

Carton of TAX Rates available for Domestic Companies

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The Taxation Laws (Amendment) Act, 2019 (TLA) had introduced Section 115BAA and Section 115BAB to the Income-tax Act, 1961 (Act), with effect from 1 April 2020 i.e. Assessment Year (AY) 2020-21, providing for lower tax rates for domestic companies and in these trying times of pandemic, it may be worth looking at these provisions so that tax cost can be optimised within the framework of law as laid down by the TLA.

However, after the introduction of Section 115BAA and Section 115BAB to the Act, domestic companies have a challenging task at hand of choosing an appropriate tax rate from a carton of tax rates. At present, there are five different tax rates applicable to domestic companies and the same are tabulated as under:

Particulars	Applicability and Exit options	Tax rate
Section 115BA	<p>Applicable to:</p> <p>Domestic companies [other than those covered by Section 115BAA or Section 115BAB]:</p> <ul style="list-style-type: none"> • which are 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 • which are set up and registered on or after 1 March 2016. <p>Exit option:</p> <p>Domestic companies which has opted for Section 115BA of the Act can still opt for Section 115BAA of the Act. In other words, once the option under Section 115BAA of the Act has been exercised, option under Section 115BA of the Act will be withdrawn.</p>	25%
Section 115BAA	<p>Applicable to:</p> <p>Domestic companies [other than those covered by Section 115BA or Section 115BAB].</p> <p>Exit option:</p> <p>Once the option under Section 115BAA of the Act has been exercised, it cannot be subsequently withdrawn unless domestic companies fail to satisfy conditions prescribed in Section 115BAA(2) of the Act.</p>	22%

Section 115BAB	<p>Applicable to:</p> <p>Domestic companies [other than those covered by Section 115BA or Section 115BAA]:</p> <ul style="list-style-type: none"> • <input type="checkbox"/> which are 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 • <input type="checkbox"/> which are set up and registered on or after 1 October 2019 and commences manufacturing of an article or thing on or before 31 March 2023. <p>Exit option:</p> <p>Once the option under Section 115BAB of the Act has been exercised, it cannot be subsequently withdrawn unless domestic companies fail to satisfy conditions prescribed in Section 115BAB(2) of the Act.</p> <p>However, where domestic companies fail to satisfy conditions prescribed in Section 115BAB(2)(a)(ii)¹, Section 115BAB(2)(a)(iii)² or Section 115BAB(2)(b)³ of the Act, such domestic companies can still opt for Section 115BAA of the Act.</p>	15%
Part I/Part III of First Schedule to the Finance Act, 2020	<p>Applicable to:</p> <p>Domestic companies:</p> <ul style="list-style-type: none"> • <input type="checkbox"/> Where total turnover or gross receipts in the year 2017-2018/2018-2019 does not exceed Rs. 400 crores; • <input type="checkbox"/> In any other case. 	25% 30%

Analysis:

To help domestic companies make a right choice, we have tabulated and highlighted below some of the key provisions and have discussed some of the important issues that requires consideration before domestic companies opt for a particular tax rate from a carton available:

Particulars	Section 115BA	Section 115BAA	Section 115BAB	Part I/Part III of First Schedule to the Finance Act, 2020
				(For domestic companies with total turnover or gross receipts > Rs. 400 crores (For domestic companies with total turnover or gross receipts < Rs. 400 crores)

					in the year 2017-2018/2018-2019)	in the year 2017-2018/2018-2019)
Tax rate	25%	22%	15%	25%	30%	
Surcharge where total income is up to Rs. 1 crore	Nil	10%	10%	Nil	Nil	
Surcharge where total income is between Rs. 1 crore and Rs. 10 crores	7%	10%	10%	7%	7%	
Surcharge where total income exceeds Rs. 10 crores	12%	10%	10%	12%	12%	
Minimum Alternate Tax (MAT)	15%	Nil	Nil	15%	15%	
Deduction under prescribed Sections (refer Appendix)	Not available	Not available	Not available	Available	Available	
Deduction under Chapter VI-A under the heading "C-Deduction in respect of certain incomes"	Not available except deduction under Section 80JJAA	Not available except deduction under Section 80JJAA or Section 80M	Not available except deduction under Section 80JJAA or Section 80M	Available	Available	
Set off of brought forward losses/unabsorbed depreciation to the extent attributable to any deduction under prescribed Sections (refer Appendix)	Not available	Not available	Not applicable	Available	Available	

