

Impact of Ordinance and exploring avenues for restructuring business activities

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Overview of the Ordinance

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- **Key tax amendments**
 - **Reduction in tax rate for domestic companies to 25.17% & new manufacturing companies concessional rate of 17.16% – MAT provisions will not apply**
 - **Reduction in MAT Rate to 17.47%**
 - **Removal of increased surcharge on Listed Securities & FII's**
 - **Prospective application of buy back tax on listed companies**

Overview of the Ordinance

- **New – Section 115BAA (25% Tax Rate)**
 - Domestic company can opt from AY 2020-21
 - Effective tax rate - 25.17% (22% + 10% + 4%) & **MAT will not apply**
 - Subject to the following conditions:
 - Specified deductions cannot be claimed
 - Losses brought forward attributable to specified deductions to lapse
 - Depreciation to be allowed as per the rates prescribed
 - Option to be exercised to be by the taxpayer before due date of return of income – flexibility of exercising the option in future years
 - once exercised, cannot be subsequently withdrawn for that year or any subsequent year
- Option for S. 115BA companies to opt for this regime

Overview of the Ordinance

- **New - Section 115BAB (17.16% Tax Rate)**
 - Domestic manufacturing company
 - Effective tax rate – 17.16% (15% + 10% + 4%), MAT will not apply, ITP will apply
 - Subject to the following conditions:
 - Company is incorporated on or after October 01, 2019 and commences production on or before March 31, 2023
 - Company is not formed by splitting up or reconstruction of business already in existence
 - Restriction on use of second-hand plant & machinery (more than 20%) and used hotel & convention centre
 - Restriction on any other business activity
 - Same conditions of S. 115BAA

Specified Deductions

Section	Deduction / Incentive
10AA	Deduction for units established in Special Economic Zones (SEZ)
32AD	Deduction for investment in new plant and machinery in notified backward areas
33AB	Deduction in respect of tea, coffee or rubber business
33ABA	Deduction in respect of business consisting of prospecting or extraction or production of petroleum or natural gas in India
35(1)(ii)*	Deduction for donation made to approved scientific research association, university college or other institutes for doing scientific research which may or may not be related to business
35(1)(iia)*	Deduction for payment made to an Indian company for doing scientific research which may or may not be related to business
35(1)(iii)*	Deduction for donation made to university, college, or other institution for doing research in social science or statistical research

* Deduction u/s 35(1)(iv) – capital expenditure on scientific research – continues to be allowable

Specified Deductions

Section	Deduction / Incentive
35(2AA)	Deduction for donation made to National Laboratory or IITs, etc. for doing scientific research which may or may not be related to business
35(2AB)	Deduction for capital expenditure (excluding cost of land and building) on in house scientific research relating to business of bio-technology or manufacturing any article or thing
35AD	Deduction in respect of capital expenditure incurred in respect of certain specified businesses , i.e., cold chain facility, warehousing facility, etc.
35CCC	Deduction for expenditure on agriculture extension project
35CCD	Deduction for expenditure on skill development project
Part C of Chp. VIA	Primarily profit linked deductions (except Section 80JJAA)

Overview of the Ordinance

- Comparative effective tax rate before and after exercise of option:

Sr. No.	Nature of domestic company	Current ETR (%)	ETR on exercise of option (%)	Reduction in tax liability
1	Total turnover or gross receipts =< INR 400 cr during FY 2017-18 or new manufacturing companies incorporated between March 01, 2016 and September 30, 2019 <ul style="list-style-type: none"> Income < INR 1 cr Income > INR 1 cr but < 10 cr Income > INR 10 cr 	26% 27.82% 29.12%	25.17% 25.17% 25.17%	0.83% 2.65% 3.95%
2	Optional tax rate for new manufacturing companies incorporated on or after October 01, 2019 <ul style="list-style-type: none"> Income < INR 1 cr Income > INR 1 cr but < 10 cr Income > INR 10 cr 	26% 27.82% 29.12%	17.16% 17.16% 17.16%	8.84% 10.66% 11.96%
3	Other domestic companies <ul style="list-style-type: none"> Income < INR 1 cr Income > INR 1 cr but < 10 cr Income > INR 10 cr 	31.2% 33.38% 34.94%	25.17% 25.17% 25.17%	6.03% 8.21% 9.77%

