

K C Mehta & Co.

Chartered Accountants

*Embracing the Taxation (Amendment)
Ordinance 2019*

Suril Mehta

CA Regional Conference, Bharuch

28th December 2019

K C Mehta & Co.

Chartered Accountants

Independent Member of

B K R
INTERNATIONAL

Introduction

The changes

- Corporate income tax rate has reduced
 - 22% rate for all companies
 - 15% rate for new manufacturing companies
 - MAT rate has been reduced to 15%

The new rates



□ 22%

- Applicable to all companies
- Specific tax exemption won't be available
- MAT doesn't apply
- MAT credit will lapse

The new rates



□ 15%

- Applicable to new manufacturing companies
- Specific tax exemption won't be available
- MAT doesn't apply
- MAT credit will lapse



Once eligible,
benefit for life

Existing rates...

Are still relevant



And not obsolete



Existing rates

□ 25 & 30%

- Applicable to all companies

- Specific tax exemptions continue

- MAT is applicable

- MAT credit will be allowed

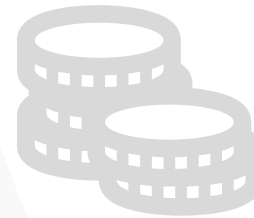
Existing rates

□ 25%

- Turnover in FY18 \leq 400 crores

□ 30%

- Other than the above



Consider the turnover in *CY minus 2*

Surcharge

□ 25% & 30%

- 0 – 1 : 0%
- 1-10 : 7%
- 10+ : 12%

□ 15% & 22%

- 0+ : 10%;

□ 25% & 30%

- 26% / 31.2%
- 27.82% / 33.4%
- 29.12% / 34.9%

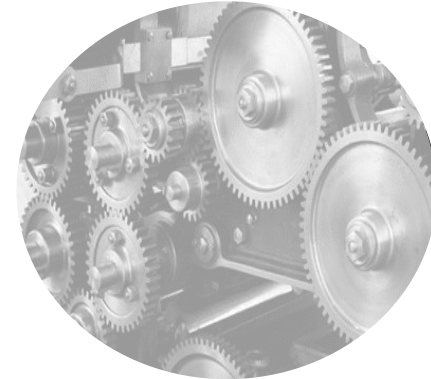
□ 15% & 22%

Effectively: 17.16% & 25.17%

15% tax regime

Conditions

- ❑ Company!
- ❑ Incorporation date
- ❑ Manufacturing or production
 - No other business
- ❑ Manufacturing commencement date
- ❑ Splitting-up/reconstruction of business in existence
- ❑ New P&M
- ❑ No specific tax incentives
 - Re-computation of loss



Company

- ❑ Company! *Only companies are eligible*
- ❑ Incorporation date
- ❑ Manufacturing or production
 - No other business
- ❑ Manufacturing commencement date
- ❑ Splitting-up/reconstruction of business in existence
- ❑ New P&M
- ❑ No specific tax incentives
 - Re-computation of loss

Incorporation date

- Company!

- Incorporation date; *Should be incorporated on or after 1 Oct 2019*

- Manufacturing or production

 - No other business

- Manufacturing commencement date

- Splitting-up/reconstruction of business in existence

- New P&M

- No specific tax incentives

 - Re-computation of loss

- ❑ Company!
- ❑ Incorporation date
- ❑ **Business: Manufacturing or production**
 - No other business
- ❑ Manufacturing commencement date
- ❑ Splitting-up/reconstruction of business in existence
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 - Re-computation of loss



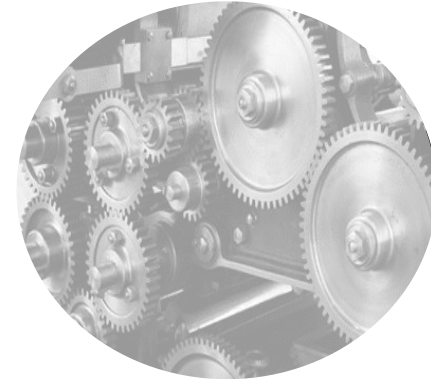
Manufacturing or Production

- ❑ The company should be engaged in manufacturing or production activity.
- ❑ Manufacturing refers to changing the form of the product.
- ❑ Production is a wider term.
- ❑ No other business is permissible (consulting, agency, etc.)