Impact of brought forward losses and unabsorbed depreciation:

As per Section 115BAA(2)(i) of the Act, domestic companies engaged in the business of manufacture or production of any article or thing or generation, transmission or distribution of power, will not be allowed deduction for additional depreciation as per Section 32(1)(iia) of the Act while computing income-tax payable as per Section 115BAA(1) of the Act.

Accordingly, as per Section 115BAA(2)(ii) read with Section 115BAA(3) of the Act, any brought forward loss on account of additional depreciation as per Section 32(1)(iia) of the Act, also, will be not be allowed to be set-off while computing income-tax payable as per Section 115BAA(1) of the Act and will be deemed to have been given full effect to.

However, as per proviso to Section 115BAA(3) of the Act, if any additional depreciation as per Section 32(1)(iia) has not been given full effect to prior to AY 2020-21 then such domestic companies will be allowed to make corresponding adjustment to the written down value of the block of assets as on 1 April 2019 provided such domestic companies opt for Section 115BAA of the Act for AY 2020-21 on or before

the due date specified under Section 139(1) of the Act for furnishing the return of income (**the underlined portion is very critical**).
Let's understand this by way of an example:

Existing domestic company engaged in the business of manufacture or production of any article or thing (which has not opted for Section 115BA of the Act) has a brought forward loss (not attributable to any deduction under prescribed Sections) of Rs. 50, unabsorbed depreciation of Rs. 75 and unabsorbed additional depreciation of Rs. 25 resulting in total brought forward loss as well as unabsorbed depreciation of Rs. 150 for AY 2020-21.

Now, if this domestic company opts for Section 115BAA of the Act for AY 2020-21, then while computing income-tax payable, this domestic company will not be allowed to set-off unabsorbed additional depreciation of Rs. 25 - but as per proviso to Section 115BAA(3) of the Act, this domestic company will be allowed to make corresponding adjustment of Rs. 25 to the written down value of the block of assets as on 1 April 2019 (in respect of which, set off of unabsorbed additional depreciation of Rs. 25 is not allowed) and claim normal depreciation as per Section 32(1)(ii) of the Act.

However, if this domestic company does not opt for Section 115BAA of the Act for AY 2020-21 and opts for Section 115BAA of the Act for AY 2021-22 or for another subsequent AY, then, assuming this domestic company has the same position of brought forward loss as well as unabsorbed depreciation for AY 2021-22 like AY 2020-21, this domestic company will not be allowed to set-off unabsorbed additional depreciation of Rs. 25 **and will also lose the benefit of proviso to Section 115BAA(3) of the Act.**

In effect, the benefit of proviso to Section 115BAA(3) of the Act is available only if the option is exercised for AY 2020-21 and not otherwise. Thus, domestic companies engaged in the business of manufacture or production of any article or thing or generation, transmission or distribution of power, will have to critically evaluate the impact of Section 32(1)(iii) of the Act before making any choice for AY 2020-21 because once the option under Section 115BAA of the Act has been exercised, it cannot be subsequently withdrawn unless such domestic companies fail to satisfy conditions prescribed in Section 115BAA(2) of the Act.

Taxability of other income:

As per first proviso to Section 115BAB of the Act, where the total income of domestic companies includes any income, which has neither been derived from nor is incidental to manufacturing or production of an article or thing and in respect of which no specific tax rate has been provided separately, such income will be taxed at the rate of 22% and no deduction or allowance in respect of any expenditure or allowance will be allowed while computing such income.