Global Tax Rates

- Effective tax rate for new manufacturing business in India - 17.16%
- after including DDT - 31.63% (non-resident)
- Effective tax rates including DDT of other South Asian countries:
 - Malaysia – 24%
 - Vietnam - 20%
 - Thailand – 28%
 - Indonesia – 40%
- These countries also have significant tax holidays – ranging from 5 to 20 years

Overview of the Ordinance

Particulars	Company (15%)	Company (22)%	LLP	Individuals (MMR)
Corporate Tax Rate	15%	22%	30%	30%
Applicable Surcharge	10%	10%	12%	37%
Applicable Cess	4%	4%	4%	4%
Effective Tax Rate	17.16%	25.17%	34.94%	42.74%
Dividend Distribution Tax (without gross up)	17.47%	17.47%	Not Applicable	
Tax on Dividend (in hands of individuals)	14.25%	14.25%	Not Applicable	
Business earns PBT of INR 100 cr				
Profit before Tax (INR crs)	100	100	100	100
Tax on PBT	-17.16	-25.17	-34.94	-42.74
Profit after tax	82.84	74.83	65.06	57.26
DDT	-14.47	-13.07	NA	NA
Income in hands of shareholder	68.37	61.76	65.06	57.26
Tax in the hands of the individual	-9.74	-8.80	Exempt	NA
Cash Balance in hands of individual	58.63	52.96	65.06	57.26
Ultimate Effective Tax	41.37%	47.04%	34.94%	42.74%

Overview of the Ordinance

- **Section 115JB amended**
 - MAT rate reduced to 15% from 18.5% - effective rate reduced from 21.55% to 17.47%.
 - MAT liability for units located in IFSC to continue at 9%
- **Grandfathering of buy-back tax (section 115QA)**
 - Buy-back provisions not to apply to buy-back of listed company shares where public announcement for buyback was made before July 05, 2019.

Rollback of Enhanced Surcharge

Finance Act (No. 2), 2019 -

- Surcharge on Individual, HUF, AOP, BOI, AJP– 25%/37%

- Surcharge reduced to 15% (earlier rate) for –
 - Capital Gain – both LTCG & STCG – subject to payment of STT –
 - Equity Shares;
 - Equity Oriented Funds
 - Units of business trust (InvITs and REITS)

 - FII's – capital gain – any security

Controversies & Issues

Transition to new regime

Controversies & Issues

- **Allowability of brought forward MAT credit ?**
 - S. 115JAA deals with MAT Credit - No amendment to S. 115JAA.
S. 115JAA(5) – Set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of sub-section (1) of section 115JA or section 115JB, as the case may be] for that assessment year.
 - Three possible views
 - View – 1 No set off
 - View – 2 100% Set off
 - View – 3 Set-off restricted to normal tax more than notional MAT liability.

Controversies & Issues

- View – 1 No set off
 - CBDT – Circular No. 29/2019 dated October 2, 2019
 - CBDT Circular is not binding on Assessee – CIT v. Hero Cycles (P.) Ltd. (228 ITR 463) (SC)
 - Can write off of MAT credit be claimed as an expense u/s 37(1) ?
 - S. 37(1) – Interest on income tax – East India Pharmaceutical Works Ltd. v. CIT (224 ITR 627) (SC) & Bharat Commerce & Industries Ltd. v. CIT (230 ITR 733) (SC) – Against
- View – 2 100% Set off
 - S. 115JB not being applicable – MAT payable is zero – therefore 100% set-off

Controversies & Issues

- **Allowability of unabsorbed additional depreciation**

- S. 115BAA – restricts ‘set off of carried forward loss’ – relating to specified deductions

- *Is unabsorbed additional depreciation a carried forward loss ?*

- CBDT View – Circular No. 29/2019 dated October 2, 2019 – Yes
- Unabsorbed depreciation is an allowance u/s 32(2) and not a loss
CIT v. Shri Subhulaxmi Mills Ltd. [2001] 249 ITR 795 (SC) – S. 79

- Can the company add unabsorbed depreciation to block of asset ?