Manufacturing or Production - restriction

- *(b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and*
- The restriction seems to narrow
 - Licencing of intangibles
 - Carrying out investment activities
- Ancillary income shouldn't be a problem

- ❑ Company!
- ❑ Incorporation date
- ❑ Manufacturing or production
 - No other business
- ❑ **Manufacturing commencement date**
- ❑ Splitting-up/reconstruction of business in existence
- ❑ New P&M
- ❑ No specific tax incentives
 - Re-computation of loss



Manufacturing commencement date

- Manufacturing or production should commence by 31 March 2023
- Phase (a) *the company has been set-up and registered on or after the 1st day of October, 2019, and has commenced manufacturing on or before the 31st day of March, 2023, and,—*

Will a trial run be enough to satisfy this condition?

Manufacturing or Production – quantum or type

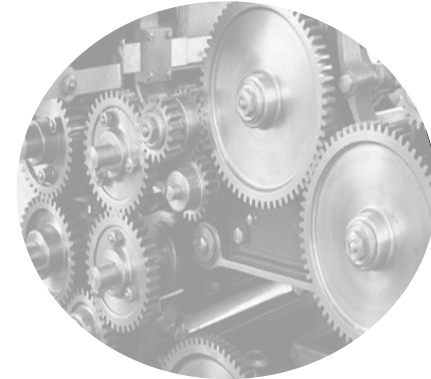
- *Only focus is on commencement of manufacturing or production*
 - *Type or quantum isn't relevant.*

Splitting-up – business in existence

- (i) development of computer software in any form or in any media;*
- (ii) mining;*
- (iii) conversion of marble blocks or similar items into slabs;*
- (iv) bottling of gas into cylinder;*
- (v) printing of books or production of cinematograph film; or*
- (vi) any other business as may be notified by the Central Government in this behalf; and*

Why such exclusions?

- ❑ Company!
- ❑ Incorporation date
- ❑ Manufacturing or production
 - No other business
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- ❑ **Splitting-up/reconstruction of business in existence**
- ❑ New P&M
- ❑ No specific tax incentives
 - Re-computation of loss

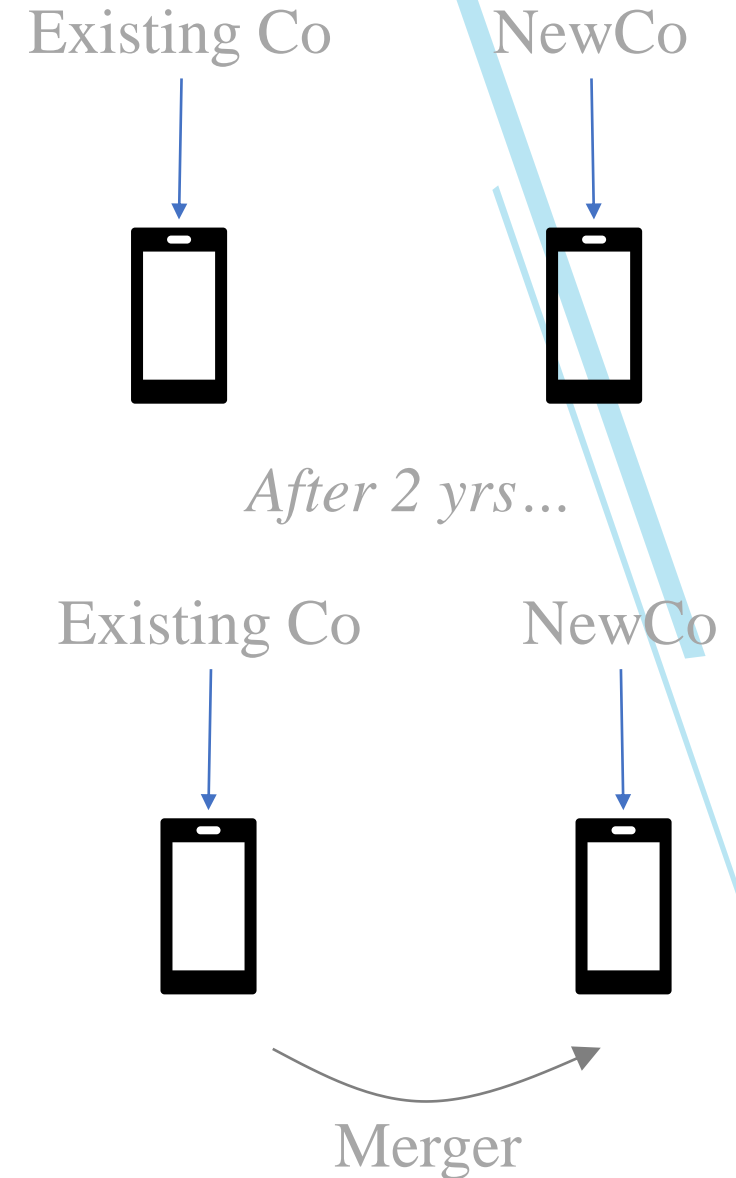


Splitting-up - analysis

- *“The business is not formed by splitting up, or the reconstruction, of a business already in existence”*
 - *‘Not formed’*
 - *‘The business is not formed by splitting up or reconstruction’*
 - *Instead of ‘the company is not formed by splitting up or reconstruction’*
 - *Splitting-up or reconstruction*
 - *Business already in existence*

