TIME TO ROLL BACK MAT

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There is a paradigm shift in the concept of Minimum Alternative Tax (MAT) as envisaged under the Direct Taxes Code (DTC). As against the 'book profit' base used in the present income-tax law to levy MAT, 'gross value of assets' is proposed to be considered as the basis in the DTC.

The logic, as explained in various forums so far on behalf of the Government, is that corporate entities which have scarce economic resources at their disposal should exploit them efficiently so as to make adequate profits, failing which they must end up paying 2 per cent of the gross value of the assets as MAT.

Price on inefficiency

Only if the tax calculated on the profits made is more than the MAT can a company can avoid the tax, and not otherwise. According to informed sources, it is perceived as a liability imposed on companies for inefficiency or to discourage suppression of profits earned.

Further, the ability to invest in assets is also perceived as an indicator of the capability to pay tax. If any company finds it difficult to bear the brunt of MAT, the message is to hand over ownership and control to someone else who can manage the assets more efficiently to earn profits on which the tax liability surpasses MAT obligation.

Government, no doubt, has the prerogative to choose any criteria to determine the tax levy on a person and make it appear reasonable as well as logical. Nevertheless, the acceptability of such criteria from the perspective of the country's economic growth and taxpayer compliance needs to be examined.

Fundamentally, the 'value of assets' is a good base for levy of wealth tax, but certainly not for calculation of income-tax. Economically, this approach is detrimental to capital-intensive industries, especially infrastructure-related businesses, and puts the service sector at an advantage.

In a situation where India is striving to attract more investments and, at the same time, improve infrastructure facilities, one has to ponder the desirability of this move. The country needs to strengthen the manufacturing sector vis-À-vis China's, and this proposal in the DTC will not help achieve it. Again, there will be discrimination between similar businesses carried on by companies and unincorporated bodies such as partnership firms and LLPs which are not covered within the ambit of MAT.

Earlier, the concept of Fringe Benefit Tax (FBT), borrowed from Australia and New Zealand, was deleted by the Finance Act, 2009 after four years of implementation owing to strong resentment from taxpayers.

MAT seems to be partly borrowed from Argentina's tax code. In Argentina, however, there is allowance for the gestation period when an industry does not make profits not because of inefficiency but due to high cost of operations initially and depreciation allowance.

The rate, it is understood, is only 1 per cent against 2 per cent sought to be adopted in India for non-banking companies (banking companies 0.25 per cent). Above all, in a country where accounting standards are in vogue for about 32 years and where the revenue department has a strong mechanism for unearthing concealed income, such ad hoc introduction of MAT to make revenue collection easy will hamper growth in investment and dampen the spirit of industrialisation.

If an analysis is made with reference to certain listed companies which are in the capital-intensive field, aggregation of net block of fixed assets, capital work-in-progress, investments and current assets turns out to be substantial.

In select cases, the percentage of MAT to sales of the company works out to anywhere between 8 and 24 in which case MAT would drain those companies of their internal accruals, which otherwise normally get ploughed back into business.

Questionable rationale

Though the proposed concept may be plausible, the rationale for adopting the 'gross value' as a yardstick is questionable. It has to be 'net value' as otherwise there will be inequity between companies A and B with same gross value of assets but differently leveraged ending up paying the same MAT amount.

It is possible that A has invested own funds with hardly any debt funding whereas B might have substantially acquired the assets out of borrowings. In this example, it would be illogical to presume that the ability to pay taxes is equal only by reckoning the gross value of assets.

It is possible that B incurs losses in the initial years only because of heavy finance charges and, ironically, it would be burdened with MAT also at par with A.

Further, if this example is modified to assume that A is in a non-priority sector because of which it could not get bank funding, whereas B is in a high priority segment and gets bank lending support, MAT would prove to be counterproductive by adding to the project cost annually and may even affect its feasibility by extending its gestation period.

MAT does not provide for relief in calculation of gross value of assets in the case of holding and subsidiary companies. If there is a holding company and subsidiary company, there would be double taxation under MAT as the same amount would be included in the holding company's case as investment and in the subsidiary's case in the form of assets funded by that investment.

If there is a scenario of multiple subsidiaries, where D is a subsidiary of C, C of B, and B of A, the levy gets duplicated at multiple levels as there is no exclusion provided for.

Even when book profit is kept as an alternative base for MAT under the existing law, credit is allowed to be carried forward to be set off against tax on normal profits within 10 years. This principle of fairness is omitted in the DTC by declaring that MAT is a final tax and no credit would be allowed.

The DTC has many welcome provisions and features. The endeavour of writing the Code on a clean slate requires to be commended and the simplicity sought to be achieved appreciated. But a few areas of concern should be addressed by the Government, and MAT tops the list. One should remember that MAT found its way into tax legislation on the ground that companies showed book profit to declare dividend but returned loss for tax purpose by utilising various incentives. As the DTC has done away with all those incentives, there is no case for continuing with MAT in any form whatsoever.

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