

Mat — Before And After The Finance Bill, 2006

Entry and Exit of Book Profits Tax

Minimum Alternate Tax (MAT) has been a matter of concern for the corporate sector. It was dropped after a brief spell of three years after its introduction from A.Y. 1988-89 because of the widespread opposition to this tax. It was felt that it is not merely an alternate tax, but a multi-point income-tax, as section 115J(2) provided that what is absorbed by way of current depreciation, past losses and unabsorbed depreciation carried forward would be lost in

was incorporated in section 115J(1). But this provision was understood by revenue differently as requiring a split up between the losses and depreciation and not as understood as carried forward loss being a mass incapable of being split up, so that the amount of loss or depreciation which is less was required to be considered usually on a larger amount on the basis of company law interpretation. The narrow departmental view was overruled by the Supreme Court decision in *Surana Steels Pvt. Ltd. v. Dy. CIT* (1999) 237 ITR 777 (SC).

so as to render the decision of the Supreme Court in *Surana Steel Ltd.*'s case (*supra*) inapplicable. This Explanation in the new section 115JB(2) in the renamed MAT required losses and depreciation to be split up, so as to defeat the very purpose of the Act to tax a company having profits computed under company law, but which does not distribute such profits. To the extent carried forward loss and depreciation is not adjusted in the manner required under company law, MAT becomes not a tax on profits not distributed, but becomes applicable even to a company with eroded capital. In fact, trading companies and companies with nominal loss or depreciation find that the benefit of past loss or depreciation is hardly available. MAT was vehemently opposed by the corporate sector. Mr. N.A. Palkhivala was highly critical of the re-introduction of the tax on book profits in the following words:

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The Finance Bill 2006 is bereft of any major changes in corporate taxation. From the point of view of the corporate sector, it has reason to be disappointed with the mere dilution of Fringe Benefits Tax, and that too not to the extent to which it would have liked by limiting it to actual untaxed fringe benefits enjoyed by the employees. Same is the grievance related to Banking Cash Transaction Tax, which, however, is promised to be withdrawn in the near future. Service Tax is hiked and has now been extended to more than a dozen new services, which is likely to have a wider impact.

regular assessment, though the tax is collected on the basis of book profits tax. The second objection was that no credit was given for book profits tax in the year the base gets shifted from book profits to regular statutory base.

A major controversy which arose was the quantification of past loss or depreciation, whichever is less, following the interpretation of section 205(1) proviso (b) of the Companies Act, 1956, which

Book Profits Tax Back as MAT

True to the adage that old taxes never die, it was reintroduced from A.Y.1997-1998, but then, with the departmental interpretation of quantification of loss or depreciation, whichever is less, being statutorily recognised by substituting the company law provision in section 205 of the Companies Act, 1956 by an Explanation to the Explanation under section 115JA(2),

“The proposed Section 115JA is, in my opinion, constitutionally illegal, economically unsound and morally repugnant. It violates Article 14 of the Constitution in as much as (a) it hits only limited companies and thus discriminates against them as compared to other categories of taxpayers, and (b) it discriminates between companies which have adopted the straight-line method of depreciation in their books and others, which

have adopted the written-down value basis. It further violates Article 19 of the Constitution because it imposes a burdensome restriction on the company's right to carry on business and account for its profits to its shareholders in its own way - which restriction is neither reasonable nor in the public interest".

But such resistance was sought to be mollified by the next Finance Act bringing in limited tax credit to be absorbed in five years under section 115JAA for the MAT tax against regular tax payable in a later year. Even so, the restricted set off on one hand and the assumed absorption of past losses and depreciation against regular income even when the tax is paid on book profits, continued to be irritants.

New MAT for Old

The half-hearted credit allowed for MAT paid under section 115JA was sought to be nullified by reframing the MAT in a new garb by substitution of section 115JA by section 115JB barring the right of credit in respect of MAT paid under section 115JB. Apart from the object of withdrawal of credit, the other object apparently was to withdraw the deduction for new industrial undertakings covered under section 80IA and 80IB, which were allowed under section 115JA but left out in section 115JB. Even the benefit of deduction of income from investments in infrastructure industries though falling under Chapter III was excluded for reasons which were not apparent, but described as an incident of rationalising process as "explained" in the Memorandum accompanying the Finance Bill, 2000 substituting section 115JB for section 115JA.

