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No. 08, Arul Nagar, Seera Thoppu,

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Tiruchirappalli – 620102

Phone : +91 94896 71437 - info@iledu.in / Chairman@iledu.in

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A CRITICAL STUDY ON MINIMUM ALTERNATIVE TAX IN INDIA

AUTHOR - RAGHUNATH, M, LL.M (TAXATION LAW), SCHOOL OF EXCELLENCE IN LAW, TAMIL NADU DR. AMBEDKAR LAW UNIVERSITY, CHENNAI

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Abstract

Minimum alternate taxation is a measure taken by the legislature to address the issue that companies which declare high profits, but pay low or no taxes ('zero-tax' companies). Parliament has experimented with numerous approaches to legislate MAT since 1983 and continues to do so in the proposed Direct Tax Code. This paper shows the various changes made in MAT regime over the years and the interpretational problems that have arisen with provisions of MAT credit, advance payment and calculation of book profits. It then considers the demerits of this taxation regime with reference to the economic effects of the burden of this tax, and the attendant compliance and record-keeping costs. With this in mind, this paper argues that the MAT regime should be modified and puts forth two proposals for reform.

Keywords: Minimum Alternative Tax, Companies, Book profits, Zero tax companies

INTRODUCTION

Normally, a company is required to pay tax on income computed by the rules of the Income Tax Act, but the profit and loss account is made in compliance with the provisions of the Companies Act. There was a huge number of companies who had book profits as per their profit and loss account but they were not paying any tax because income computed as per provisions of the income tax act was either nil or negative or insignificant. In such cases, the companies were not paying any income tax. These companies are popularly known as " ZeroTax companies".

Over the last two decades, Parliament has experimented with various approaches to address the issue of disproportionately low tax revenue collected from highly profitable companies. The major cause of this problem is not tax evasion nor a lack of adequate government enforcement, but the statutory features of the tax system – incentives, deductions, and exemptions. These policies have made it possible for companies to greatly reduce their taxable income, which leads the observers to coin the phrase 'zero-tax' companies. Parliament has responded by amending the Income Tax Act, 1961 ('ITA') and introducing the Minimum Alternate Tax ('MAT') concept. MAT is a clause of indirect tax laws that restrict tax exemptions granted to businesses, requiring them to pay a minimum amount of corporate tax to the government.

This paper analyses the MAT regime in terms of its legal and economic effects in the present scenario. In Part II this paper delves into the history of MAT regime and the objective of MAT for which it is brought and in Part III, this paper examines the problems with the MAT regime. Finally, in Part IV proposes two solutions that could replace the present regime for corporate taxation.

II. BACKGROUND OF MINIMUM ALTERNATIVE TAX REGIME

The concept of MAT was introduced under the income tax act to tax 'zero tax' companies, i.e., companies that make high book profits and declaring substantial dividends to shareholders but not paying tax to the Govt by taking advantage of the various incentives provided therein in the form of a liberal rate of depreciation, sector and region-specific

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exemptions provided in the Income-tax Act. MAT is in consonance with a fundamental canon of taxation– all entities must be taxed in proportion to their ability to pay[991].

The first legislative step taken by the government in addressing the problem of Zero tax companies was made in 1983, with the addition of provision 80VVA to the ITA[992]. Sec.80VVA provided that the aggregate number of deductions that a company could make in one year could not exceed 70 percent of the pre-incentive total income[993]. In effect, there was a ceiling on the total amount of incentives or allowances that a company was allowed to avail of in a given assessment year. However, allowed companies to carry forward these unabsorbed allowances of the previous year and set off against taxable income in the future assessment year[994]. This provision, however, proved to be unsuccessful in preventing companies from avoiding tax liability[995]. In 1987, this provision was replaced with §115J, by which, the quantum of taxable income was determined concerning the 'book profits' for the first time.

