Newsflash: Clarifications on computation of book profit for the purpose of levy of MAT under section 115JB of the Income-tax Act for Indian Accounting Standards (Ind AS) compliant companies

CBDT Circular No. 24 of 2017 dated 25 July 2017

THE POWER OF BEING UNDERSTOOD

RSM

1.0 Background

The Finance Act, 2017 introduced tax provisions under Minimum Alternate Tax (MAT) provisions for Indian Accounting Standards (Ind AS) compliant companies. The provisions resulted in most Ind AS adjustments, including transition impact, being taxed under MAT provisions.

The Central Board of Direct Taxes (CBDT) received representations from various stakeholders seeking clarifications on certain issues arising therefrom. The matter was referred to an expert committee. The committee after duly considering the representations from stakeholders has recommended issuance of clarifications by way of FAQs for these issues. The matter was considered by the Board and the following clarifications are issued.

2.0 Frequently Asked Questions

Q1 The profit for the period may include Marked to market (MTM) gains / losses on account of fair value adjustments on various financial instruments recognized through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (i) of Explanation 1 to section 115JB(2) of the Act. Whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT?

A1 Since MTM gains recognized through profit or loss on FVTPL classified financial instruments are included in book profit for MAT computation, it is clarified that MTM losses on such instruments recognized through profit or loss shall not require any adjustments as provided under clause (i) of Explanation to section 115JB(2) of the Act. However, in case of provision for diminution / impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of Explanation 1 to section 115JB(2) of the Act shall apply.
It is further clarified that for financial instruments where gains and losses are recognized through Other Comprehensive Income (OCI), the amended provisions of MAT shall continue to apply.

Q2 For the purpose of section 115JB of the Act, what shall be the starting point for computing Book Profits for Ind AS compliant companies? Whether Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and loss) of Division II of Schedule III to the Companies Act, 2013] or Total Comprehensive Income (including other comprehensive income) [Item number XV in Part 2 (Statement of Profit and loss) of Division II of Schedule III to the Companies Act, 2013] shall be the starting point?

A2 Starting point for computing book profits for Ind AS compliant companies shall be Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and loss) of Division II of Schedule III to the Companies Act, 2013].

Q3 As per Explanation to section 115JB(2C) of the Act, the convergence date is defined as the first day of the first Indian Accounting Standards reporting period as defined in Ind AS 101. The Memorandum explaining the provisions of the Finance Bill 2017 mentions that the adjustments as on the last day of the comparative period is to be considered. It may be clarified as to what would be the appropriate manner for computation of transition amount on convergence date, 1st April i.e., at the start of the day or at the end of the day?

A3 In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year. The amounts as on start of the opening date of the first year of adoption should be considered for the purposes of computation of transition amount.

For example, companies which adopt Ind AS with effect from 1st day of April 2016 are required to prepare their financial statements for the year 2016-17 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st day of April 2015 and restate the financial statements for the comparative period 2015-16. In such case, the first time adoption adjustments as of 31st March 2016 should be considered [i.e., the start of business on 1st day of April 2016 9or, equivalently, close of business on 31st day of March 2016)] for computation of MAT liability for previous year 2016-17 (Assessment Year 2017-18) and thereafter.

Q4 As per Indian GAAP, proposed dividend was required to be recognized in the financial statements for the year for which it pertained to even though these were declared in the subsequent year. Section 115JB of the Act already provides for adjustments for dividend for computation of book profit. As per Ind AS, the amount of proposed dividend (including dividend distribution taxes) is required to be recognized in the year in which it has been declared rather than year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for FY 2015-16 which was recognized in profit and loss account in FY 2015-16 is required to reversed and credited to Retained Earnings. For the computation of MAT, whether these balances would form part of the transition amount and thus be adjusted over a period of 5 years?

A4 Adjustment of proposed dividend (including dividend distribution taxes) shall not form part of the transition amount.

Q5 Under Ind AS, adjustments on the transition date may have a corresponding impact on deferred taxes. Should the deferred taxes on such amounts be considered for the purpose of transition amount?

A5 Any deferred taxes adjustments recorded on the transition date shall be ignored for the purpose of computing Transition Amount.

Q6 As mentioned Question No. 1, clause (i) of Explanation 1 to section 115JB(2) of the Act provides for adjustments for computation of book profit for the amount or amounts set aside as provision for diminution in the value of any asset. Convergence date adjustments may include adjustment for Provision for Bad and Doubtful Debts (Expected Credit Loss adjustment) at the time of transition. Whether these adjustments would form part of the transition amount referred to in section 115JB(2C) of the Act?

