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THE TAXATION LAWS (AMENDMENT) BILL, 2019

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

Highlights of the Ordinance and the Bill

- 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 Bill 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.

- The Bill provides new domestic manufacturing companies with an option to pay income tax at the rate of 15%, provided they do not claim certain deductions. These new domestic manufacturing companies must be set up and registered after September 30, 2019, and start manufacturing before April 1, 2023.

- 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.

- 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 by a company, in case its normal tax liability after claiming deductions falls below a certain limit. The Bill adds that the provisions regarding MAT credit will also not apply to companies opting for the new rates.

- The Ordinance reduces the MAT rate (applicable for companies not opting for the new tax rates) from 18.5% to 15% with effect from the financial year 2019-20. The Bill amends this provision by making it effective from the financial year 2020-21.

Key Issues and Analysis

- In 2017-18, 29% of the 8.4 lakh companies paid tax at an effective rate higher than 25%. The Bill allows these companies a lower statutory tax rate option of 25.17%. 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 Bill 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.

PART A: HIGHLIGHTS OF THE ORDINANCE AND THE BILL

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 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] The Taxation Laws (Amendment) Bill, 2019 was introduced in Lok Sabha on November 25, 2019 to replace the Ordinance.[8]

Key Features

Some provisions of the Bill are different from those of the Ordinance. Key differences are italicised.

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 Bill 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 Bill 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. 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).

- *The Bill clarifies that certain businesses will not be considered as manufacturing businesses. These include businesses engaged in: (i) development of computer software, (ii) printing of books, (iii) production of cinematograph film, (iv) mining, and (v) any other business notified by the central government.*

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. *The Bill includes a new provision which makes the new options invalid for companies in certain cases. If companies choosing a new option do not follow certain conditions, they cannot exercise the new option for that year and subsequent years. In some cases, companies for whom the 15% tax rate option becomes invalid can opt for the 22% tax rate option.*

- 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 normal 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. The Ordinance reduces the MAT rate from 18.5% to 15% with effect from the assessment year 2020-21 (i.e. financial year 2019-20). *The Bill amends this provision by specifying that the reduced MAT rate will apply with effect from the financial year 2020-21.*

- 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. *The Bill adds that the provisions regarding MAT credit under the IT Act will also not apply to such companies. MAT credit is the amount of additional tax a company is required to pay as MAT, in excess of its normal tax liability (as per the other provisions of the IT Act). This MAT credit can be used by a company to pay tax in the future (within a 15-year period).*

Surcharge on capital gains

- A surcharge is levied on top of the tax paid on income. This surcharge is applicable at the rate of: (i) 10% of tax, for income between Rs 50 lakh and one crore rupees, (ii) 15% of tax, for income between one crore rupees and two crore rupees, (iii) 25% of tax, for income between two crore rupees and five crore rupees, and (iv) 37% of tax, for income more than five crore rupees. The Bill separates surcharge on capital gains from that on all other income. Income excluding capital gains will be subject to surcharge as per the above slabs. Capital gains will also be subject to surcharge as per the above slabs, if the total income does not exceed one crore rupees. Otherwise, a flat 15% rate of surcharge will be applicable for capital gains.

Note that this provision of the Bill is applicable only to certain cases: (i) investments by foreign institutional investors, and (ii) investments by domestic persons in securities where the securities transaction tax is paid.

PART B: KEY ISSUES AND ANALYSIS

Impact of lower tax rate options provided to domestic companies

The Bill 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 Bill 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 Bill for new domestic manufacturing companies.[9]

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

Effective tax rate after deductions	Proportion of companies	Share in total ta
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 d by profit before tax. Data is for both domestic and foreign compar

Sources: Statement of Revenue Impact of Tax Incentives, Receip Budget, Union Budget 2019-20; PRS.

We analysed the latest quarterly filings (Q2 2019-20) by the BSE100 companies to see how many of them are opting for the new rates. Of the 100 companies, 48 companies have opted for the new rates for the financial year 2019-20.[10] The 52 others have not given a clear indication on opting for the new 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 IT Act: The Bill specifies certain deductions under the IT Act which cannot be claimed by companies opting for the new 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 classifies deductions based on whether they can be claimed with the new rates. Note that the Bill 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 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.

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	Asia	Tax	Europe	Tax	America	Tax	Others	Tax rate

	rate		rate		rate	s	rate		
Hong Kong	16.5%	Indonesia	25%	UK	19%	USA	25.8%	South Africa	28%
Singapore	17%	China	25%	Russia	20%	Canada	26.8%	New Zealand	28%
Thailand	20%	South Korea	27.5%	Italy	27.8%	Argentina	30%	Australia	30%
Vietnam	20%	Japan	29.7%	Germany	29.8%	Mexico	30%		
Malaysia	24%	**India#**	**35%**	France	34.4%	Brazil	34%		

Note: #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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[10]. Q2 2019-20 filings submitted by the BSE100 companies.

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