Splitting-up - formation

- ❑ *'The business is not formed by splitting up or reconstruction'*
- ❑ *Case: Foxconn has a plant in Chennai*
 - *it establishes a NEW CO with NEW investment*
 - *After 2 years.....*
 - ❑ *it merges the existing company into the NEW CO*



Splitting-up – business in existence

- *“The business is not formed by splitting up, or the reconstruction, of a business already in existence”*
 - *There has to be an existing business*
 - *It doesn't talk about assets*
 - *Only business*

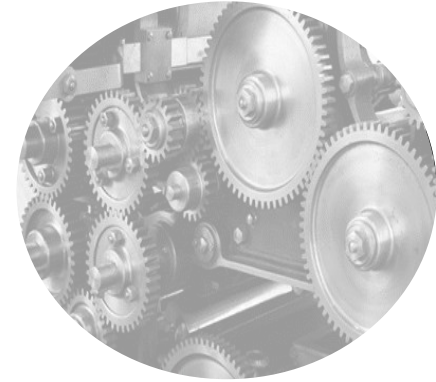
Transfer of CWIP?

Splitting-up or Reconstruction

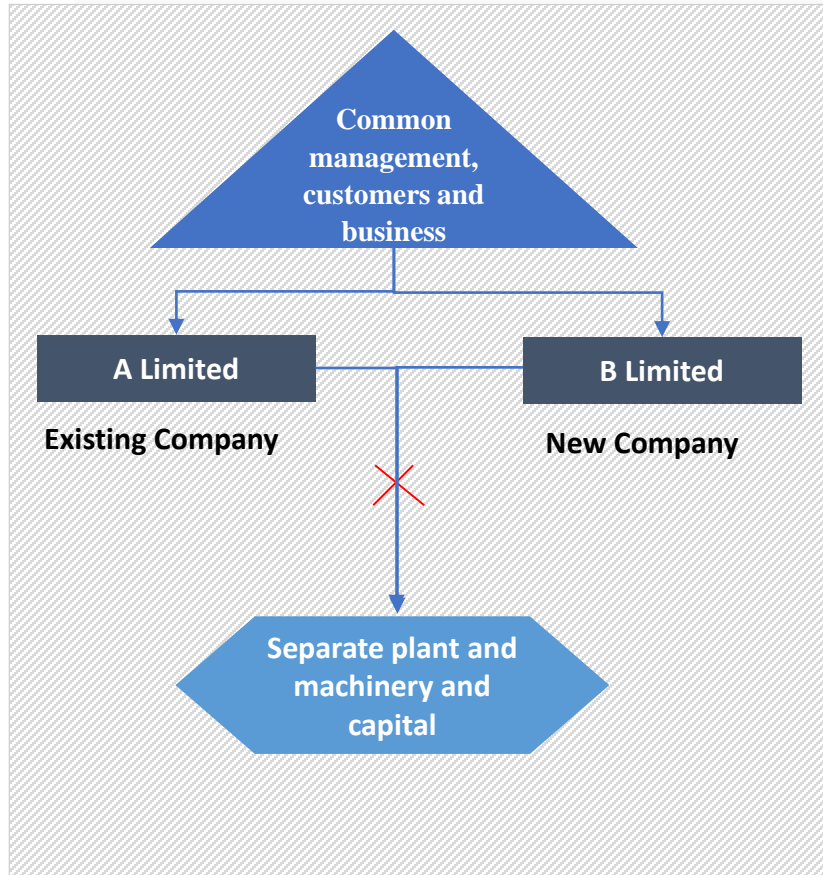
- “The business is not formed by splitting up, or the reconstruction, of a business already in existence”

Meaning of splitting-up or reconstruction?