Book profits were defined as "the net profit as shown in the profit and loss account for the relevant previous year"[996] as determined by the provisions in Parts II and III of Schedule VI to the Companies Act, with certain positive and negative adjustments. Depreciation losses also had to be calculated per the Companies Act's provisions. Thus, the concept of 'deemed total income' was introduced. Under §115J, if the total taxable income of a company is less than thirty percent of its book profit, the total income of such assessee chargeable to tax for the relevant previous year shall be deemed to be an amount equal to thirty per cent of such book profit. Now the companies had to maintain two sets of accounts– one for calculating total taxable income under the general provisions of the ITA and the second one for book profits under the provisions of the Companies Act. At the end of the year, companies were liable to pay tax on the amount calculated under the general provisions of the ITA or on the book profit calculated under the 115J regime whichever is higher. However, this provision was repealed in the 1990 finance act.

Again, the concept of MAT was re-introduced in 1997 vide Sec.115JA, in a modified form, introducing the concept of 'MAT credit'. A new tax credit scheme is introduced by which MAT paid can be carried forward for set-off against regular tax payable during the subsequent five- year period subject to certain conditions, as under: -

When a company pays tax under MAT, the tax credit earned by it shall be an amount that is the difference between the amount payable under MAT and the regular tax. MAT credit will be allowed to carry forward for a period of five assessment years immediately succeeding the assessment year in which MAT is computed[997].

These provisions were eventually replaced by §115JB in 2000, which is the provision of law embodying the current MAT regime. Sec.115JB is a complete conceptual change from 'deemed total income' to 'deemed tax' on book profits which means the previous regimes focused on the determination of minimum deemed income to be taxed under the prevailing slab rate, but the new regime under Sec.115JB emphasized computing the minimum deemed tax. As per section 115JB (1), every company shall liable to pay a Minimum Alternate Tax. If its tax on total income, computed at the normal rate, is less than 15% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the company shall be 15% provided that the previous year relevant to the assessment year commences after 1st April

[991] Adam Smith, Wealth of Nations 499 (2007)
[992] Finance Act, 1983
[993] ITA, Sec.80VVA (1)
[994] ITA, Sec.80VVA (3)
[995] Rajiv Gandhi, Union Minister of Finance, Budget Address before the Lok Sabha: Union Budget for the Year 1987-88, (February 28, 1987); Also quoted in Apollo Tyres LTD v. Commissioner of Income Tax, (2002) 9 SCC 1: [2002] 255 ITR 273 (SC).
[996] ITA, Sec.115J (1A)
[997] ITA, Sec.115JAA(3).

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2020. Sec.115JB does not apply to the income from any business carried on in or any services rendered by a company in a Special Economic Zone.

The current MAT regime under the Income tax act is similar to the US Alternate MinimumTax ('AMT'). The MAT regime under ITA was introduced by the legislature to ensure that "no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions and credits"[998]. It is pertinent to note that US AMT applies to 'all taxpayers' including individuals and companies. In contrast, the provisions of MAT under the ITA extend only to companies and limited liability partnerships[999]. A taxpayer is liable to pay under the AMT regime if the Tentative Minimum Tax ('TMT') is more than the 'regular taxable income' for a particular year. The starting point for the calculation of the TMT is the regular taxable income itself[1000]. This income is recalculated through various 'adjustments' and 'preferences' mentioned under the provisions of the Internal Revenue Code[1001]. One of the most important adjustments is made through the process of ('BUP') business untaxed reported profits and ('ACE') adjusted current earnings. Both these adjustments entail an addition of a certain percentage of the difference between its tentative adjusted minimum tax income and its net book income, to the calculation of the minimum tax income.

As will be seen, the TMT is a parallel of book profit under the Companies Act in the Indian MAT system, although they may differ in their computation. The intention of the taxation regime in both jurisdictions is, however, the same to curtail the benefits of various exemptions and deductions if they result in little or no tax liability.

III. ISSUES ARISES FROM THE CURRENT MAT TAX REGIME

A. DIFFICULTIES IN COMPLIANCE AND RECORD KEEPING

As outlined above, the introduction of MAT requires companies to calculate their taxable income by both the general provision of the ITA and through the company's act provisions. This increases the costs of record-keeping and compliance for companies. When the AMT was introduced to companies in the US, studies showed that firms spent 18 percent more on compliance costs where such tax applied to them[1002]. In India as well, MAT is identified as a 'legal hot spot' that increases the costs of compliance[1003].

