
• The eligibility conditions to be satisfied by a company opting for the concessional tax regime of 22% has been tightened to include that not only deduction for specified incentives/tax holidays will be unavailable,	• As part of the eligibility conditions, the Ordinance provided that deduction would not be available for specified incentives/tax holidays and losses attributable to such deductions. There

[1] Read our alert summarizing details of the concessional tax regimes proposed under the Ordinance at https://dhruvaadvisors.com/insights/files/Dhruva_Direct_Tax_Alert_The_Taxation_Laws_Amendment_Ordinance_2019.pdf

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Clarification/Amendment proposed in the Bill	Dhruva comments
but also losses and unabsorbed depreciation attributable to such incentives will not be allowed. • Similar restriction has been placed on utilisation of brought forward losses and unabsorbed depreciation transferred on amalgamation, demerger, etc under section 72A of the Act to the extent such losses/unabsorbed depreciation are attributable to the disallowed incentives.	was ambiguity as to whether unabsorbed depreciation attributable to such incentives would be allowed. This has been now clarified.
• The company is allowed to correspondingly adjust the written down value of its block of assets as on April 1, 2019 in the prescribed manner for the unabsorbed depreciation attributable to the additional depreciation under section 32(1)(iia) of the Act.	• This relief has been given to the company opting to avail the concessional tax regime in financial year 2019-20. Where the company opts for the concessional tax regime in a financial year after 2019-20, a literal reading of the provisions of the Bill suggests that this relief may not be available.
• With respect to the deductions/incentives which a company is not allowed to claim to enjoy the concessional tax regime, an exception has been provided. A company having a Unit (as defined in Special Zones Act, 2005) in International Financial Services Centre ('IFSC') can continue to avail the tax holiday provided in section 80LA(1A)[2] of the Act.	• This amendment seems to have been brought in with a view to promote IFSC and GIFT city. This should encourage taxpayers for setting up Units in IFSC, as after availing the tax holiday, the taxpayer will have no liability to pay either normal tax or MAT for at least 10 years.
• Section 115JAA of the Act is proposed to be amended to provide that a company opting for the 22% concessional tax regime under section 115BAA of the Act will not be allowed to utilise the MAT credit.	• This amendment could be a major factor for a company deciding whether or not to opt for this regime. Such companies will need to utilize the MAT credit or forgo it before opting for the concessional tax regime.
• Where a company fails to satisfy the prescribed eligibility conditions in any previous year, the option becomes invalid in respect of that year and onwards, and the regular provisions of the Act shall become	• In order to be eligible for the concessional tax regime, the Bill provides that a company will not be allowed a deduction for specified incentives and losses/unabsorbed depreciation attributable to such specified incentives.

[2] Where the gross total income of a taxpayer, being a Unit of an IFSC, includes specified income, a deduction is allowed from such income, of an amount equal to 100% of such income for any 10 consecutive assessment years, at the option of the taxpayer, out of 15 years

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applicable, as if the option had not been exercised.	The Bill does not provide any guidance as to the manner of determining the losses/unabsorbed depreciation attributable to disallowed incentives, resulting in taxpayers employing different permutations to determine the same. This could result in instances where the company's determination is not in consonance with that of the department, leading to breach of eligibility condition by the company and consequent withdrawal of the regime. Making the company ineligible for the concessional tax regime in the year of violation of prescribed conditions and for thereafter seems harsh.

Amendments proposed to Section 115BAB of the Act (concessional tax rate of 15% for new domestic manufacturing companies)

The Ordinance provided for introduction of a new section 115BAB in the Act which provided a concessional tax rate of 15% (plus surcharge of 10% and cess of 4%) for newly set-up domestic manufacturing companies subject to fulfilment of specified conditions. It was also provided that companies opting for this concessional tax regime will not be subject to MAT. The clarifications/amendments provided in the Bill with respect to this concessional tax regime are as under:

Clarification/Amendment proposed in the Bill	Dhruva comments
• It has been clarified that the business of manufacture or production of article/thing shall not include business of: – Development of computer software in any form or in any media; – Mining; – Conversion of marble blocks or similar items into slabs; – Bottling of gas into cylinder; – Printing of books or production of cinematograph film; or – Any other business as may be notified by the Central Government in this behalf.	• The clarification that the 15% tax rate will not be available to companies engaged in the development of computer software, mining, production of cinematograph film, etc comes as a dampener. However, no clarification has been issued for companies engaged in the production of other digital content, contract manufacturing, power generation, etc and one can expect litigation around this issue.
• The concessional tax regime of 15% will apply not only to manufacturing income but	• The term "derived from" or "incidental to" manufacturing/production has not been