Case-laws on splitting-up or reconstruction



Case 1 – Commonality of management/employees/business



Situation

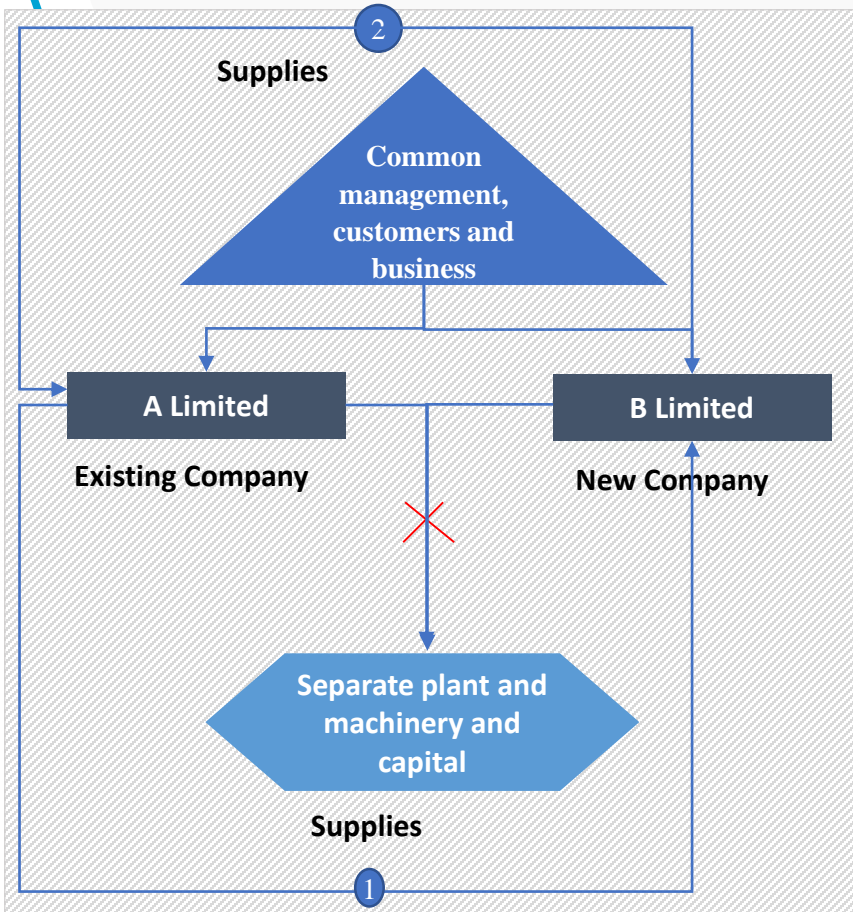
- The new company is formed with the same management, customers and business.
- The new company has raised funds separately and has invested in fresh plant and machinery
- The new company will produce an improved product.

Question

Whether this will be considered as splitting up/ reconstruction ?

The same has been observed in the cases of CIT v. Deco De Trend (Madras HC), Commissioner of Income-tax v. Sagun Gems (P.) Ltd (Rajasthan HC) and ACIT vs Metal Alloys Corp. (Rajkot ITAT)

Case 2 – Commonality of management/employees/business



Situation

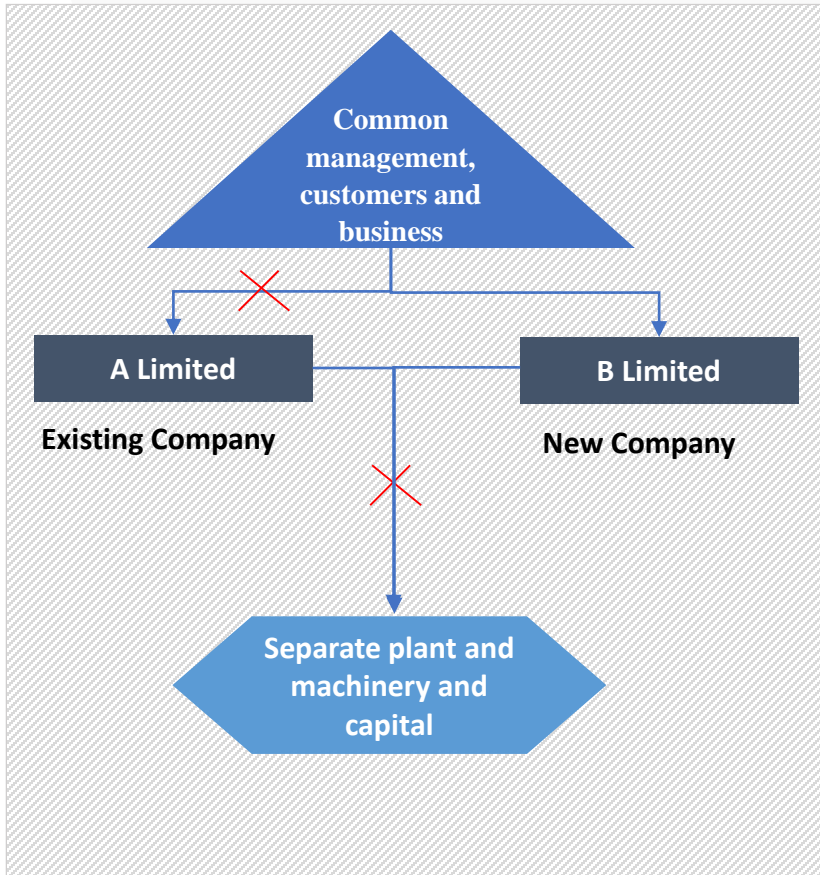
- Continuing with Case 1 and the additional facts being:
 - The existing company supplies to the new company; or
 - The new company supplies to the existing company.

