Business Standard

A tale of two taxes

The trajectories of corporate and minimum alternate tax do not reveal tax policy rationale

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An unwarranted result of the growing complexity of corporate tax is decline in revenues reflecting tax incentives and tax avoidance through transfer pricing and questionable corporate structures. No matter how streamlined at the outset, the corporate tax acquires concessions over time for a focused interest group with financial clout. The minimum alternate tax (MAT) has been popular among policy-makers of different governments as an antidote. Internationally, various MAT bases have been used including gross assets, sales or turnover. In India, it is a particularly defined book profits.

By improving tax contribution, MAT enables movement closer to the original intention of the law. MAT averages out the effective tax rate, thus keeping the marginal tax rate low. It, therefore, improves efficiency by minimising allocative distortions. It also improves equity by requiring all companies to pay near the average tax rate and helping eliminate zero tax companies.

MAT is a tax presumably imposed to collect correct corporate income tax (CIT) revenue. Thus, when the CIT rate declines, so should the MAT rate, and vice versa. To explain, when government lowers CIT rates, its intention should presumably be to leave more resources with taxpayers. Accordingly, a lower MAT should suffice to garner close to the new, lower, expected CIT revenue.

Both the CIT and MAT series have changed frequently since the MAT's inception through the Finance Act, 1987, at 15 per cent of book profit **(1)**, in the background of a 50 per cent CIT rate. Unfortunately, space constrains elaboration. Suffice it to say that, from AY 1988-89 to AY 2021-22, the MAT rate changed eight times — including abolition and reintroduction — the CIT rate nine times, surcharge 15 times, cess twice, and the CIT base five times. Changes in surcharge and cess have added to the variation.

The question that arises is whether the CIT and MAT rates moved in the same or opposite

Table 1: CIT-MAT: RECENT RATES (%)

Conditions	Rates (Assessment year)				
CIT	2017-18	2018-19	2019-20	2020-21	2021-22
Total income > ₹10 crore	34.61[1/]	34.61	34.94	34.94	34.94
₹1 crore < total income < ₹10 crore	33.06	33.06	33.38	33.38	33.38
Total turnover < ₹5 cr in FY '14-15	31.96	–	–	–	–
Total turnover < ₹50 cr in FY '15-16	–	27.55	–	–	–
Total turnover < ₹250 cr in FY '16-17	–	–	27.82	–	–
Total turnover < ₹400 cr in FY '17-18	–	–	–	27.82	–
Total turnover < ₹400 cr in FY '18-19	–	–	–	–	27.82
Special taxation regime:[2/]					
Existing manufacturing companies[3/]	–	–	–	25.17	25.17
New manufacturing companies[4/]	–	–	–	17.16	17.16
MAT rate	**18.5**	**18.5**	**18.5**	**15.0**	**15.0**

1/ 34.61 = 30% + 12% Surcharge (SC) + 2% Education Cess (EC) + 1% Secondary education and higher education cess (SHEC). EC: 0.67 = [30 + (30 * 0.12)] * 0.02, SHEC: 0.34 = [30 + (30 * 0.12)]* 0.01. In AY 2019-20, EC and SHEC were replaced by Health and Education Cess (HEC): 1.34 = [30 + (30 * 0.12)] * 0.04. Other years are similarly calculated reflecting changes in CIT, SC, EC, SHEC, and HEC.
2/ GoI introduced special taxation regime on 200919; 3/ When it opts for s 115BAA; 4/ When it opts for s 115BAB.
Source: Author's calculations.

