Editorial

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Corporates still on Mat

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JUST when it seemed that the corporate sector was coming out of its indolence, and deserving of a helping hand, the Finance Minister, Mr. Yashwant Sinha, decided to strike. His Budget, though at first reading gave the impression of sparing the corporates, a detailed study proves otherwise.

The Budget has not raised the surcharge on company income and profits, currently at 10 per cent. But this is no consolation as already the present effective rate of 38.5 per cent (35 per cent basic plus surcharge) is substantially higher than in most countries including Argentina, Brazil, Finland, Malaysia, Norway and Singapore, where the rates are in the 25-30 per cent range. In Switzerland, Hong Kong, Hungary and a few other countries, the rates are lower than 25 per cent.

And to avoid any discrimination(to use his own words) *vis-a-vis* individual assessees on whom he has been harsh, Mr. Sinha announced a steep increase in the tax on distributed profits, from 10 per cent to 20 per cent. Together with a surcharge of 10 per cent (illogical as tax cannot be levied on an amount which is not an income), the effective rate of dividend tax works out to 22 per cent.

This will hamper seriously the ability of companies to maintain reasonable payouts. To illustrate: Consider a company that pays a dividend of 15 per cent. At no existing dividend tax of 10 per cent, it is required to generate a post-tax return of 16.67 per cent (15/1-0.1). In turn, this would require a corresponding pre-tax return of 27.10 per cent (16.67/1-0.385). Now, with the dividend tax raised to 22 per cent, the required post-tax return will have to be 19.23 per cent (15/1-0.22) and the pre-tax return a 31.27 per cent (19.23/1-0.385). In the face of increasing costs of basic inputs and services on the one hand, and the growing competition particularly from MNCs (resulting lower realisation from sales) on the other, it is unlikely that the companies would be able to step up profitability to such levels. Consequently, there is a strong possibility of reduction in the rates of dividend. Some companies have already given a hint to this effect.

The 100 per cent hike in the tax on distributed profits made a mockery of the abolition of the dividend tax in the hands of shareholders. Ironically, even the million shareholders who would not have otherwise paid any tax under the earlier regime, would suffer by way of reduction in dividend rate.

Mr. Sinha's tirade against the corporate sector does not stop here. On the face of it, it would appear that the levy of MAT of 7.5 per cent - against the earlier 10.5 per cent - is relief. Deeper scrutiny would reveal that companies would actually end up paying more tax in absolute terms due to exclusion of various deductions, while calculating book profits under the Companies Act. Further, the manner in which specific clauses have been worded makes it possible for MAT being collected even from a company incurring losses.

The corporates have been further penalised by the withdrawal of the tax credit. MAT is essentially in the nature of a deemed tax. Consequently, it would be illogical to deny set-off against legitimate taxes payable in the subsequent years. This would, in fact, strike at the very root of incentives to the companies for taking up expansion, modernisation and diversification.

MAT was introduced primarily with the objective of bringing into the net companies that paid high dividend and yet not any taxes. However, following the introduction of tax on distributed profits - now raised to a hefty 20 per cent - there is no justification for continuing with MAT. The Government should either have dividend tax or MAT; to retain both is illogical.

It may be pertinent to note that even as successive governments vowed to rationalise the tax regime, in turn promising lower effective rates of tax, they have ended up making it more complicated besides, entailing an increasing burden. Thus, on the corporate front, there is the basic rate, surcharge, dividend tax, surcharge on dividend tax and MAT. This multiplicity of tax rates with overlapping objectives is seriously detrimental to the healthy growth of industry.

The decision to withdraw tax exemption on export earnings over five years, has generated much outcry from the export community. It has reasons to worry. This is because products made in India are already at a significant disadvantage, on account of high interest rates (these are almost double the cost of funds in other countries), high cost of power, taxes on inputs/raw materials and so on. Against this backdrop, the tax exemption provided some relief.

Before withdrawing tax concession on export earnings, there is an urgent need to remove/minimise the various handicaps. Unfortunately, while hardly any dent has been made on the latter, the Government has started making significant moves on the latter. This could cause a serious setback to exports at a time when the situation is beginning to look up and there is need for consolidation.

The introduction of tax on perquisite value of ESOP (Employees Stock Option Plan) is ill-conceived and badly timed. Under this, an employee allotted a share at a price lower than the fair market value, will be taxed on the difference between the two, at the time of allotment. But from where will he get money to pay the tax? Obviously, he cannot generate it by selling the share; doing so will go against the very principle of the plan, that is, engendering on the employee a sense of belonging to the company.

Assuming that somehow the employee does arrange the cash, there is another problem. In various IT companies where ESOP is in operation, the current market value of shares is at dizzy heights. The price at which shares are allotted to employees may be lower in relation to this, thereby leading to potential capital gains. It is, however, important to note that this is not the actual gain.

Against this backdrop and a tax having already been paid on the potential gain - as per provision in the Finance Bill and in the event of market-value declining to below the offer price (considering the prevailing unusually high market rate, such a possibility is not ruled out), the employee would be put in a highly anomalous situation. In short, he would have to pay a tax despite capital loss!

The Government should avoid levying a tax on notional capital gain. The only logical and practical way of dealing with stock options is to tax these as capital gains when, stocks are actually sold by the employees. The gains for this purpose is the difference between the sale price and the stocks-price.

Contrary to the laid-down objective that the resource- mobilisation effort would be broadbased, it would appear that the Finance Minister has kept a narrow focus. This has resulted in not just an increasing burden on those who are already paying taxes, but also in a more complicated tax-structure.

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