- Explanation 3 to S. 43(6) – carried forward depreciation is deemed to be actually allowed - CIT v. Kamala Mills Ltd. [1949] 17 ITR 130 (Calcutta HC); CIT v. Hindustan Petroleum Corpn. Ltd. [1991] 187 ITR 1 (Bombay

Controversies & Issues

- If partial c/f loss has been set-off - what is attributable carried forward loss ?
 - Circular : No. 26(LXXVI-3) [F. No. 4(53)-IT/54], dated 7-7-1955 – set-off method beneficial to the tax payer
 - S. 36(1)(iii) & S. 14A - Owns funds presumption
- **Surcharge on other income @ 12% (S. 112A, S. 111A, S. 115BBD etc).**
- Impact on Accounts (Ind AS 12)
 - Reversal of deferred tax asset & liability due to rate change under the new regime – impact in P&L, OCI, Other Equity – depending on

New Manufacturing Company

Controversies & Issues

- **Benefit 15% Tax to New Manufacturing Entity**

- What is manufacturing ?

- *S2(29BA) "manufacture", with its grammatical variations, means*
a change in a non-living physical object or article or thing,—
(a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or

(b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure;

Controversies & Issues

- Construction ?
 - S. 80HH & S. 84 – CIT v. N.C. Budharaja & Co. (204 ITR 412) (SC) - Against
 - S. 32A – Builders Association of India v. UOI (209 ITR 877) (SC) – Against
- **Software or other intangible item ?**
 - CIT v. Radio Today Broadcasting Ltd. [2016] 382 ITR 42 (Delhi HC) – production of radio program – ‘thing’ could have intangible characteristic
- Manufacture v. repackaging v. ancillary activity
- Generation of electricity ?
- Packaged food item, restaurants ?
- Mining ore or extraction of crude oil ?

Controversies & Issues

- Goods manufactured on Job work
 - Job worker
 - CIT v. Impel Forge & Allied Industries Ltd. [2010] 326 ITR 27 (P&H HC)
 - CIT v. Taj Fire Works Industries [2007] 288 ITR 92 (Madras HC)
 - ACIT v. Narendra Polyplast (60 taxmann.com 398) (Mum. Trib.)
 - Contractee
 - ACIT v. A. Mukherjee & Co. (P.) Ltd. [1978] 113 ITR 718 (Calcutta HC) - books
 - CIT v. Continental Engines Ltd. (338 ITR 290) (Del HC) – few activities
 - Who is the manufacturer ?

Test of Condition

Condition	Point of test
Set-up & registered on or after October 1, 2019	1st Year
Commencement of Manufacturing on or before March 31, 2023	
Not formed by splitting up or restructuring of existing business	1st Year
Second hand plant and machinery & use of hotel & convention center	Year-on-year
Engaged in any other business	Year-on-year
Not to claim specified deductions	Year-on-year

- DCIT v. ACE Multi Axes Systems Ltd. [2018] 400 ITR 141 (SC)

Controversies & Issues

- Point of commencement of Manufacturing (requirement – on or before March 31, 2023) –
- Trial Product / Proto-type to be sent for approval of authorities is not manufacturing
 - CIT v. Hindustan Antibiotics Ltd. (93 ITR 548) (Bom.)
 - ACIT v. Southern Structurals Ltd. (110 ITR 164) (Mad.)
 - Applicable in the present scenario ?
- Delay in issuance of licence required for commencement of manufacturing
 - *80-IB – Delay of authorities issuing completion certificate (application made within stipulated time) – PCIT v. M/s Ambey Developer Pvt Ltd [2018] TIOL 207 (P&H HC)*

Controversies & Issues

- Does not use of plant or machinery previously used for any purpose –
 - Whether use would include plant or machinery taken on lease /license ?
 - Chapter VI-A – “formed by transfer to new business P&M previously used for any purpose”
 - CIT v. Bakeman’s Home Products [2008] 166 Taxman 150 (P&H HC); and Himson Fadis Machinery (P.) Ltd. v. CIT [2010] 327 ITR 61 (Gujarat HC) – old plant was leased
 - 20% used P&M allowed – comparison with ‘total value’ of P&M used by the Company ?

