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New Tax Reforms - Incentivising the Indian Economy

November 6, 2019

The Indian government recently announced a series of changes to the income tax regime through the Taxation Laws (Amendment) Ordinance (the "Ordinance"), which took effect on September 20, 2019. The tax reforms are primarily aimed at reducing tax rates for corporations and encouraging foreign investment.

Set forth below is a summary of the key changes brought into effect through the Ordinance:

Reduced corporate tax rates. Prior to the Ordinance, the Income Tax Act 1961 (the "ITA") levied a 30% corporate tax on domestic companies, and allowed a lower rate of 25% for companies with a total turnover not exceeding INR 4 billion (approximately USD 56 million) in the fiscal year prior to the assessment year. The Ordinance now permits domestic companies to opt for a 22% tax rate, subject to fulfilling certain prescribed criteria, including prohibitions on (i) claiming other deductions and exemptions under the ITA, (ii) setting off carried-forward losses attributable to such deductions and (iii) claiming certain types of depreciation under the ITA.

The Ordinance also permits manufacturing companies incorporated on or after October 1, 2019 that begin manufacturing by March 31, 2023 to opt for a reduced tax rate of 15% (as opposed to the current lowest option of 22%), subject to fulfilling the prescribed criteria described above. In addition, the lower tax rate is not available to manufacturing companies that (i) were formed by splitting up or reconstructing a business that was already in existence, (ii) are engaged in any business other than manufacturing, (iii) use plant or machinery which was previously used in India, or (iv) use any building previously used as a hotel or convention centre.

The reduced tax rates are available from the fiscal year 2019 - 2020 onwards, and a decision by a company to avail itself of a reduced tax rate is irrevocable for subsequent fiscal years.

Minimum alternative tax reduction. Prior to the Ordinance, if the income tax (computed in accordance with the ITA) payable by an Indian company on its total income was less than 18.5% of its book profit, such book profit would be deemed to be the company's total income and was taxable at the minimum alternate tax ("MAT") rate of 18.5%. The Ordinance has reduced the MAT threshold to 15% of book profits and the applicable tax rate to 15%. The Ordinance further clarifies that MAT is not applicable to domestic companies that opt for the lower corporate tax rates described above.

Roll-back of enhanced surcharge. Earlier this year, the Indian government had announced an increase in surcharge rates for taxpayers with taxable income from INR 20 million (approximately USD 280,000) to INR 50 million (approximately USD 700,000), and INR 50 million (approximately USD 700,000) and above, by 3% and 7%, respectively. Although the move was seemingly targeted at high net worth individuals, the Finance Act 2019 expanded the applicability of the higher surcharge to associations of persons and bodies of individuals, creating uncertainty regarding the applicability of such surcharges to foreign portfolio investors set up as trusts and alternative investment funds in India. With foreign investors critical of the changes, the Finance Minister announced a partial relaxation in August 2019 in the case of capital gains on sales of certain securities by foreign portfolio investors. In a welcome move for foreign portfolio investors, the Ordinance now provides a further rollback, stipulating that the increased surcharge will not apply to capital gains on the sale of any securities (including derivatives) in the case of associations of persons or bodies of individuals.

Tax on buy-back of listed securities. Since 2013, a 20% tax has been levied on the buy-back of unlisted shares of domestic companies in India. However, earlier this year, the 20% tax was extended to listed companies with effect from July 5, 2019. To curb ambiguity, the Ordinance now clarifies that the new provision will not apply to the buy-back of listed shares announced prior to July 5, 2019. While this clarification provides some relief for entities that made their announcements before the cut-off date, foreign investors in Indian companies may need to consider this new tax applicable to share repurchases when structuring their investments in listed companies in India.

These tax amendments form part of a series of regulatory reforms driven by the Indian government to boost the country's slowing economy. The Ordinance follows the recent relaxation of the Foreign Direct Investment Policy, under which 100% foreign direct investment is now permissible without prior government approval in the single-brand retailing, contract manufacturing and coal mining sectors. On the capital markets front, the Securities and Exchange Board of India also recently announced changes to the foreign portfolio investment regime to make the route more attractive for foreign investors.

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Please note that Debevoise & Plimpton does not practice Indian law and that this update is based on publicly available information.

Please do not hesitate to contact us with any questions.

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