A6 Adjustments relating to provision for diminution in the value of any assets other than the ones mentioned in Question Number 1 above, shall not be considered for the purpose of computation of the Transition Amount. Therefore, adjustments relating provision for doubtful debts shall not be considered for the purpose of computation of the transition amount.

Q7 Under section 115JB of the Act, transition amount has been defined as the amount or the aggregate of the amounts adjusted in the 'Other Equity' (excluding capital reserve and securities premium reserve) on the convergence date. Whether changes in share application money on reclassification to 'Other Equity' would form part of the Transition Amount?

A7 Share application money pending allotment which is reclassified to Other Equity on transition date shall not be considered for the purpose of computing Transition Amount.

Q8 Under Ind AS, Investments in preference shares is considered to be liability and the corresponding dividend expense is debited to Profit and loss account as interest cost. Should such interest expense on preference shares be deducted for the purpose of MAT computation?

A8 For the purpose of computation of MAT, profit / Transition Amount shall be increased by dividend / interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

Q9 How do we account for items such as equity component, if any, of financial instruments like Non-Convertible debentures (NCDs), Interest free loan, etc., included in other equity as per Ind AS for computation of transition amount under MAT?

A9 Items such as equity component of financial instruments like NCDs, Interest free loan, etc. would be included in the Transition Amount.

Q10 Where revaluation / fair value adjustments have been made to items of Property, Plant and Equipment (PPE) under Ind AS, as per section 115JB of the Act, the book profit of the previous year in which the items of PPE are retired, disposed or realized shall be increased or decreased, as the case may be, by the revaluation amount relatable to such items of PPE. Whether the revaluation amount to be considered for adjustment should be the gross amount of the revaluation or the amount after adjustment of the depreciation on the revaluation amount?

A10 The book profit of the previous year in which the items of PPE are retired, disposed, realized or otherwise transferred shall be increased or decreased, as the case may be, by the revaluation amount after adjustment of the depreciation on the revaluation amount relatable to such asset. This has been explained by an illustration as under

Particulars	Erstwhile Indian GAAP	Ind AS (considering fair value / revalua-tion adjustment on PPE)	Fair value / Revaluation Adjustments and corresponding depreciation
WDV / Deemed Cost as on 1 April 2015	100	1000	900
Depreciation @10% for FY 2015-16	10	100	90
WDV as on 1 April 2016	90	900	810
Depreciation @10% for FY 2016-17	9	90	81
WDV as on 1 April 2017	81	810	729*
Sale value as on 1 April 2017	900	900	
Profit on sale credited to P&L	819	90	
Adjustment for MAT – revaluation amount after adjustment of the depreciation	0	729*	
Profit on sale to be considered for MAT	819	819	

Q11 How should adjustments for service concession arrangements be treated for the purpose of computation of book profit under MAT?

A11 Adjustments on account of Service Concession arrangements would be included in the Transition Amount and also on ongoing basis.

Q12 Existing clause (iii) of explanation to section 115JB(2) of the Act provides for deduction of lower of the amount of loss brought forward or unabsorbed depreciation as per books of account for computation of book profits. In case where, on adjustment of transition amount, the losses as per books of accounts get wiped off, whether deduction for the said amount would be available for assessment year 2017-18 onwards?

A12 For assessment year 2017-18, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31 March 2016. For the subsequent periods, the position as per books of account drawn as per Ind AS shall be considered for computing lower of loss brought forward or unabsorbed depreciation.

Q13 How Capital Reserves or Securities Premium Reserves existing as per old Indian GAAP reclassified to Retained Earnings / Other Reserves on Convergence Date be treated for MAT purpose?

A13 The Capital Reserves or Securities Premium existing as on the Convergence date as per the erstwhile Indian GAAP which are reclassified to Retained Earnings / Other Reserves under Ind AS and vice versa, shall not be considered for the purposes of Transition Amount.

It is further clarified, that even after such reclassifications, the amount of revaluation reserve shall continue to be considered as revaluation reserve for the purposes of computation of book profit and shall also include transfer to any other reserves by whatever name called or capitalized.

Q14 Companies which follow accounting year other than March 2017 ending for Companies Act purposes are required to transition to Ind AS will have to prepare financial statements for MAT purposes for FY 2016-17 partly under Indian GAAP and partly under Ind AS. How should such companies compute MAT on transition to Ind AS?

