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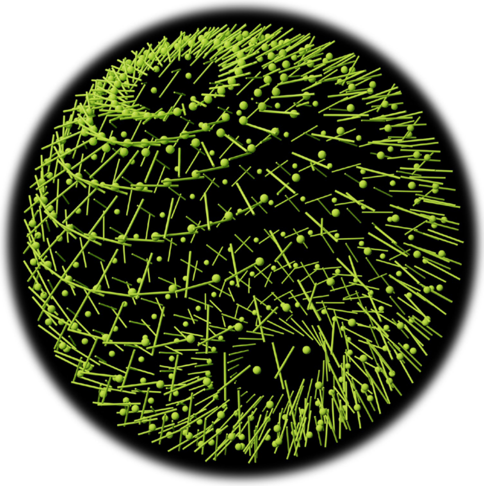
Need to relook at the proposed minimum tax



One of the key changes proposed in the Finance Bill 2020 is the introduction of a new tax known as minimum tax, commonly referred to as alternative minimum tax (AMT). The tax is proposed to be levied at the rate of 1% on the gross turnover where the minimum tax is higher than the instalment tax due under the current regime.

It appears that the objective of the minimum tax is to ensure that companies in tax losses pay a fair share of corporation tax in spite of the losses. However, this may be contradictory, albeit in the short term, since the low taxable profits and tax losses arise because of justifiable reasons like macroeconomic factors such as political instability, inflations and natural disasters and incentives provided for under the relevant tax laws and regulations to promote desirable social and economic goals. Imposing minimum tax would curtail the said incentives. Under the proposed change, companies will be required to compute two distinct tax liabilities each year: instalment tax under the current regime and minimum tax. Companies would then be required to pay the higher of the two amounts. The proposal would therefore be burdensome to taxpayers and negate the principle of certainty and simplicity.

The above said, given the perennial revenue shortfalls, it is likely that the provision will be retained when the bill is eventually enacted into law since it is one of the ways of expanding the tax base and will surely earn the National Treasury some additional revenue and contribute towards bridging the revenue gap. To this end, the proposal should be tweaked to address some on the teething problems.

The proposed amendment as currently worded implies that instalment and minimum tax would be imposed concurrently. The two taxes are mutually exclusive, and the section should be amended to make it clear that minimum tax shall only apply where 1% of a company's gross turnover is lower than the tax due under the ordinary tax regime.

In some instances, companies incur losses due to circumstances beyond their control. For instance, under the current Covid-19 pandemic, many companies are likely to incur losses for the current year and probably the next two years. Imposing an additional burden in the form of minimum tax on such companies would exacerbate their challenges. The proposal should therefore be amended to impose the tax on companies that are in net losses for at least three consecutive years. Such a period would allow businesses reasonable time to rebound from the effects of such negative circumstances that affect their business. This is the case in Tanzania, where minimum tax applies on companies that have been in a loss position for three consecutive years.

Ordinarily, most start-ups, especially capital-intensive ventures such as manufacturers, incur heavy initial investment costs while recording sluggish sales. Such fledgling start-ups should be cushioned by being granted a grace period, say 5 years during which the proposed provisions of minimum tax should not apply. This logic informed the change in the case of Nigeria, where, effective January 2020, companies that have been in business for less than four calendar years are exempted from minimum tax.

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As currently proposed, capital and labour-intensive companies with high turnover and small profit margins such as airlines would perpetually fall under the ambit of minimum tax. The increased tax burden would aggravate the fragile cash flow situation for such companies. To this end, the proposed law should provide for mechanism to exempt companies in such low margin sectors from AMT.

As currently proposed, it is not clear if the minimum tax is final tax or an advance tax. On one hand, if treated as final tax, companies that are in tax losses for prolonged periods would bear an additional burden since the tax would be an additional expense which cannot be set off against future tax liabilities. On the other hand, if treated as an advance tax, the credit would be available for set off to the extent that the tax payable under the normal regime is higher than the minimum tax. The latter option would be more favourable to companies. In India, credits arising from AMT are available for set off against normal tax and may be carried forward for up-to fifteen years.

Addressing the above issues would go a long way in ensuring a smoother implementation of the proposed minimum tax, especially in the wake of the current Covid-19 pandemic.

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