This proviso may have significant impact on those domestic companies which also earns other income. Let's understand this by way of an example:

Domestic company was incorporated on 1 April 2020 for carrying on the business of manufacturing of an article. During the year ended 31 March 2021, such domestic company borrowed Rs. 1,000 for purchasing plant and machinery and constructing a manufacturing unit. Until deployment of funds so borrowed for the intended purposes, such domestic company invested Rs. 500 in shares of Company A and earned Rs. 75 as dividend. For earning such dividend income, such domestic company incurred interest expense of Rs. 20. Now, as per proviso to Section 115BAB of the Act, dividend income of Rs. 75 will be taxed at the rate of 22% and no deduction will be allowed for the interest expense Rs. 20 resulting in a cash outflow of Rs. 16.5. But if such domestic company opts for Section 115BAA of the Act then such

domestic company will be able to claim a deduction of Rs. 15 being (20% of the dividend income of Rs. 75) as per Section 57 of the Act while computing income-tax payable at the rate of 22% resulting in a cash outflow of Rs. 13-2, which is less than a cash outflow under Section 115BAB of the Act by Rs. 3-3.

Likewise, if such domestic company earns let's say a rental income from let out of any of its property which is taxable under the head 'Income from House property', then, in a situation where such domestic company opts for Section 115BAB of the Act, no deduction will be allowed as per Section 24 of the Act (being 30% of annual value and interest on borrowed capital) and such rental income will be taxed on a gross basis at the rate of 22%. Whereas, if such domestic company opts for Section 115BAA of the Act then such rental income will be taxed after claiming deduction as per Section 24 of the Act at the rate of 22%.

Thus, if one looks at the other income of such domestic companies, Section 115BAA of the Act may appear to be a better choice over Section 115BAB of the Act. However, domestic companies should critically evaluate the impact of their other income before opting for Section 115BAA of the Act or Section 115BAB of the Act because once the option under Section 115BAA of the Act has been exercised, it cannot be subsequently withdrawn unless such domestic companies fail to satisfy conditions prescribed in Section 115BAA(2) of the Act and in such situation, such domestic companies will risk their income from manufacture or production of any article or thing being taxed at the rate of 22% *vis-à-vis* 15% as per Section 115BAB of the Act.

MAT credit:

As per Section 115JB of the Act, provisions relating to MAT will not apply to those domestic companies which has exercised option under Section 115BAA of the Act or Section 115BAB of the Act.

Thus, where domestic companies which has MAT credit either opts for Section 115BAA of the Act or Section 115BAB of the Act, question arises that whether such MAT credit will lapse or such domestic companies will be allowed to carry forward this amount of MAT credit since provisions relating to MAT will not apply.

If MAT credit lapses then this may be a significant loss for domestic companies in a situation where such domestic companies fail to satisfy conditions prescribed in Section 115BAA(2) of the Act or Section 115BAB(2) of the Act in any of the subsequent AY, as may be applicable and are consequently governed by the normal provisions of the Act.

At present, there is no clarity on this aspect. The way the provisions of Section 115BAA of the Act and Section 115BAB of the Act are worded, only brought forward loss and unabsorbed depreciation attributable to any deduction under prescribed Sections (refer Appendix) will not be allowed. There is no corresponding language in these Sections with respect to MAT credit and hence domestic companies will have to evaluate whether MAT credit will be available, or not. Prima facie, it appears that MAT credit should be available once domestic companies go back to the normal provisions of the Act provided the time limit for availing MAT credit has not expired. However, litigation on this account cannot be ruled out.

Exercise of option:

It is interesting to note the difference in the language used in Section 115BAA of the Act and Section 115BAB of the Act with respect to exercise of option under respective Sections.

Relevant extract of Section 115BAA of the Act is as under:

"(5) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the returns of income for any previous year relevant to the assessment year commencing on or after the 1st day of April, 2020 and such option once exercised shall apply to subsequent assessment years."

On a plain reading of the provisions of Section 115BAA of the Act, it can be said that domestic companies that wish opt for Section 115BAA of the Act should exercise their option under Section 115BAA of the Act on or before the due date specified under Section 139(1) of the Act for furnishing the return of income of the AY for which such domestic company wishes to exercise an option, commencing on or after AY 2020-21.