Controversies & Issues

- Year of exercising the option
 - View – 1 Year of incorporation of the Company (first return of income)
 - View – 2 Year of fulfilment of all the conditions (including commencement of manufacturing)
 - Option to exercise the option to be taxed u/s 115BAB should succeed the compliance of condition.
 - Otherwise, Section 115BAB(2)(c)(ii),(iii)& 115BAB(3) would be otise
 - S. 115BAB “*exercised . . . before the due date . . for furnishing first of the returns for any previous year*”
- CTC ▪ S. 115BA “*exercised . . . before the due date . . . for furnishing*

Controversies & Issues

- *Exercise of option on or before the due date u/s 139(1) – directory*
 - *CIT v. Berger Paints (India) Ltd. (No.2) (254 ITR 503) (Cal HC)*
 - *CIT v. Magnum Export (P.) Ltd (262 ITR 10) (Cal. HC)*
 - Subsequent non-fulfilment of condition
 - Any impact on earlier years ?
 - Can one opt for section 115BAA or will they be taxed at the highest rate?
 - S. 115BAA – non-obstante clause
 - What if condition is satisfied in subsequent year S. 115BAA v. S. 115BAB ?
- CTC
- Specific v. General ?

Controversies & Issues

- Restriction – *Company is not engaged in any business other than the business of manufacture or production of any article or thing - Research & Distribution of such article or thing permitted*

- Ancillary activities related to primary business
 - After sales service during the warranty period
 - AMC
 - Investment of liquid funds in short term debt instruments ?
 - Renting out spare machinery or building ?

- Business would include profession ?

Controversies & Issues

- Expansion of business into new product or increasing the capacity or backward/forward integration (after 2023) ?
- Nominal quantum - *Value of transferred machinery was nominal it could not result in denial of benefit to the assessee. This conclusion was reached by construing the provision either on principle of commercial expediency or practical common sense or to avoid unjust hardship to the assessee. Bajaj Tempo Ltd. V. CIT [1992] 196 ITR 188 (SC)*
- Tax rate for ancillary income ?

Controversies & Issues

- Restriction – Company is not formed by splitting up, or the reconstruction of a business already in existence.

- Textile Machinery Corporation Ltd. v. CIT (107 ITR 195) (SC)

- New Manufacturing unit is wholly owned subsidiary manufacturing same product ?
 - CIT v. Ganga Sugar Corporation Ltd. [1973] 92 ITR 173 (Delhi HC)
 - CIT v. Electric Construction & Equipment Co. Ltd. [1976] 104 ITR 101 (Calcutta HC)
 - CIT v. Hindustan General Industries Ltd. [1982] 137 ITR 851 (Delhi HC)

Controversies & Issues

- GAAR on formation of WOS ?
 - Main Purpose to obtain tax benefit
 - Four Test
 - *creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;*
 - *results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;*
 - *lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or*
 - *is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for **bona fide purposes**.*

- Reduction in operations of old manufacturing company ?

- Transfer of old R&M at nominal price ? Transfer pricing provisions will apply ?

Structuring of Existing Corporate Structure

Structuring of Existing Corporate Structures

- **Split the existing business into different companies:**
 - Manufacturing units entitled to tax benefits – to continue under earlier regime and pay MAT @ 17.47%
 - Manufacturing units not entitled to tax benefits - opt for new regime and pay tax @ 25.17%
 - Commercial justification of split – risk of GAAR

Structuring of Existing Corporate Structures

- **Demerger** of manufacturing units not entitled to tax benefits into new company
 - NCLT approval required
 - Lesser stamp duty cost – can be avoided if de-merger in a wholly owned subsidiary
 - MAT Credit transfer ? – Adani Gas Ltd. ACIT [2016] TIOL146 (Ahm Trib) – transferred to resulting company; DCIT v. TCS E-Serve International Limited [2019] TS 516 (Mum T)– continued with de-merged company
- **Slump sale** of manufacturing units entitled to tax benefits to wholly owned subsidiary at book value
 - Deduction to continue - CBDT Circular 1/2013 dated January 17, 2013
 - Stamp Duty Cost – structured – transfer of immovable property

