Roadmap for phasing out of incentives released

20 November 2015

Background

The Finance Minister, in his Budget Speech of 2015 had announced a phased reduction in corporate tax rates from the current 30% rate (excluding surcharge and cess) to 25% over a four year period. It was also announced that this reduction in corporate tax rates would be accompanied by a corresponding phasing out of exemptions and deductions.

In this regard, the Government has now released proposals for public comments in which it has set out the manner in which exemptions and deductions will be phased out.

Proposed Principles for implementing the phase out of incentives

The principles that are proposed to be followed for the implementation of the phasing out of incentives are as under:

a) Profit linked, investment linked and area based deductions will be phased out for both corporate and non-corporate tax payers.
b) Incentive provisions having a sunset date will not be modified to advance the sunset date.
c) Similarly, sunset dates provided in the Act will not be extended.
d) In case of tax incentives with no terminal date, a sunset date of 31 March 2017 will be provided either for commencement of the activity or for claim of benefit depending upon the structure of the relevant provisions of the Act.
e) There will be no weighted deduction with effect from 1 April 2017

Detailed Proposals in relation to specific incentives

<u>Rates of Depreciation</u>

The highest rate of depreciation under the Income-tax Act is proposed to be capped at 60% with effect from 1 April 2017. Currently, in respect of certain assets (e.g. pollution control equipment, renewable energy equipment etc.), higher depreciation rates, including upto 100% in some cases is available.

Weighted Deduction

Currently, a weighted deduction of 150% of capital expenditure is allowed under Section 35AD in respect of cold chain facilities, warehousing facilities for storage of agricultural produce, affordable housing projects, production of fertiliser etc. It is proposed that no weighted deduction will be allowed on any specified business with effect from 1 April 2017.

Expenditure on eligible projects/schemes

Under Section 35AC of the Act, taxpayers are eligible to claim a deduction in respect of payments to public sector companies/local authorities/other approved institutions for carrying out notified projects or schemes for promoting social and economic welfare. It is proposed that no deduction under this provision will be available from financial year 2017-18 onwards.

Scientific Research Expenditure

Section 35 of the Act provides for a deduction in respect of both capital and revenue expenditure incurred on scientific research. It also allows for a weighted deduction for such expenditure in specified cases and in respect of donations made to certain institutions/associations/company for scientific research. These deductions are proposed to be capped at 100% with effect from 2017-18 onwards.

Incentives with no sunset date

In respect of the following incentives where no sunset date is provided under the Act, a sunset date of 31 March 2017 is proposed to be provided for commencement of activity:

a) Development, operation and maintenance of infrastructure facility [Section 80-IA (4)(i)].
b) Development of special economic zone (Section 80-IAB).
c) Export of articles or things or services by a unit located in a Special Economic Zone (Section 10AA).
d) Commercial production of natural gas in blocks licenced under CBM-IV and NELP VIII. [Section 80-IB(9)(iv)&(v)].
e) Commercial production of mineral oil from blocks licenced under a contract awarded up to 31.03.2011. [Section 80-IB(9)(ii)]

Expenditure on agricultural extension / skill development projects

The existing weighted deduction of 150% in respect of expenditures on notified agricultural extension projects and skill development projects is proposed to be capped at 100%

Comments

The release of policy proposals on phasing out of incentives is a milestone in several respects. It rightly indicates that the evolution of tax policy is a year-round activity and not merely an annual budget time event. Further, as noted in the Press Release, proposals may help bringing about transparency and clarity in the tax regime. Most importantly, even though some fine-tuning of these proposals may need to take place as part of the consultative process, it provides a clear roadmap for the future, which can potentially go a long way in providing certainty and stability to taxpayers.

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