A14 In view of second proviso to section 115JB(2) of the Act, companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the balance period.

For example, a Company following December ending will be required to prepare, accounts for MAT purposes under Indian GAAP for 9 months upto December 2016 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January 2017.

PRESS RELEASE (RELEVANT EXTRACT OF THE COMMITTEE REPORT)

In addition to the above FAQs, the CBDT has also come out with a Press Release dated 25 July 2017 on issues arising from implementation of MAT provisions relating to Ind AS compliant companies. The Press Release states that the CBDT has accepted recommendations of the Committee regarding issuance of circular in the form of FAQs which has been issued vide Circular No. 24 of 2017 dated 25 July 2017.

Further, in order to have wider consultation in response to Committee's recommendations regarding amendment to the provisions of section 115JB of the Act w.e.f. 1st April 2017, the relevant part of the Committee's report has been uploaded on the department website and stakeholders are requested to send the comments / suggestions on email ID dirtpl2@nic.in latest by 11th August, 2017.

The relevant extract of MAT-Ind AS Committee Report dated 17 June 2017 containing the recommendations regarding amendment to provisions of section 115JB of the Act is reproduced below for ready reference.

Under Ind AS, there are certain transactions with shareholders / related parties which are at lower or higher than fair value, needs to be accounted for at fair value with corresponding adjustments to equity. Subsequently, when these assets are either depreciated or disposed of, the value adopted at the time of receipt of such assets (i.e., fair value) would be considered for depreciated or profit / loss on disposal, as the case may be. Similarly, when loans / advances are received or given at a concessional rate of interest, similar adjustment to equity will take place and there would be corresponding impact on the P&L during the term of such loans / advances. While debit / credit to the P&L would affect the book profits, the corresponding adjustment in the equity is not captured in computation of book profits. Therefore, certain amendments are required in section 115JB for these items.

It may be noted that adjustments for similar items at the time of transition to Ind AS has already been incorporated in the amendments made to section 115JB vide Finance Act, 2017. Therefore, to have parity between the transition adjustment and ongoing adjustments on account of items adjusted to other equity, the committee recommends that the amendment is required to be made w.e.f. 1st April 2017 i.e., the date of effectivity of the amendment made by the Finance Act 2017. It is proposed that sub-section (2A) of section 115JB be amended by inserting proviso (e) after proviso (d) in sub-section (2A) as under:

"(e) increased by all amounts or aggregate of the amounts credited during the previous year to any item of other equity, or decreased by all amounts or aggregate of the amounts debited during the previous year to any item of other equity, as the case may be, but not including –
(i) Profit / (Loss) for the period as per statement of profit and loss transferred to other equity;

(ii) items relating to Other Comprehensive Income;

(iii) share application money pending allotment;

(iv) money received against share warrants;

(v) capital reserve in respect of Business combinations of entities under common control as per Appendix C of Ind AS 103; and

(vi) securities premium reserve collected in cash and cash equivalent."

For further information please contact:

RSM Astute Consulting Pvt. Ltd.

13th Floor, Bakhtawar, 229, Nariman Point, Mumbai - 400021.

T: (91-22) 6108 5555 / 6121 4444

F: (91-22) 6108 5556 / 2287 5771

E: emails@rsmindia.in

W: www.rsmindia.in

Offices: Mumbai, New Delhi - NCR, Chennai, Kolkata, Bengaluru, Surat, Hyderabad, Ahmedabad, Pune, Gandhidham and Jaipur.

facebook.com/RSMinIndia

twitter.com/RSM_India

linkedin.com/company/rsm-india

RSM Astute Consulting Pvt. Ltd. (Including its affiliates) is a member of the RSM network and trades as RSM. RSM is the trading name used by the members of the RSM network.

Each member of the RSM network is an independent accounting and consulting firm each of which practices in its own right. The RSM network is not itself a separate legal entity of any description in any jurisdiction.

The RSM network is administered by RSM International Limited, a company registered in England and Wales (company number 4040598) whose registered office is at 50 Cannon Street, London EC4N 6JJ .

The brand and trademark RSM and other intellectual property rights used by members of the network are owned by RSM International Association, an association governed by article 60 et seq of the Civil Code of Switzerland whose seat is in Zug.

This newsflash is general in nature. In this newsflash we have summarized CBDT circular no. 24 of 2017 dated 25 July 2017. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said notification and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

26 July 2017

© RSM International Association, 2017