Re-Structuring of Non- Corporate Entities

General Methods

- **General methods of reorganisation of business**
 - Sale of Business (Slump Sale or Itemised Sale)
 - Conversion of Firm into Company
 - Succession of Sole Proprietor by Company
 - Merger/De-merger of Firm/LLP into Company

Sale of Business

- Sale of business – Slump sale or itemised sale – factors to be considered –
 - Indexation on longterm capital asset, value of block of asset
 - Tax Rate (Non-depreciable asset, block, stock in trade)
 - S. 50C, 56(2)(x)
- CTD Slump exchange ?

Conversion of Firm into Company

• Modes of Conversion

- Conversion under Chapter XXI (Part I) of Companies Act, 2013 (Part IX of Companies Act, 1956)

- Acquisition of business of the firm:
 - Sale of business to the Company
 - Takeover by Corporate Partner on dissolution of firm

Conversion of Firm into Company

- Conversion under Chapter XXI (Part I) of Companies Act, 2013 (Part IX of Companies Act, 1956) :
 - No statutory exemption under the Act
 - Statutory vesting – no transfer – no consideration – no capital gain in the hands of the Firm – not required to comply with S. 47(xiii)
 - CIT v. Texspin Engg. & Mfg. Works (263 ITR 345 (Bombay HC))
 - CIT v. Ravishankar R Singh [2018] TS 447 (SC) (SLP Dismissed)

Succession of Firm by a Company

- Section 47(xiii) – Exempts transfer of capital asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm.
- Conditions:
 - **all the assets and liabilities** of the firm before the succession become the assets and liabilities of the company;
 - all the partners of the firm becomes the **shareholders** of the company in the **same proportion** of their capital accounts;
 - the partners of the firm do not receive any **consideration** other than by way of allotment of shares in the company; and
 - aggregate **shareholding** of the partners in the company is not less

Succession of Sole Proprietor by a Company

- Depreciation on Goodwill ?
 - SNB Infrastructure Pvt Ltd v. ITO [2018] TIOL 921 (Mum Trib.) – Against
 - Chitra Publicity Company (P) Ltd. V. ACIT [2010] 127 TTJ 1 (Ahmedabad) (TM)
 - DCIT v. Suyash Laboratories Ltd. [2016] 41 CTC 65

Succession of Sole Proprietor by a Company

- Section 47 (xiv) exempts succession of a sole proprietary concern by a company in the business carried on by it. The succession can be pursuant to sale or otherwise transfers capital asset to the company.

- Conditions:
 - **all the assets and liabilities** of the sole proprietary concern relating to the business immediately before the

Merger of Firm/LLP into Company

- Partnership Act, 1932 – does not recognize merger or de-merger.
- LLP Act – permits merger or de-merger amongst LLP.
- No statutory provision under LLP Act permitting merger of LLP into Company
 - NCLT has approved merger of LLP into Company in following cases:
 - M/s. Real Image LLP with M/s. Qube Cinema Technologies Pvt. Ltd. (CP/123/CAA/2018) (Chennai NCLT)
 - Vertis Microsystems LLP with Forgeahead Solutions Private Limited (Petition No. 190 and 191 of 2017) (Mum. NCLT)

Merger of Firm/LLP into Company

- Partnership

- *Favour – Kirtilal Kalidas Diamond Exports (148 Comp Case 607) (Bom. HC) – Companies Act, 1956*
- *Against – Kediya Ceramics, In re [2017] 86 taxmann.com 166 (NCLT - Ahd.) – Companies Act, 2013*

- Tax consequences – No statutory exemption for merger/demerger

Merger of Firm/LLP into Company

Partners of LLP

- Demerger
 - No transfer of capital assets; interest in demerged LLP continues

- Amalgamation
 - Dominoes Printing Science Plc (A.A.R. No. 1290 of 2012)

- Resulting /Amalgamated LLP
 - Section 56(2)(x)
 - Inadequate consideration?
 - Specified Property?

Thank You

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