AmCham's Submissions on MAT

1. Background and legislative history

The MAT provisions provide that in the case of a company, if the tax payable on the total income as computed under the Act (hereinafter referred to as "normal provisions") in respect of any previous year is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of the taxpayer and the tax payable for the relevant previous year shall be 18.5% of its book profit.[1] Explanation 1 to sub-section (2) of section 115JB provides (hereinafter referred to as "Explanation") that the expression "book profit" means net profit as shown in the profit and loss account prepared in accordance with the provisions of the Companies Act as increased or reduced by certain adjustments, as specified in the Explanation.

As per the Finance Act 2015, a new clause i.e. clause (iid) has been inserted in the Explanation. The new clause (iid) provides that while calculating the book profit, the following shall be reduced from the net profit as shown in the profit and loss account:

> *the amount of income accruing or arising to an assessee, being a foreign company, from,-*
>
> *(A) the capital gains arising on transactions in securities; or*
>
> *(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,*
>
> *if such income is credited to the profit and loss account* ***and the income-tax payable thereon in accordance with the provisions of this Act, other than the provisions of this Chapter, is at a rate less than the rate specified in sub-section (1); [Emphasis added]***

Before we delve into the issue on hand, it is important to carefully consider the history of MAT. Such tax was, for the first time, introduced in the form of section 115-J, by the Finance Act, 1987, with effect from assessment year 1988-89. The Finance Minister, in his budget speech; and also the "object's clause" relating to the said section, clearly brought out the rationale for introducing MAT as a measure to nullify the approach of certain companies of reflecting significant profits in their books of account prepared under the provisions of the corporate laws, thus ensuring prosperity in stock markets and other areas, yet managing their tax affairs in a manner that they paid nil or insignificant taxes. Section 115-J, amongst others, also provided that the book profit, with reference to which MAT was leviable, was required to be arrived at in accordance with the provisions of the Companies Act, a condition, which has permeated through the decades in sections 115-JA and 115-JB as well, with certain further safeguards. *Incidentally, in his budget speech, the erstwhile Finance Minister went a step ahead to mention that the relevant provisions were intended to apply to widely held companies, thus clearly manifesting the legislative intent of targeting companies, who would have otherwise obtained mileage from various stakeholders of the economy through reflecting healthy profits in its accounts, while managing its taxation affairs in a manner so as to pay nil or negligible taxes.*

It is well settled by a plethora of rulings of the Supreme Court that the budget speech of the Finance Minister; "notes on clauses"; and "object's clause" of Finance Bills, are tools of interpretation of statutes, as they manifest the legislative intent in enacting statutes. Thus, the legislative mandate and intent for introducing and restoring MAT over a period of more than two decades, were always loud and clear that companies, who could have otherwise obtained mileage from shareholders and other constituents of the economy, including stock market, by reflecting

[1] For the sake of simplicity, the surcharge and cess have not been considered in this petition

health and prosperity in the accounts prepared under the mandate of the corporate laws of the country, while paying nil or negligible income tax, either through aggressive tax planning or obtaining fiscal incentives, running contrary to the entries in the accounts prepared for such corporate obligation, were sought to be covered under MAT.

Also, the CBDT circular No. 794 of 2000 which explained the MAT provisions wherein CBDT arrived at the effective rate by multiplying 30 per cent of the Book Profits by the normal corporate tax rate of 35 per cent, which was the rate of tax applicable to domestic companies only. In the relevant year, the rate of tax applicable to foreign companies was 48 per cent. Taking cue from the Circular it can be reasonably construed that the effective rate of MAT was worked out with reference to domestic companies only.

Foreign companies, like FIIs, who merely traded on the stock markets of the country, without having any establishment in India; and had no obligation to prepare accounts under the corporate laws of the country; and accordingly no propensity to obtain mileage from shareholders and other stakeholders, being the one and only objective for introducing the concept of MAT, never had any liability whatsoever to MAT, irrespective of whether or not their incomes from buying and selling shares were exempt from income tax under section 10(38). Indian companies, enjoying capital gains exemption under section 10(38), still have to pay MAT, as expressly provided by the said section, as per the very philosophy of introducing the concept of MAT, as discussed above, however, not FIIs, since they were never intended to fall under the ambit of MAT in the first instance.

The concerns arising out of above amendment are discussed below:

2. Applicability of amendment based on tax rates

As a general principle MAT provisions are applicable if the income tax liability as per the normal provisions is less than the tax liability computed as per the MAT provisions. Thus, the scheme of MAT provisions is based on comparison of amount of tax liability and not the applicable tax rate. However, the above-mentioned amendment requires the comparison of applicable tax rate and thus, the exclusion from MAT is available only if the tax rate applicable on the specified nature of income is less than MAT rate (18.5%). Such a comparison is not in sync with the scheme of MAT provisions and is creating unintended results, discussed subsequently. Secondly, the comparison of MAT tax liability with the tax liability under normal provisions in newly inserted clause (iid) is not necessary at all since such comparison is already made in subsection (1) to Section 115JB on totality basis.

It is requested that the requirement to compare the tax rate as envisaged by the amendment (last part of the amendment as extracted above (in bold)) should be omitted and the nature of income mentioned in the amendment should be allowed to be reduced, irrespective of the income tax rate applicable on such income.