Relevant extract of Section 115BAB of the Act is as under:

"(7) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the first of the returns of income for any previous year relevant to the assessment year commencing on or after 1st day of April, 2020 and such option once exercised shall apply to subsequent assessment years."

On a plain reading of the provisions of Section 115BAB of the Act, it can be said that domestic companies that wish opt for Section 115BAB of the Act should exercise their option under Section 115BAB of the Act on or before the due date specified under Section 139(1) of the Act for furnishing the **first of** the return of income of the AY commencing on or after AY 2020-21.

Does this mean that those domestic companies that does not opt for Section 115BAB in the first year of its formation/operation but wishes to opt for Section 115BAB in the second year of its formation/operation will not be able to do so. Let's understand this by way of an example:

Domestic company was incorporated on 1 April 2020 for carrying on the business of manufacturing of an article. Now, as per Section 115BAB of the Act, if such domestic company wishes to opt for Section 115BAB of the Act then such domestic company will have to exercise option under Section 115BAB of the Act on or before the due date specified under Section 139(1) of the Act for furnishing the first return of income for AY 2021-22.

But if such domestic company does not wish to opt for Section 115BAB of the Act for AY 2021-22 and wishes to opt for Section 115BAB of the Act for AY 2022-23 then such domestic company may not be able to do so because the option under Section 115BAB of the Act should be exercised on or before the due date specified under Section 139(1) of the Act for furnishing the first return of income for AY 2021-22.

Impact of surcharge:

Domestic companies whose total turnover is less than Rs. 400 crores during the year 2017-2018 or 2018-2019 and whose total income is less than Rs. 1 crore, for such domestic companies, it may not make any sense to opt for Section 115BAA of the Act because effective tax rate as per Section 115BAA of the Act will be 25.17% (being 22% plus surcharge of 10% plus education cess of 4%) *vis-à-vis* 26% (25% plus education cess of 4%) as per Part I/Part III of First Schedule to the Finance Act, 2020.

Thus, such domestic companies will have to evaluate whether it makes sense to opt for Section 115BAA of the Act and forgo the benefit of any deduction under prescribed Sections (refer Appendix) and the benefit of set off of brought forward losses as well as unabsorbed depreciation for a benefit of 0.83% in tax rate.

Conclusion:

For existing domestic companies with total turnover or gross receipts of less than Rs. 400 crores during the year 2017-2018/2018-2019:

For such domestic companies, choice is basically between, tax rate of 22% (excluding surcharge and education cess) as per Section 115BAA of the Act and tax rate of 25% (excluding surcharge and education cess) as per Part I/Part III of First Schedule to the Finance Act, 2020.

By opting for Section 115BAA of the Act, domestic companies will not be allowed any deduction under prescribed Sections (refer Appendix) and will also not be allowed to set off brought forward losses and brought forward unabsorbed depreciation attributable to any deduction under prescribed Sections (refer Appendix). Thus, such domestic companies will have to critically evaluate whether it makes sense to forgo the benefit of any deduction under prescribed Sections (refer Appendix) and the benefit of set off of brought forward losses as well as unabsorbed depreciation for a benefit in tax rate as tabulated below:

Total income	Tax rates (including surcharge and education cess @ 4%)	
	Section 115BAA	Part I/Part III of the First Schedule to the Finance Act, 2020
Less than Rs. 1 crore	25.17%	26%
Between Rs. 1 crore to Rs. 10 crores		27.82%
More than Rs. 10 crores		29.12%
		0.83%
		2.65%
		3.95%

For existing domestic companies with total turnover or gross receipts of more than Rs. 400 crores during the year 2017-2018/2018-2019:

For such domestic companies, choice is basically between, tax rate of 22% (excluding surcharge and education cess) as per Section 115BAA of the Act and tax rate of 30% (excluding surcharge and education cess) as per Part I/Part III of First Schedule to the Finance Act, 2020.