Question

Whether this will be considered as splitting up/ reconstruction ?

The same has been observed in the cases of Textile Machinery Corporation Ltd. v. CIT (SC), Gujarat Alkalies & Chemicals Ltd. v. CIT (Gujarat HC) and CIT vs Atul Ltd (Gujarat HC)

Case 3 – Case 1 + Old Co. shuts down



Situation

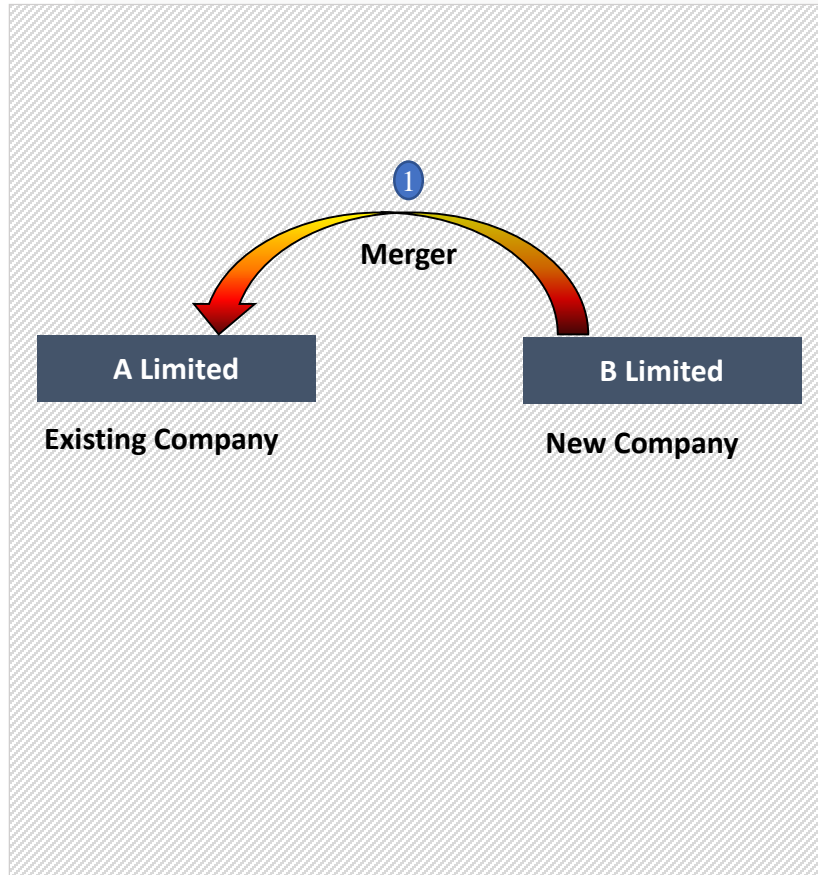
- The new company is formed with the same management, customers and business. It has raised funds separately and has invested in fresh plant and machinery.
- The Existing Company will be shut down after formation of the new company and the new company will produce an improved product.

Question

Since the existing entity is closed and against that, business is started in a new entity will that appear as a case of splitting up/ reconstruction of existing business?

The same has been observed in the case of Pr. CIT v. Green Fire Exports (2019) (Supreme Court)

