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Code puts firms on the MAT again

Exemptions cut, so incidence increases

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It would be prudent to hold the cheer.

The proposed reduction in corporate tax rate from 30% to 25% in the new direct tax code is only one side of the story.

The cut has been offset by a reduction in exemptions and the dreaded change in the minimum alternate tax (MAT), which would hit companies that have to invest heavily in their businesses.

So who benefits? Companies in the fast-moving consumer goods (FMCG), logistics, and pharmaceuticals spaces gain, while information technology companies take a hit, in the long run.

"The tax incidence for corporate India will increase under the draft income-tax code," said Ajay Parmar, head of research, institutional equities at Emkay Global Financial Services, "even though the code has simplified the calculation of income or profits from business".

Tax consultants Nishith Desai & Associates says, while there are a number of constructive measures, these have been overshadowed by the negative ramifications of certain provisions.

Experts said the treatment of various incomes of a company has been changed and hence, the tax thereon would be different.

For instance, income from business assets would be termed as business income and that from investment assets would be known as capital gains, instead of being classified as other income.

Also, Parmar points out, "Profit on sale of business capital asset/ slump sale will be treated as business income (currently treated as capital gains)."

Some of these changes will have an adverse effect on both Indian and offshore mergers & acquisitions involving Indian subsidiaries," the Nishith Desai & Associates report said.

"Currently, subject to certain conditions, the transfer of shares of an Indian company, pursuant to an offshore merger of two foreign companies, is tax exempt. Due to a possible drafting error, such transfer of shares would not qualify for the tax exemption under the code," the report said.

But the biggest concern is with respect to MAT, which companies would have to pay based on assets, not book profits, at the rate of 0.25% for banks and 2% for others.

Sudhir Kapadia, head of tax & regulatory services at KPMG, said MAT would apply to fixed assets and so it is expected that capital intensive companies will suffer higher tax because of MAT, in spite of the corporate tax rate being proposed to be reduced to 25%.

"FMCG and service companies would benefit as the base is poor. Surely MAT is a concern," Kapadia said.

Surendra Goyal and Vishal Agarwal, analysts with Citigroup, said the code substitutes profit-linked incentives by a new scheme that applies to nine areas.

"This is contrary to the new scheme contained in the code which will continue to apply to existing situations (grandfathering clause), where a new rule will apply to all future situations," Goyal and Agarwal said in a note on Thursday.

Income from new special economic zones (SEZs) will not be exempt from tax and existing SEZs will continue to enjoy the benefits till the expiry of the benefit period, Parmar said.

The information technology sector, too, may not give its thumbs-up to the code as the profit-based incentive structure suggested would adversely impact it in the long-run.

Such being the case, it's anybody's guess what will actually show up in the final document after an expected series of
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