NEWSFLASH : RATIONALISATION OF MAT PROVISIONS UNDER IND AS IN LINES WITH CBDT COMMITTEE RECOMMENDATIONS WITH CERTAIN CHANGES

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1.0 Background

With the Ministry of Corporate Affairs (MCA) notifying (Indian Accounting Standards) Ind AS implementation in a phased manner from financial year commencing on or after 1 April 2016, the Central Board of Direct Taxes (CBDT) set up a committee called Accounting Standards Committee, "the Committee" in June 2015 with a direction to suggest framework for Minimum Alternate Tax (MAT) in view of transition to Ind-AS.

The Committee submitted its first interim report in March 2016 and subsequently in July 2016. The Finance Bill 2017 ('the Bill') has rationalized the provisions of section 115JB of the Income Tax Act, 1961 ('the Act') in line with Ind AS and incorporated most of the recommendations of the Committee. However, there are certain changes / additional aspects that the bill has covered.

In this publication we take a closer look at the proposals of the Bill with regards to MAT levy for companies adopting Ind AS and also examine the changes as compared to the recommendations of the Committee made in its July 2016 report.

For ensuring horizontal equity across the companies irrespective of the fact that whether they follow Ind AS or the existing Indian GAAP, the Central Government had issued Income Computation and Disclosure Standards (ICDS) for computation of taxable income for specified heads of income. This publication does not deal with computation of ICDS by Ind AS companies and only focuses on proposals under the Bill for Ind AS companies covered under the MAT provisions of section 115JB.

2.0 MAT on Ind AS financial statements - whether OCI items will be included?

Ind AS income statement consists of profit and loss account and, what is known as other comprehensive income (OCI). The question had arisen in practice was whether MAT calculation would be based on net profit before OCI items or would it be based on net profit after OCI items.

The Finance Bill proposes no further adjustments to the net profits before OCI of Ind AS compliant companies, other than those already specified under section 115JB of the Act shall be made. In other words, MAT calculations would be based on profit before tax.

3.0 MAT on first time adoption and Ind AS adjustments

3.1 Ind AS adjustment in comparative financial year

In the first year of adoption of Ind AS, the companies are required to 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 (reserves) 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 Bill proposes that for the purposes of computation of book profits under section 115JB in the year of adoption, the amounts adjusted as of the opening date of the first year of adoption shall be considered. For example, companies which adopt Ind AS with effect from 1 April 2016 are required 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 1 April 2015 and restate the financial statements for the comparative period 2015-16. In such a case, the first time adoption adjustments as of 31 March 2016 shall be considered for computation of MAT liability for previous year 2016-17 (assessment year 2017-18) and thereafter.

This proposal did not feature in the Committee recommendations and is a welcome clarification for Ind AS companies covered under MAT provision.

3.2 MAT implications for first time adoption transition adjustments

The adjustments arising on account of transition to Ind AS from existing Indian GAAP are required to be recorded directly in Other Equity at the date of transition to Ind AS. Several of these items would subsequently never be reclassified to the statement of profit and loss / included in the computation of book profits. Examples of such items include: revaluation surplus on PPE and intangible assets; fair value changes arising on investment in equity instruments designated as fair value through OCI; and re-measurement (including actuarial changes) in defined benefit obligation plans." Accordingly, the following treatment is proposed:

Item	Point in time
Changes in revaluation surplus of property, plant and equipment (PPE) and Intangible assets	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred
Re measurements of defined benefit plans	To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS
Any other item	To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS

The period of five years proposed above shall be previous years 2016-17 to 2020-21 for phase I Ind AS companies (Ind AS effective from financial year 2016-17 onwards) and previous years 2017-18 to 2021-22 for phase-II Ind AS companies (Ind AS effective from financial year 2017-18 onwards).

The proposal to spread MAT impacts due to re measurement of defined benefit plans and other first time adoption adjustments in retained earnings over five years is a change from the recommendations of the Committee (spreading over three years). This represents a fair trade-off between stakeholders' concerns on front loading the MAT levy and tax authority's concerns on such adjustments escaping MAT levy.

3.3 Fair valuation of PPE and intangible asset as deemed cost upon first time adoption of Ind AS

An entity may use fair value in its opening Ind AS balance sheet as deemed cost for an item of PPE or an intangible asset as per provisions of Ind AS 101. If such an option is availed, the items of PPE or intangible asset are measured at fair value at the transition date with a corresponding impact on the retained earnings/reserves. In such cases the treatment under MAT proposed is as under

- The existing provisions for computation of book profits under section 115JB of the Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits. Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and Intangible assets shall be ignored for the purposes of computation of book profits.
- Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment.
- Similarly, gain/loss on realisation/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.

3.4 Investments in subsidiaries, joint ventures and associates at fair value as deemed cost upon first time adoption of Ind AS

Ind AS 101 allows an entity either to fair value its investments in subsidiary, associate and joint venture companies or to measure them at cost in its separate financial statements. If the fair value option is used the investments are measured at fair value at the transition date with a corresponding impact on retained earnings/reserves. In such cases, retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.

3.5 Cumulative translation differences arising on first time adoption of Ind AS

Under Ind AS 101, an entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition.

In such cases, to ensure that such cumulative translation differences on the date of transition that is transferred to retained earnings, are taken into account for MAT, the Bill proposes that these shall be included in the book profits at the time of disposal of foreign operations.