Clarification/Amendment proposed in the Bill	Dhruva comments
also to income "derived from or incidental to manufacturing/production". Income which is not derived or incidental to manufacturing/production will be taxable at the rate of 22% without deduction for any expenditure or allowance.	defined in the Bill. While there are judicial precedents which could give the taxpayer guidance on how to interpret the term "derived from", the term "incidental to" is largely untested. This is likely to result in litigation. • Taxation of non-qualifying income on a gross basis without allowing deduction for direct/incidental expenses is likely to result in litigation.
• The short-term capital gains derived from transfer of a capital asset on which no depreciation is allowable will be taxable at the rate of 22%.	• This amendment is likely to result in an ambiguity on the correct tax rate applicable in certain situations such as short-term capital gains arising on transfer of listed securities which are taxable at the rate of 15% as per section 111A of the Act.
• Deemed income due to applicability of domestic transfer pricing provisions will be taxable at the rate of 30%.	• The taxation of deemed income due to the applicability of transfer pricing provisions at 30% without any fall back to the concessional regime of 22% seems harsh. The applicability of this provision can be better understood with an example. Say where a company has a taxable profit of Rs 100. Due to applicability of domestic transfer pricing provisions, the department may contend that the normal profit is only Rs. 80. In such case, Rs. 80 will be taxable at the concessional rate of 15% and the balance Rs. 20 will be taxable at the rate of 30%.
• The eligibility conditions to be satisfied by the manufacturing company opting for the concessional tax regime of 15% has been widened to include that not only deduction for specified incentives/tax holidays will be unavailable, but also losses and unabsorbed depreciation deemed under section 72A of the Act as is attributable to such deductions will not be allowed.	• This is a welcome clarification.

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• It has also been clarified that in case of amalgamation, the amalgamated company can continue to enjoy the concessional tax regime of 15% provided the prescribed eligibility conditions are continued to be satisfied by the amalgamated company.	
• On violation of eligibility conditions provided in section 115BAB of the Act, the option will become invalid, and the company will lose the concessional tax regime of 15% from the year of violation. The company could, however, opt for the 22% regime under section 115BAA of the Act without availing specified deductions/incentives. Having once opted for the 22% tax regime, the company cannot subsequently withdraw the option for the same or any other year.	• Given several ambiguities in law and being a beneficial provision, the company should ideally have been allowed to move back to the 15% concessional tax regime in the year in which the defect is cured or ineligibility condition is fulfilled.
• The Central Board of Direct Taxes ('CBDT') in consultation with Central Government has been given the power to issue guidelines to resolve difficulties that may arise in complying with the qualifying conditions in relation to use of second-hand plant and machinery, hotel/convention center as well as condition of not engaging in any business other than manufacture /production. Every such guideline is required to be laid before each House of Parliament and shall be binding on the person and the Tax Authority.	• This is a welcome move and can help in quick resolution of ambiguous issues.
• The Bill provides for uniform rate of surcharge of 10% for all domestic companies opting for concessional tax regime of 22% or 15% on all types of incomes including capital gains.	• The Ordinance provided for levy of surcharge at the rate of 10% for domestic companies availing the concessional tax regime of both 22% and 15%. There was an ambiguity as to whether the reduced surcharge rate will be applicable on other incomes like capital gains. This amendment helps in clarifying issues. However, an ambiguity still prevails as to whether the reduced surcharge rate will be applicable on tax chargeable and paid under other sections like 115-O of the

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Clarification/Amendment proposed in the Bill	Dhruva comments
	Act (dividend distribution tax) and 115QA of the Act (buy back tax).

Other changes provided in the Bill

- The Ordinance had provided that the higher rate of surcharge of 25%/37% imposed by the Finance Act, 2019 will not be applicable to Foreign Portfolio Investors ('FPIs') who were set-up as association of persons and body of individuals. The Bill now extends the relief even to FPIs which are set-up as artificial juridical persons.

- In respect of buyback tax which has now been made applicable even to listed companies, the Ordinance had provided a carve out in respect of buybacks which were announced prior to July 5, 2019. The Bill ratifies this change made in the Ordinance.

- Similarly, the Bill ratifies the provision relating to decrease in MAT rate from 18.5% to 15% for all companies.

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