Comments On the Proposed Direct Tax Code – By Nitesh Bhandari

I would like to give my opinion on some of the provision contained in the new direct tax code. They are as follows:

With reference to the provisions related to the Minimum alternative Tax contained in the draft of the New Direct Tax Code, the MAT tax base is expected to increase by number of folds. The code if cleared without modification would impose MAT at a rate of 2% (0.25% for any banking companies) of gross block of assets including the capital work in progress and book value any other assets after netting off the amount of accumulated depreciation and debit balance of Profit & Loss account if included in the gross block of the assets. This implies that bigger the size of the balance sheet, the higher the amount of Minimum Alternate tax to be paid.

This signifies that the capital Intensive companies (Power, Infrastructure, Oil & Gas) might have to pay higher taxes even in case of poor performance. And companies will have to pay taxes even if they are in pre-operative stage, where they have made investments but are yet to generate revenue. This will de-motivate promoters from investment in projects which take longer time to start production. To further worsen the ahead the carry forward option of credit of taxes paid as MAT is also proposed to be withdrawn.

On the contrary, in the service sector where capital investment in not on the higher side might have a benefit from this as in the initial times where the companies are still in the loss making stage might not be burdened with MAT. To be precise this provision will de-motivate Indian companies from heavy Capital & R&D expenditure and also might lead companies to lower their already penned capex plans.

For Example if we go by NHPC Limited's financial which recently hit the market with its IPO they might have tough time ahead as this code comes into effect. A small analysis with the numbers is given below

All Amounts in Rs. Crores	
Figures as on 31.03.2009	
Gross Block of Fixed Assets	28115
Capital Work In Progress	9331
Sub Total	37446
Less : Accumulated Depreciation	4409
Net Fixed Assets	33037
Investments	1791
Current Assets	5227.36
Total Assets	40055.4
Mat Liability 2% Thereon	801.107
Direct Sales For the year ended 31.03.2009	3444.78
MAT as a % on SALES	**23.26**
Profit Before Tax	1411.94
MAT as a % on Profit	56.74

This clearly sends out a message that the more you invest in business the more the tax you will have to pay to the government. It unjustifiable to tax the company based on their assets rather than the profits. In current times when India wants to bring in more of investment this will prove to be of lot of disappointment for the government. This will lead to more of investments flowing out of India into China and many other countries where the state is giving number of privileges to the investors.

Comparison of number for some other companies

All Amounts in Rs. Crores
As on 31.03.2008

Company	Unitech	Mundra Port SEZ	DLF	RIL	L & T	TCS
Net Block Of Fixed Assets	96.09	2841.83	1474.38	61883.63	2946.44	2669.08
Capital Work In Progress	7083.41	405.83	1781.79	23005.84	699	685.13
Investments	1398	1082.66	1839.83	22063.6	6922.66	5936.03
Current Assets	8749.16	1397.96	18345.94	43196.37	16496.48	9250.79
Gross Assets	**17326.66**	**5728.28**	**23441.94**	**150149.4**	**27064.58**	**18541.03**
Mat tax liability	346.53	114.57	468.84	3002.99	541.29	370.82
Sales - Excluding other income	2486.79	818.58	5496.96	133805.8	24946.11	22401.92
% of Sales to Gross Assets	14.35	14.29	23.45	89.12	92.17	120.82
% of MAT to Sales	13.93	14.00	8.53	2.24	2.17	1.66

This provision might put the reality companies under more pressure and also is partial to service sector or to the sectors where capital requirement is on the lower side. This MAT provision looks more to be on lines of Wealth Tax where NET assets are taxed but here GROSS assets are charged.

In case of companies with more number of subsidiary companies, they will have to pay more taxes. Assume “A” is the holding company for “B” and “B” is the holding company of “C” and “C” is another holding company of “D” and so on. The holding company “A” will have INVESTMENT amount in “B” on their asset side and “B” will have yet another amount of Investment in “C” appearing on their balance sheet. This means that there will be double taxation within the country, whereas the government states that it wants to reduce double taxation among countries.

With regards to the shift from Exempted – Exempted – Exempted [EEE] model to the Exempted – Exempted – Taxed [EET] model, people especially senior persons who have made investments based on tax free returns will be impacted. Insurance sector is said to be the backbone of the economy and if the returns at the end of the term of investment are taxed will de-promote savings in insurance also having in view the lower rate of return involved in it. So in the nation’s interest at least Insurance should remain under the EEE model.

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