Taxpayers Need to be Careful While Assessing Provisions in Tax Laws

Expert Take

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The Taxation Laws (Amendment) Bill, 2019 was passed by the Lok Sabha on December 2, 2019 to replace the ordinance promulgated in September. This ordinance provided for significant tax cuts for domestic companies.

While the broad framework of the headline corporate tax rate cuts for domestic companies (22%) and for the newly set-up manufacturing companies (15%) remains unchanged, there are, however, a few significant changes proposed in the Bill.

Corporate India will do well to carefully understand these changes and the impact these could have before deciding the way forward.

The most important and far-reaching change relates to the scope of activities that would amount to 'manufacture' or 'production' in order to qualify for the most favourable 15% headline tax rate. The provisions expressly exclude 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 cylinders, printing of books and the production of cinematograph films from being considered as manufacture and production of an article or thing. Moreover, the provisions also now contain an enabling clause empowering the government to notify any other business that may be excluded from this favourable tax rate cut.

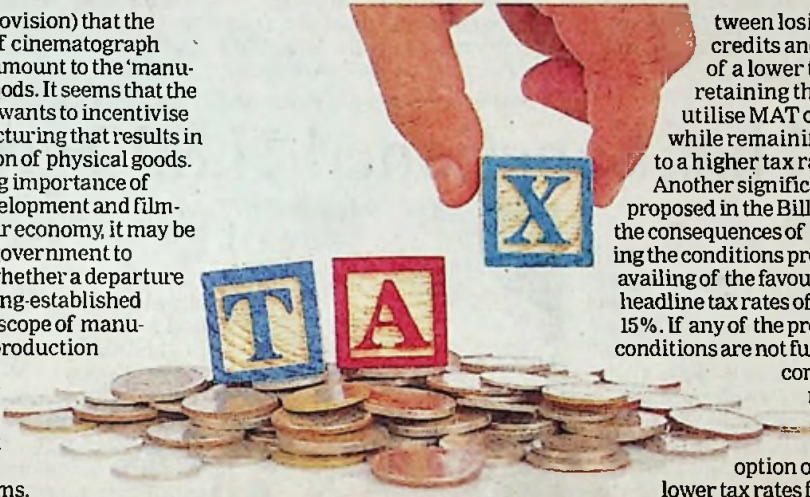
This change adversely impacts software and media industries. The terms 'manufacture' and 'production' have been used in several other provisions in income-tax law over the years and courts and the government have interpreted them widely.

One wishes that tax legislation is not as selective. Even these well-meaning reductions are hemmed in by operational challenges

For instance, in the context of software, it has been accepted that the development of software would amount to the 'production' of an article or thing. In 1993, there was even an amendment in the context of tax incentives for software-exporting units.

This amendment clarified that the production of computer programmes would amount to the 'production' of an article or thing. The position in the case of production of cinematograph films was similar. In fact, the CBDT had even issued a circular (in the context of a different provision) that the production of cinematograph films would amount to the 'manufacture' of goods. It seems that the government wants to incentivise new manufacturing that results in the production of physical goods.

Considering importance of software development and film-making to our economy, it may be prudent for government to reconsider whether a departure from these long-established positions on scope of manufacture and production is warranted in the case of software development and cinematographic films.



Moreover, the question on how taxpayers who are planning to set up new manufacturing companies, will ever be certain that their business will not be made ineligible for the favourable tax cut at any later date remains.

Another important change relates to the availability of minimum alternate tax credit to companies that have exercised the option to be governed by the 22% headline tax rate. The ordinance did not deal with this issue though it was subsequently clarified by the CBDT that such credits would not be available to those taxpayers who chose to avail of the favourable tax rate option.

This clarification is now being sought to be incorporated into the law, presumably to avoid further controversy and litigation on this subject. This will impact those companies that, having already paid MAT in earlier years, will now have to carefully consider the impact of permanently losing MAT credits that they may have accumulated if they wish to avail of the favourable tax rate immediately. In such cases, it is possible that they may also need to write off such accumulated MAT credits in their financial statements.

These companies will now have to carefully weigh their options in deciding whether and when to opt for this new favourable tax rate regime. The choice will be between losing MAT credits and availing of a lower tax rate or retaining the right to utilise MAT credits while remaining subject to a higher tax rate.

Another significant change proposed in the Bill deals with the consequences of not fulfilling the conditions prescribed for availing of the favourable lower headline tax rates of 22% or 15%. If any of the prescribed conditions are not fulfilled, the company will neither be able to avail of the option of these lower tax rates for the year in which any such prescribed conditions are violated, nor in any of the subsequent years.

This is a particularly stringent provision and companies will need to be careful that even inadvertently these prescribed conditions are not violated in any year if they want to continue to avail of these lower tax rates. Taxpayers need to be vigilant and carefully assess these beneficial provisions before even attempting to take any legitimate advantage. One wishes that tax legislation is not as selective and complex. Even these well-meaning tax rate reductions are hemmed in by considerable operational challenges.

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