Case 4 – Existing company merges with New company



Situation

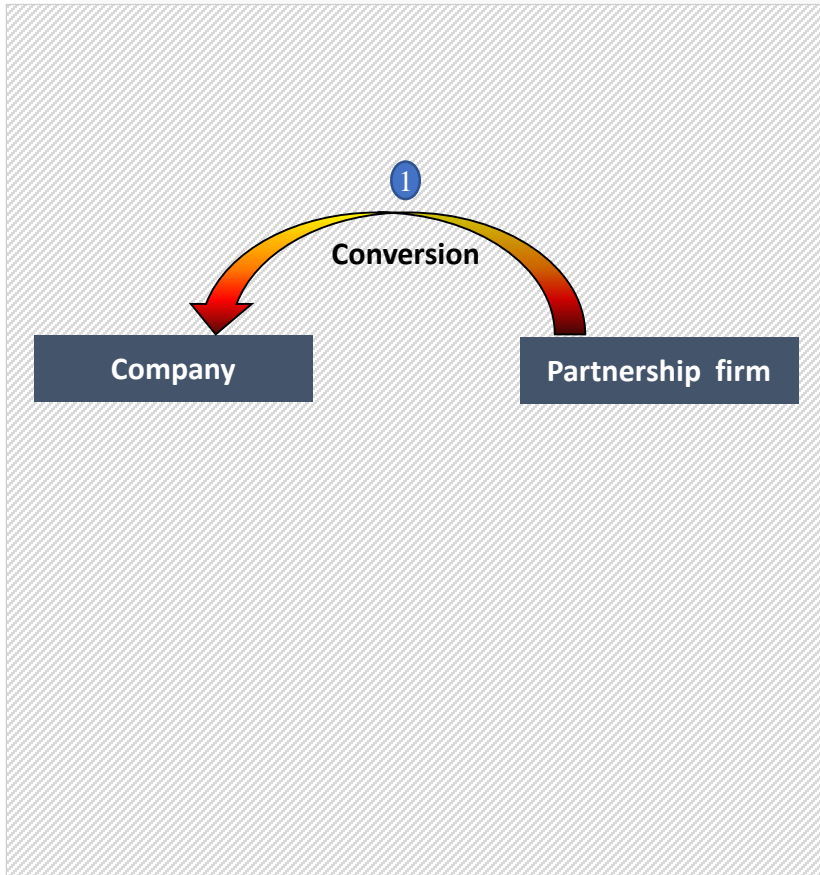
- The new company eligible to take benefit of the new regime merges with existing company?

Question

Would the existing company still be able to claim the benefit of the new regime?

The same has been observed in the cases of CIT v. Deco De Trend (Madras HC), Commissioner of Income-tax v. Sagun Gems (P.) Ltd (Rajasthan HC) and ACIT vs Metal Alloys Corp. (Rajkot ITAT)

Case 5 – Partnership firm converts to a company



Situation

- There are no tax cuts for LLPs or partnership firms whereas the tax rates for new manufacturing companies have been reduced to 15%.
- In such a situation, the company structure may be more beneficial and hence partnership firm is converted to a company.

Question

Would such company still be able to claim the benefit of the new regime or whether it will be considered as reconstruction/ splitting up?

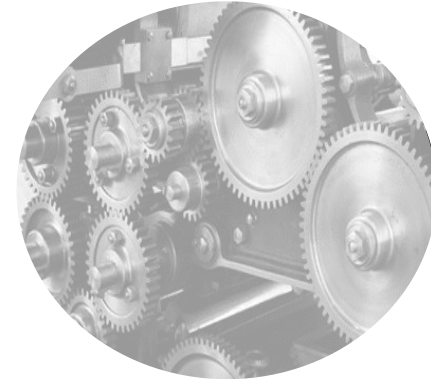
This has also been observed in the case of CIT v. Prisma Electronics (Allahabad HC)

Fresh Business Test – Summary

Situations

Common management and similar business (where existing/ old business is not closed down)	Not considered as splitting-up or reconstruction if all the other conditions are fulfilled.
Common management and similar business (where existing/ old business ceases to exist)	Shutting down old unit to start a new company doesn't automatically lead to splitting up of the existing business. However, all the other relevant facts like new investment, use of old assets, etc. need to be analysed.
Same employees	Not considered as splitting-up or reconstruction if major employees are not still employed in the existing company. If however, majority of the employees of the existing concern are transferred, the same may be considered as splitting up or reconstruction.
Same customers	Not considered as splitting-up or reconstruction as the company is not considered to be having control on customers.
Conversion of firms/ sole proprietorship concerns into new Companies	New companies will not be able to take benefit since the formation date will be the date of formation of the erstwhile concern and not the date of conversion.
Merger of a new company claiming benefit with an existing company	From the plain reading, it seems that the benefit can be availed. However, the same is yet to be tested.