While the meaning of infrastructure for purposes of section 80IA relief is proposed to be extended in the Finance Bill, 2006 to cover building and developing a housing project as well as construction of a hotel of not less than Three Star category, deduction for infrastructure capital fund and infrastructure capital company proposed for withdrawal of concession even in regular assessment is incomprehensible, while this incentive deduction was removed from A.Y.2005-2006 itself in computation of book profits under section 115JB.

Proposals in the Finance Bill, 2006

Since the Finance Act, 2005 has reduced the depreciation rates enhancing the statutory income, while Fringe Benefit Tax, though not deductible in regular assessment, can reduce book profits. More cases should have fallen out of the MAT net, but then it will now be made good by increase in the rate from 7.5% to 10%. Further, long term capital gains falling under section 10(38) will be liable for MAT. Inclusion of such long-term capital gains, which is a balance sheet item and not part of the operating profits amounting to capital accretion, should not have been even otherwise included. But then, this provision limited to long term capital gains from sale of shares and units even for MAT, should mean that the legislative intent is that all capital gains cannot be included before A.Y.2007-2008, settling a long-standing controversy in favour of the taxpayer.

The sop for MAT liability under section 115JB was the revival of credit for MAT tax paid under section 115JB against regular assessment from A.Y.2006-2007 for five

years as was available for tax paid under section 115JA, but the Finance Bill, 2006 now proposes to extend it to seven years.

Another Departure from Company Law

Another amendment proposed in the Finance Bill, 2006 is to nullify the Supreme Court decision in *Apollo Tyres Ltd. v. CIT* (2002) 255 ITR 273 (SC), which had held that the option available under company law for a change in the method of depreciation consequent on revaluation of assets permissible under company law available for book profits tax as well with effect from A.Y.2007-2008. It is therefore yet another decision of the Supreme Court after *Surana Steels Pvt. Ltd. v. Dy. CIT* (1999) 237 ITR 777 (SC), which was nailed in section 115JA.

Liability of Foreign Companies for MAT

The ruling of Authority for Advance Ruling in P.No.14 of 1997 In re (1998) 234 ITR 335 (AAR) and *Nicco Resources Ltd. v. CIT* (1998) 234 ITR 828 (AAR) is that foreign companies are also liable for MAT. Many of the provisions relating to computation of income under Part II and III of Schedule VI of the Companies Act, 1956 and the requirement that the book profits would be on the basis of the accounts laid before the annual general meeting should ordinarily rule out such application. But then, sub-section (4) of section 115JA had made a provision, which is absent under section 115J, to the effect that all other provisions for the Income-tax Act will apply to an assessee being a company, "save as otherwise provided in this section". This is repeated in section 115JB(5). If the intention is to make foreign compa-

nies liable, the mode of computation of book profits in absence of the accounts as required for domestic companies would have to be indicated, while a warning as to the prospect of MAT is required for foreign investors including Foreign Institutional Investors, welcomed as a part of the globalisation process. This aspect of the matter has not been resolved even in the present Finance Bill.

What Next?

Corporate sector, because of MAT, suffers tax incidence more than other classes of assesseees, whether they are individuals, Hindu Undivided Families or firms. It is corporatisation, which should help to bring businesses and industries under corporate discipline. In the light of this objective, even if it is not possible to give any concessions to corporations, one would have thought, that it is time that the first steps are

taken to reduce the degree of discrimination, so that business does not get out of companies. In any reform of corporate taxation, MAT should be the first liability to be discarded. Dividend taxation should be the next target, because it is a double tax on corporate profits even as recognised in Singapore. It is also necessary that the distortion of real income by artificial provisions deeming incomes and disallowances, besides taxes like FBT, would require to be dismantled, so that the stage is set for adoption of audited income computed under company law as the base for income-tax law as well. Rigid enforcement of Accounting Standards and company law regulations would appear to be necessary for such reform, since this alone could pave the way of the much-professed objective of simplicity making compliance easier and tax avoidance, rendered difficult, if not impossible. □