Apparently, Section 115BAA of the Act may appear to be a better choice subject to evaluation of various aspects, some of them are listed above.

Total income	Tax rates (including surcharge and education cess @ 4%)	
	Section 115BAA	Part I/Part III of the First Schedule to the Finance Act, 2020
Less than Rs. 1 crore	25.17%	31.2%
Between Rs. 1 crore to Rs. 10 crores		33.38%
More than Rs. 10 crores		34.94%
		6.03%
		8.21%
		9.77%

For newly set up domestic companies:

Such domestic companies should evaluate the impact in light of the issues discussed above and more specifically the impact of other income before exercising option under Section 115BAA of the Act or Section 115BAB of the Act.

If such domestic companies opt for Section 115BAA of the Act solely based on the benefit of deduction against other income then such domestic companies will risk their income from 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, being taxed at the rate of 22% *vis-à-vis* 15% as per Section 115BAB of the Act.

Keeping in mind that such domestic companies will earn only income from 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, apparently, Section 115BAB of the Act appears to be a better choice.

In a nutshell, choosing an appropriate tax rate from a carton of tax rates, may really pose significant challenge and may not be that simple as it looks and will require a very careful evaluation.

Appendix:

Section/Chapter of the Act	Particulars
Section 10AA	Deduction for units established in Special Economic Zones (SEZ).
Section 32(1)(ia)	Depreciation in case of new plant and machinery which has been acquired and installed after 31 March 2005, by a company engaged in the business of manufacture or production of any article or thing or in the business of generation, transmission or distribution of power.
Section 32AC	Investment in new plant and machinery (only in a case where domestic company opts for a tax rate of 25% as per Section 115BA of the Act).
Section 32AD	Deduction for investment in new plant and machinery in notified backward areas in certain states.
Section 33AB	Deduction for company carrying on business of growing and manufacturing tea, coffee or rubber in India.
Section 33ABA	Deduction for company carrying on business of prospecting for, extraction of or production of petroleum or natural gas or both in India.
Section 35(1)(ii)	Deduction for any sum paid to a research association which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research.
Section 35(1)(ia)	Deduction for any sum paid to a company to be used by it for scientific research.
Section 35(1)(iii)	Deduction for any sum paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research.

Section 35(2AA)	Deduction for any sum paid to a National Laboratory or a University or an Indian Institute of Technology or a specified person with a specific direction that the said sum shall be used for scientific research undertaken under a programme approved in this behalf by the prescribed authority.
Section 35(2AB)	Deduction for any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility as approved by the prescribed authority, by a company engaged in the business of biotechnology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule.
Section 35AC	Expenditure on eligible projects and schemes (only in a case where domestic company opts for a tax rate of 25% as per Section 115BA of the Act).
Section 35AD	Deduction in respect of capital expenditure incurred for the purposes of any specified business (refer the definition given below).
Section 35CCC	Deduction for expenditure on agricultural extension project.
Section 35CCD	Deduction for expenditure on skill development project.

'Specified business' means any one or more of the following business, namely:

- i. setting up and operating a cold chain facility;
- ii. setting up and operating a warehousing facility for storage of agricultural produce;
- iii. laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network;
- iv. building and operating, anywhere in India, a hotel of two-star or above category as classified by the Central Government;
- v. building and operating, anywhere in India, a hospital with at least one hundred beds for patients;
- vi. developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;
- vii. developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;
- viii. production of fertilizer in India;
- ix. setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);
- x. bee keeping and production of honey and beeswax;
- xi. setting up and operating a warehousing facility for storage of sugar;
- xii. laying and operating a slurry pipeline for the transportation of iron ore;
- xiii. setting up and operating a semi-conductor wafer fabrication manufacturing unit notified by the Board in accordance with such guidelines as may be prescribed;
- xiv. developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility. ■■

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1. Conditions regarding use of plant or machinery.
 2. Conditions regarding use of any building previously used as a hotel or a convention centre.
 3. Conditions regarding nature of business.