This is further complicated by the fact that all companies that are liable to be taxed under Sec.115JB are also liable for payment of advance tax[1004]. Therefore, these two sets of accounts must be maintained and submitted periodically by a company over the year and, they can be subject to penalties for default of such payments under Sec.234B and Sec.234C. In addition, liability under the MAT has prompted companies to post lower profits by changing their accounting policies[1005]. These accounting practices would undoubtedly hurt companies, investors and stakeholders because displaying lower book profits lowers their reputation with potential investors and shareholders who do not receive adequately accurate information regarding the financial operation of the company.

B. ADVERSE EFFECT ON INDIAN ECONOMY

Another problem with MAT is that it creates unintended adverse effects on investment. Some companies show 'zero' or tax

[998] House Ways and Means Committee Report and Senate Finance Committee Report, S.Rep. No. 313, 99thCong., 2nd Sess.518 (1986); H.R.Rep. No. 426, 99th Cong., 2nd Sess.305-06 (1985).
[999] ITA, Chapter XIIB.A, Sec. 115JC-115JF, by Finance Act 2011, w.e.f. April 1, 2012.
[1000] John M. Janiga, Corporate Alternative Minimum Tax: A critique and exploration of Alternatives, 20 Loy.U.Chi. L.J. 21 (1988-1989).
[1001] Internal Revenue Code, 1986, §56, 57 and §58.

[1002] M. Gujarathy & S.K. Barua, Minimum Alternate Tax in India: Lessons to be Learnt from the Foreign use ofAlternate Minimum Tax, 24 Int'l Tax J. 65 1998.
[1003] Arindam Dasgupta, The Income Tax Compliance Cost of Corporations in India, 2000-01, available at http://ssrn.com/abstract=466041
[1004] Central Board of Direct Taxes, Circular on Section 115JA/115jb/Minimum alternate tax (No. 13 of 2001),November 9, 2001

[1005] Money Illusion, Economic Times, May 13, 1997

liability are highly capital intensive and can avail of tax deductions through the depreciation of machinery and goods in the initial years. These companies make high investments and are crucial to the economy and in providing employment. These companies also pay high indirect taxes like customs duty, excise and VAT[1006]. Due to the introduction of MAT, however, these companies are faced with a higher tax burden. This in turn disincentives high investment in capital goods, which is crucial for economic growth. Moreover, previously under Sec.115JA, profits derived by industrial undertakings from the business of developing, maintaining and operating any infrastructure facility covered by Sec.80-IA, were exempted from computing book profits. Under the current

Sec.115JB, however, this exemption has been removed. Further, companies with low depreciation who are making consistent losses will have to pay MAT despite heavy carry-forward losses. Companies with high depreciation will be liable for MAT in the year in which there is net profit after depreciation irrespective of the fact of heavy unabsorbed depreciation[1007].

C. COMPANIES TO PAY BOTH ADVANCE TAX AND MINIMUM ALTERNATIVE TAX (MAT)

Under the ITA, every assessee is required to pay an advance tax on their income if advance tax liability as computed in accordance with the provisions of Chapter XVII of the ITA, is Rs. 10,000 or more during the financial year. One of the interpretational issues that has arisen with respect to Sec.115JB is whether companies that pay MAT are liable to pay advance tax. Companies that make default in the payment of advance tax are subject to penalties under Sec. 234B and 234C of the ITA.

The Karnataka High Court, in Kwality Biscuits Ltd. v. Commissioner of Income Tax[1008], held that the penalties prescribed under Sec.234B and 234C do not apply where a company pays the MAT. It held that since the exercise of computing income under §115JA can only be done at the end of a financial year, the provisions relating to advance payment of tax were not applicable. This is because until accounts are audited and balance sheets prepared, the assessee will not be able to determine whether Sec.115JA is applicable or not[1009].