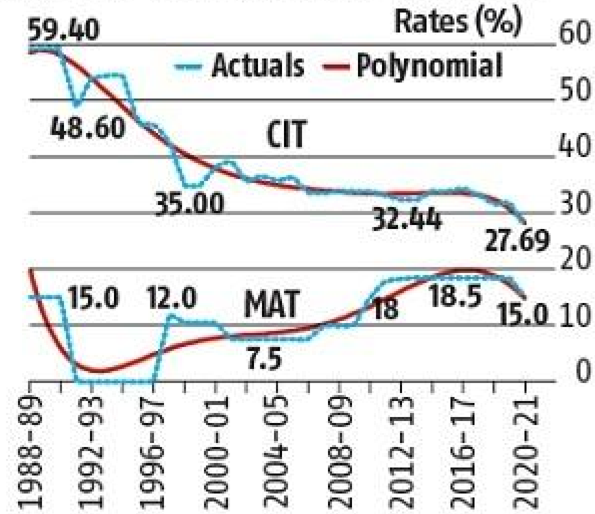
directions. Analysis of the underlying relationship that emerges between the CIT and MAT rates is not as should be expected. Figure 1 reveals that, as a polynomial trend, as the composite CIT rates (including surcharge and cess) fell over time, the MAT rate increased (except in the most recent years). This by and large defeated the government's stated intentions behind reducing CIT rate to encourage industry in those earlier years.

Table 2: RESULTS: REGRESSION MAT = C + b.CIT

Dependent Variable: MAT	Independent Variable: CIT	
	C	b
Coefficients	23.80	-0.32
95 % Confidence interval	[14.95 32.65]	[-0.54 -0.11]
Standard error	4.35	0.11
t-statistic	5.48	-3.02
p-value	0.00	0.00
R-square	0.22	

Source: Author's calculations

Figure 1. CIT-MAT: RATES OVER TIME [1/]



1/ For ease of presentation, average rates are shown when there is more than one rate in any year. Surcharge and cess are included.
Source: Author's calculations

Table 1 illustrates the CIT rates between AY 2017-18 and AY 2021-22. From 2019-20, while the intention of the underlying policy may be genuine in attempting to encourage small taxpayers and facilitate tax administration, nonetheless tax officers must face a challenge to contain tax evasion at various threshold points, and taxpayers to prove their declarations are honest.

The CIT-MAT relationship becomes clearer through a regression to test whether the CIT rate has any ramifications for the MAT rate. As already argued, the sign should be positive. However, Table 2 reveals a coefficient of (-) 0.32, that is, almost one-third of a change in the MAT rate is explained through a change in the CIT rate and that relationship is negative. The estimate is robust, so it may be safely concluded that, when the CIT rate has declined over the years, the MAT rate has increased. Possibly to stall, either erroneously or policy-driven, some of the anticipated revenue loss.

The MAT is beset with many issues. To take one example, the SEZ policy was poor and erroneous from the start. Once it was installed, however, business decisions were based on its tax promises. To include SEZs under MAT coverage retrospectively was poorer policy.

Another unresolved limitation of the MAT is its base — book profits — that has been tweaked over the years. It is dependent on declared income, hence, subject to questionable accounting practices. An advisory group on tax policy and tax administration for the Tenth Five-Year Plan, 2000-01, recommended widening the MAT base by using a mix of stock and flow concepts. It recommended that the MAT base should provide a plausible estimate of the taxable capacity of the company, reflected comprehensively in its ability to earn, and average out its ability to pay over time.

Such a base would be something other than reported commercial profits. Total assets, total sales or net worth are possible alternatives. Of these, net worth is conceptually the closest to that of income, but is narrow in base and subject to possible manipulation. Also, a minimum tax based on sales would discriminate against services while one based on total assets would work against the financial sector including banks, and heavy industry including steel and aluminium.

A possible combination of both stock and flow components would be a combination of gross assets and sales/turnover. A second option would be a combination of a percentage of net worth plus a percentage of dividends distributed. This would be economically efficient and equitable: Efficient due to its link to the minimum presumed rate of return on the owner's capital (2); and equitable as all companies would be equally unlikely to escape tax. The advisory group elucidated its proposal in detail and it would be worth revisiting it to improve MAT design.

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1. Book profit was defined as commercial profits subject to specified adjustments.
2. The greater is the performance deficit of a company, greater is the excess of the implicit tax rate on actual income over the prevailing corporate tax rate