This is a new proposal that did not feature in the recommendations of the Committee. This is a helpful clarification, particularly for companies with significant foreign operations. This will synchronize the timing of tax incidence and realization of the foreign exchange cumulative

4.0 MAT implications for ongoing Ind AS reporting

4.1 OCI items that are permanently recognized in reserves

Under Ind AS, certain items of income and expense are recognized in reserves through OCI and are never recycled back in profit and loss. Examples of such items include: revaluation surplus on PPE and intangible assets; fair value changes arising on investment in equity instruments designated as fair value through OCI; and re measurement (including actuarial changes) in defined benefit obligation plans. Since these items would permanently escape profit and loss recognition, the issue was whether and how MAT incidence would apply.

The Bill proposes that such items would be included in book profits for MAT purposes at point of time as specified below:

Item	Point in time
Changes in revaluation surplus of PPE and Intangible assets	To be included in book profits at the time of realisation / disposal/ retirement or otherwise transferred
Gains and losses from investments in equity instruments designated at fair value through other comprehensive income	To be included in book profits at the time of realisation/ disposal / retirement or otherwise transferred
Re measurements of defined benefit plans	To be included in book profits every year as the re measurements gains and losses arise
Any other item	To be included in book profits every year as the gains and losses arise

The above proposals are in lines with the recommendations of the Committee. The proposal imply that OCI items arising on PPE/ intangible asset revaluation and fair valuation of investments in FVOCI equity instruments , MAT incidence will be at the time of disposal. This would be a fair proposition considering that the OCI gain/ loss would be taxed in the year in which the company would realize the gains/losses. The proposal to tax re measurement gains and losses on defined benefit plans and other OCI items would be taxed in the year the gains/ losses arise would ensure parity with MAT treatment under Indian GAAP.

4.2 *Non-cash distribution to shareholders (such as demerger)*

Under Ind AS, Appendix A to Ind AS 10 *Events after balance sheet date*, provides that a company shall measure a liability (dividend payable) to distribute non-cash assets or business at the fair value of the assets or business to be distributed. When the company completes the distribution, it shall recognise the difference between the carrying amount of the assets distributed and the dividend payable amount recorded based on fair value. Correspondingly, the reserves are debited at fair value to record distribution as a deemed distribution. This guidance does not apply to a distribution of a non-cash asset that will ultimately be controlled by the same party or parties before and after the distribution.

The Bill provides that the difference between the fair value and carrying value of the assets of the undertaking should be excluded from book profits. In the case of a resulting company, where the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computing of book profit of the resulting company.

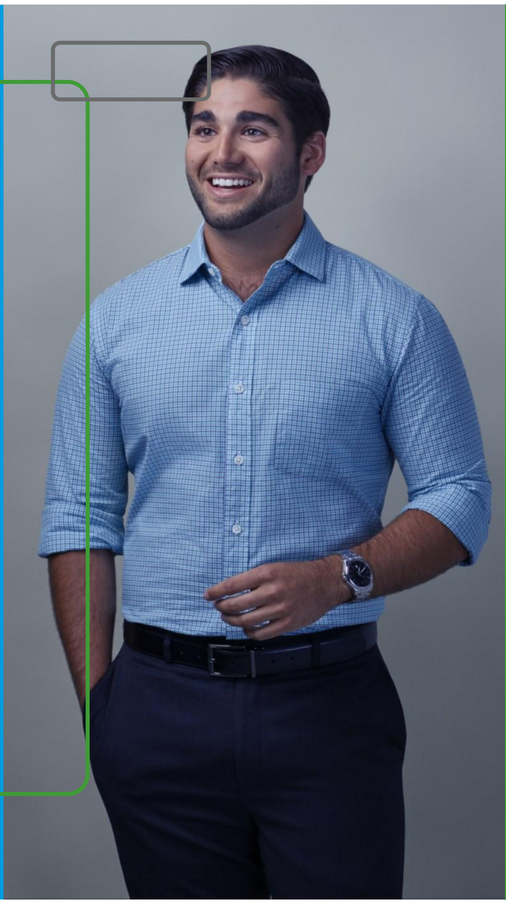
This is a new proposal that did not find mention in the Committee's recommendations. It is a welcome relief to those companies who were in the process of demerger, hive-off or spin-off arrangements that would have got accounted for as per the Appendix. In absence of this clarification in the Bill, Ind AS accounting for such arrangements may have caused a significant MAT exposure.

4.3 *Deferred tax*

Section 115JB of the Act already provides for adjustments on account of deferred tax and its provision. The Bill clarifies that any deferred tax adjustments arising on first time adoption of Ind AS recorded in reserves and surplus shall also be ignored for the purpose of MAT.

FINAL THOUGHTS

"In financial year 2016-17, around 350 listed companies would be transitioning to Ind AS, along with several unlisted companies. Many of these companies, particularly, those in Real Estate, Infrastructure, Construction and Power sectors are/ would be taxed under the provisions of MAT. These companies were spooked by the uncertainties around issues and implications of MAT under Ind AS. Given that we are approaching the end of the financial year, time was running out for these companies to understand and prepare for the tax implications. In this backdrop, we welcome the clarification and rationalization provided in the Bill."



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This newsflash is general in nature. The Finance Bill 2017 ('the Bill') has rationalized the provisions of section 115JB of the Income Tax Act, 1961 in line with Ind AS and incorporated most of the recommendations of the Committee. However, there are certain changes/ additional issues that the bill has covered. In this newsflash, we have summarized the above amendments. 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.

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