Central Board on Direct Tax issued a Circular No. 13/2001 on 9-11-2001 clarifying that all companies are liable for payment of advance tax under the new MAT provisions of S. 115JB of the Act. It is abundantly made clear in the said Circular that the new provisions of S. 115JBas introduced by the Finance Act, 2000 are a self-contained Code. Ss. (1) lays down the manner in which income-tax payable is to be computed. Ss. (2) provides for computation of 'book profit'. Ss. (5) specifies that save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company mentioned in that section. The Circular clarifies that except for substitution of tax payable and the manner of computation of book profits, all the provisions relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of the provisions of this Section. The Circular further goes on to explain the scheme of the Income-tax Act. S. 4 of the Act charges to tax the income at any rate or rates which may be prescribed by the Finance Act every year. S. 207 deals with liability for payment of advance tax and S. 209 deals with its computation based on the rates in force for the financialyear, as are contained in the Finance Act. The first proviso to S. 2(8) of the Finance Act, 2001 provides that tax would be payable by way of advance tax in respect of income chargeable u/s.115JB as introduced by Finance Act, 2000. The Circular clarifies that consequently the provisions of S. 234B and S. 234C for interest on default in

[1006] Ganesh Raj, Mat: A Strong Case for Abolition, Mint, June 25, 2009.
[1007] Ibid.
[1008] (2011) 2 SCC 415 :(2006) 284 IT 434 (SC).
[1009] Jindal Thermal Power Co. Ltd v. ITR (2000) 243 IT 519 (Kar.).

payment of advance tax and deferment of advance tax would also be applicable. This was the view taken by the Karnataka High Court in the case of Jindal Thermal Power Co. Ltd[1010] in the context of S. 115JB.

IV. SUGGESTION AND CONCLUSION

As discussed above, the MAT regime has raised significant problems in terms of the burden of tax and the difficulties in compliance and recordkeeping. Companies are required to maintain two sets of accounts and submit them periodically in order to pay advance tax. It is a basic canon of taxation law that procedure of taxation must be certain and clear. The present MAT regime falls short in this regard. In order to address the problems this paper proposes two solutions.

1. The first is to abolish MAT or reduce the tax incentives and make the depreciation provisions (depreciation rate) in the ITA in par with the Companies Act.

The problem of 'zero-tax' companies is a result of exemptions, deductions and allowing high rates of depreciation for certain industries. One way to address this problem is to increase the tax base of companies so that their taxable income increases. The high rate of depreciation under the ITA, is a significant cause for the reduction of tax base. Depreciation can be claimed by any company irrespective of its output or location, and hence, covers a greater number of companies than Special Economic Zones, tax holidays or export promotion measures. The rate of deprecation under the ITA is much higher than the rate of depreciation that can be claimed under the Companies Act. The tax base can be significantly increased if the rate of depreciation is brought on par with that in the Companies Act.

In addition, the number and extent of deductions and exemptions given to companies should be reduced. The Kelkar Committee has also recognized this as a problem, and has suggested that the MAT regime be abolished and the procedure for taxation be simplified by a reduction in the exemptions and deductions granted to companies[1011]. These changes will result in an increased tax base and a reduction in the amount of exemptions that companies may avail thus, address the problem of zero-tax companies without resorting to a MAT system.

2. The second is to have a separate legislation for corporate taxation based solely on book profits. Certain incentives, deductions can be provided to certain particular sectors if the State desires for state development. These two proposals are explored in detail below.

As show above, one of the main difficulties with MAT is the maintenance of two different sets of accounts for determining taxable income. These two accounts, moreover, must be submitted periodically for the payment of advance tax as well as at the time of filing final income tax return. Thus, the corporate taxation regime has become much more complicated and irrational. The corporate taxation regime can be simplified and made more rational, either by eliminating MAT and simplifying the existing ITA with less deductions, incentives and with broad tax base or to scrap the ITA, as is applicable to companies, and to have separate legislation for corporate taxation based only on book profits. This would have the advantage of reducing the confusion and cost of compliance with MAT and also can be modified to allow certain tax incentives in the form of deductions, exemptions in order to promote a particular sector of an industry or backward region and it can also invite foreign direct investment and growth of domestic companies.

[1010] Ibid.

[1011] Report of the Task Force on Direct Taxes, November 2, 2002, available at www.finmin.nic.in/kelkar/Full_Report.pdf (Last visited on Mar 24, 2023)