Unintended results arising out of comparison of tax rates as required by Finance Act 2015

Capital gains on listed securities

The default tax rate on long-term capital gains is 20% (with the benefit of indexation as per the second proviso to Section 48). However, in case of listed securities (other than those that may qualify under section 10(38) and units of mutual fund), proviso to Section 112 gives the taxpayer an option to apply the tax rate of 10% (without availing the benefit of indexation). In case the taxpayer opts for 10% rate, the MAT provisions may not apply (since the tax rate of 10% is less than 18.5%). However, if the taxpayer opts for 20% (on the basis that tax liability by applying 20% rate with indexation is less than 10% without indexation), the MAT provisions may be triggered. Thus, the benefit extended by proviso to Section 112 is withdrawn (to a large extent) by the amendment. Also, it creates an artificial distinction between the taxpayer which opts for proviso to Section 112 and which does not opt for such proviso.

To illustrate the above problem, let us take the following facts:

Listed securities acquired in previous year 2000-01 INR 100

Sales consideration (in previous year 2014-15[2]) INR 280

Cost inflation index (CII) for FY 2000-01 is 406 and for FY 2014-15 is 1024

Capital gains

Tax liability under MAT provisions

Book profit (INR 280 – INR 100) * 18.5% INR 33.3

Tax liability under normal provisions

	20% with indexation benefit	**10% without indexation benefit**
Sales consideration	280	280
Indexed Cost of acquisition (100 * 1024/ 406)	252	
Cost of acquisition		100
Capital gains	28	180
Tax liability @ 20% / 10%	5.6	18

Now since the tax liability with 20% rate with indexation benefit (INR 5.6) is lesser than the tax liability with 10% rate without indexation benefit (INR 18), the taxpayer may wish to choose the former. However, in such a case the MAT provisions will get triggered and the tax liability will increase to INR 33.3.

Accordingly, it is requested that the requirement to compare the tax rate as envisaged by the amendment (last part of the amendment as extracted above) should be omitted and the nature of income mentioned in the amendment should be allowed to be reduced, irrespective of tax rate applicable.

The suggestive amendment would read as under:

the amount of income accruing or arising to an assessee, being a foreign company, from,-

(A) the capital gains arising on transactions in securities; or

(B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,

if such income is credited to the profit and loss account; or

3. Amount of capital gains to be reduced

[2] FY 2014-15 has been taken since CII for FY 2015-16 is not yet available

The amendment inter alia provides that while computing the book profits, the capital gains arising on transaction of securities needs to be reduced if such income is credited to the profit and loss account and the income-tax payable thereon in accordance with the Act is at a rate less than 18.5%. The reference to the income-tax payable thereon gives an impression that the amount to be reduced is the amount computed as per the provisions of the Act. On the other hand, the amount credited / debited to the profit and loss account is computed as per the accounting standards / principles, which may not be the same as the amount computed as per the Act.

Accordingly, it is suggested that either it should be clarified that the amount to be reduced is amount actually credited to the profit or loss account or alternatively, the reference to income-tax payable thereon should be omitted (this point is already discussed in paragraph # 2 above).

4. Presumptive tax regime

The Act contains various provisions which provides for presumptive tax regime for non-residents (for instance Section 44BB). The rationale for introducing such regime is to provide simplification in computation of income. For instance, Memorandum explaining the Finance Bill 1987 (which introduced Section 44BB) states as under:

> "*The computation of the taxable income of a taxpayer engaged in business of providing services and facilities in connection with, or supplying plant and machinery on hire, used or to be used in the exploration for, and exploitation of, mineral oil involves a number of complications.*
>
> *As a measure of simplification, the Bill seeks to insert a new section 44BB in the Income-tax Act providing for determination of income of such taxpayers at ten per cent...*"

The corporate tax rate applicable on foreign companies earning the nature of income covered by such provisions continue to be 40%. For instance, the Section 44BB deems the taxable income to be 10% of the gross receipt and applying the corporate tax rate of 40%, the effective tax rate comes out to be 4%. However, on account of captioned amendment, such taxpayers may also be covered by the MAT provisions (since the tax rate is 40% which is more than the MAT rate of 18.5%). The intention of introducing the presumptive tax regime would be defeated.

Accordingly, it is suggested that the taxpayers covered by the presumptive tax regimes should be excluded from the purview of the amendment.

5. Applicable years

The above-mentioned amendment is applicable from assessment year 2016-17 (i.e. previous year 2015-16). The Finance Bill 2015 as well as Memorandum to Finance Bill indicates that the MAT provisions are not applicable to Foreign Institutional Investor (FII). This indicates the tax policy of the Government. There is no rationale for implementing this policy merely from assessment year 2016-17 onwards and not for earlier years. Accordingly, it is requested that the abovementioned amendment should be applicable from the date from which MAT provisions came into effect.

6. Capital gains exempt under Section 10(38) of the Act

Section 10(38) of the Act exempts the long-term capital gains arising from transfer of equity shares in a company or units of an equity oriented fund or units of a business trust, which has been subjected to securities transaction tax (STT). However, such capital gain is subject to MAT provisions. The existing provision (clause (ii) of Explanation) provides that while calculating the book profit, the following shall be reduced from the net profit as shown in the profit and loss account:

> *the amount of income to which any of the provisions of section 10 (other than the provisions contained in clause (38) thereof) ….*

Thus, the existing MAT provisions require the incomes which are exempt under Section 10 to be reduced from the profit as per P&L account while calculating the book profit. However, the capital gains exempt under Section 10(38) is not permitted to be so reduced.

The captioned amendment (by way of inserting new clause (iid) now seeks to exclude all capital gains arising from transactions in securities from the MAT provisions (subject to condition of tax rate as discussed in point # 2 above), without making any distinction whether it is exempt or not. Accordingly, there may be conflict between the amendment and the existing provisions. In order to avoid unnecessary litigation on this issue, the law should be clarified / amended to provide that the amendment should also be applicable to the capital gains referred to in Section 10(38) of the Act.