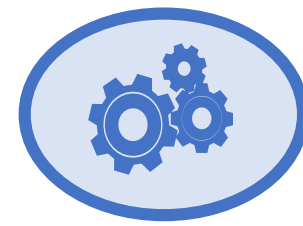
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New P&M

- ❑ *“Does not use any machinery or plant previously used for any purpose:*
- ❑ *Explanation 2.—Where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of such machinery or plant or part thereof does not exceed twenty per cent of the total value of the machinery or plant used by the company, then, for the purposes of sub-clause (ii) of this clause, the condition specified therein shall be deemed to have been complied with;*

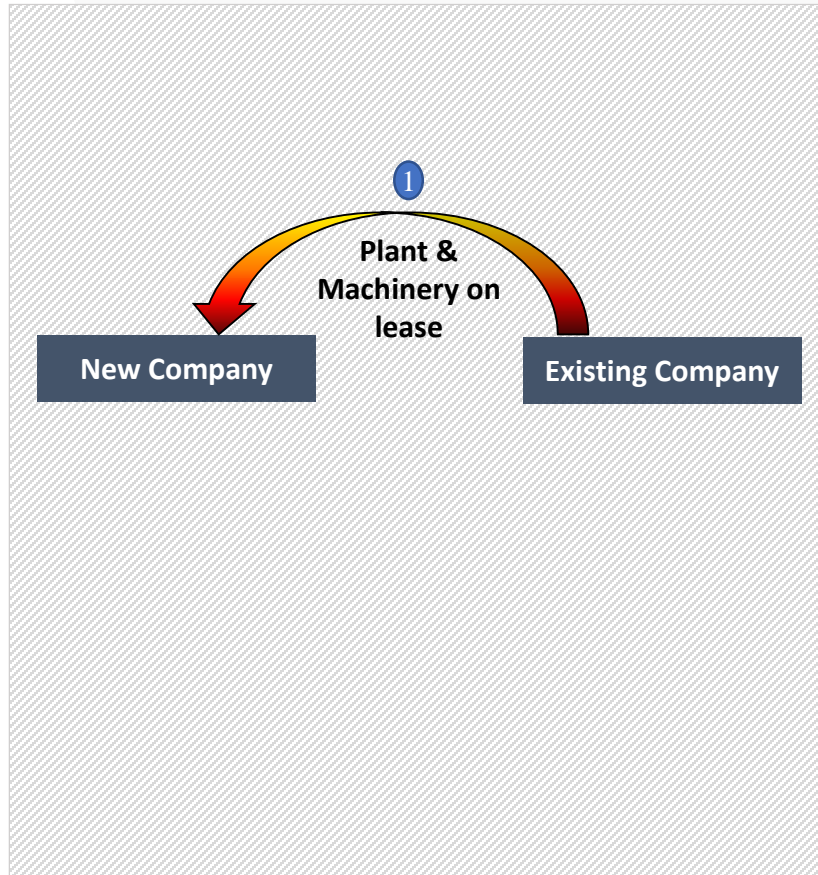
Analysis of conditions prescribed – New P&M Test



□ Issues

- What is the meaning of plant?
 - Specifically, is the civil structure which is a base for the machines, a plant?
- What is the meaning of machines?
 - What is the identification of machines which are attached to the ground/to the plant?
- How will the limit of 20% be computed?
 - What value of old and new plant and machinery be considered?
 - Will it be Gross Block, Net Block, Market Value, Replacement Cost, etc.?
- What is the meaning of ‘previously used for any purpose’?
 - In case of P&M acquired by a company but not put to use, and it sells that P&M to a ‘New Manufacturing Company’, can it be said that the same is ‘previously used for any purpose’?
- Can the old P&M be used by leasing the same instead of buying it?

Case 1 – Lease of P&M to New company



Situation

- The newly incorporated company uses a substantial portion of leased out plant of an existing concern.

Question

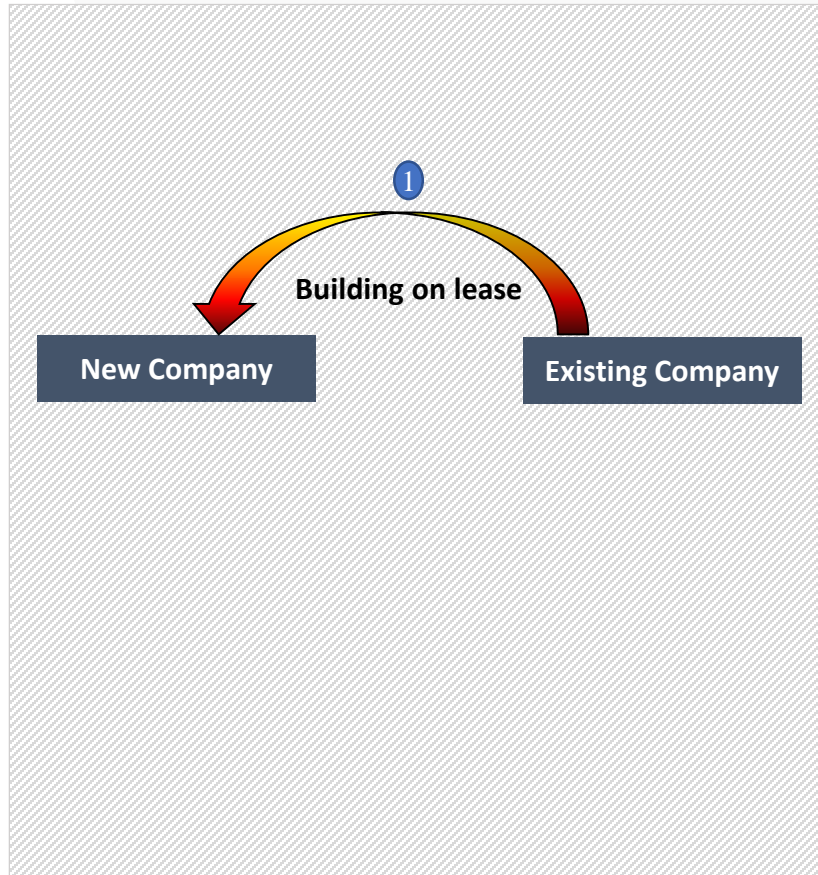
Whether the same shall be considered as use of previously used plant and machinery, thus denying the benefit ?

Analysis

- From the reading of the provisions it seems that the intention is to constitute a new industrial undertaking in the true sense.
- It should not be formed by transfer of building, machinery or plant previously **used** for any purpose and if the same is not fulfilled, the company is not entitled to lower rate.
- So, if the new unit is using more than substantial value (>20%) of plant and machinery on lease, the benefit of the regime will not be availed.
- However if newly invested plant and machinery forms a major part (>80%), the entity may be able to claim the benefit of the new regime.

This has also been observed in the case of CIT vs Super Tool Co. (Bombay HC), Stabilix Solutions (P.) Ltd. v. ITO (Kerala HC)

Case 2 – Lease of building to New company



Situation

- The newly incorporated company uses the leased premises of an exiting concern

Question

Whether the same shall be considered as use of previously used plant and machinery, thus denying the benefit ?

Analysis

- The consideration of this issue depends upon whether the building plays a vital part in the activities of the company's operations.
- In case the building is used for administrative activities the benefit shall still be available.
- However, if the building is actually forming a part of company's daily operations, it might be considered as use of used plant and machinery.
- The same needs to be critically evaluated from case to case basis.

This has also been observed in the case of CIT vs Super Tool Co. (Bombay HC), Bajaj Tempo Ltd. v. CIT (SC)

Case 3 – Classification of P&M ‘or part thereof’

Situation:

- Whether structure shall be considered as a part of P&M?

Case I – In following cases, structure shall not be considered as a part of plant and machinery:

- If the structure is such that it can be used for setting up of any plant or machinery.
- The plant can function without existence of such structure
- It does not play any active role in the production process.

After the amendment to section 43 of the income tax act which specifically states that plant and machinery does not include buildings, this stand might not hold good. However, it may also be inferred that the definition of plant is only for that particular purpose and can't be used in this provisions. The same has been observed in the case of R.C. Chemical Industries vs CIT (Delhi HC)

Case 2 – In following cases, structure shall be considered as a part of plant and machinery:

- The structure is specifically designed taking into consideration the layout of plant and machinery;
- The structure is such that the plant cannot function without existence of such structure;
- It plays an active role in the production process.

The same has been observed in the case of CIT vs R.G. Ispat (Rajasthan HC), DSM sinochem Pharmaceuticals India vs DCIT (Chandigarh ITAT) and CIT vs Shivalik Hatcheries (Himachal Pradesh HC)

New P&M Test – Summary

Parameters

Substantial utilization of leased out plant and machinery.	If leased out plant and machinery forms a substantial part of the entity's plant and machinery it is not permissible.
Leasehold building used in production facilities.	If the structure is specifically designed taking into consideration the plant and machinery then it may not be permitted. However, if the structure is not related with the plant and machinery that it is permissible.
Leasehold building used for administrative purposes	If the building is used for administrative purposes then it will not be considered to be forming a part of plant and machinery and hence the same is permissible.

- Imported plant & machinery is allowed if such plant & machinery has been installed in India and depreciation has not been claimed on the same previously in India.
- A Company cannot use any building previously used as a hotel or convention center

Thank you for holding on!



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Questions?



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