IFRS Notes

CBDT issues FAQs on computation of book profit for levy of MAT and proposes amendment to Section 115JB

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Introduction

With the adoption of Indian Accounting Standards (Ind AS) that are converged with International Financial Reporting Standards (IFRS), as per the road map laid down by the Ministry of Corporate Affairs, India now has two financial reporting frameworks that co-exist and are applicable to a mutually exclusive set of companies, with Ind AS being applicable to all listed and other larger companies and the erstwhile Accounting Standards being generally applicable to smaller companies.

The companies covered in the first phase of this transition to Ind AS are mandatorily required to prepare financial statements as per Ind AS from 1 April 2016 with the transition date as 1 April 2015.

Background

The existence of two financial reporting frameworks has also necessitated a response from the tax authorities to ensure that there is horizontal equity from a taxation perspective, for companies, irrespective of the financial reporting framework that they follow. To meet this objective, the Central Board of Direct Taxes (CBDT) has issued Income Computation and Disclosure Standards (ICDS) to provide a uniform basis for the computation of taxable income.

However, ICDS did not cover the issues relating to computation of Minimum Alternate Tax (MAT), which is based on book profits and for companies transitioning to Ind AS this may have been a significant challenge. In response to this need, the MAT – Ind AS Committee (the Committee) was formed by the CBDT in 2015. The Committee proposed a framework for computation of book profits for Ind AS compliant companies (the Framework) for the computation of book profit for the purpose of levy of MAT under Section 115JB of the Income Tax Act, 1961 (the IT Act) vide its final report dated 22 December 2016.

On 1 February 2017, the Finance Minister presented the Finance Bill, 2017 (the Bill) which contained a number of proposals including ‘computation of book profit for Ind AS compliant companies for the purpose of levy of MAT under Section 115JB of the Income Tax Act, 1961’. The Bill received the President’s assent on 31 March 2017 and became effective on 1 April 2017. The Finance Act, 2017 with the intent of providing a framework (i) to bring the adjustments being recorded on the transition date to the opening reserves into the ambit of book profits; and (ii) for computation of book profit for companies following Ind AS, introduced following two new concepts:

- The transition amount
- MAT computation formulae for Ind AS compliant companies.

Transition amount

The Finance Act, 2017 defined a new term ‘transition amount’ as:

‘Transition amount’ means the amount or aggregate of the amount adjusted in other equity (excluding capital reserve and securities premium reserve) on the date of adoption of Ind AS but excluding certain exclusions specified.

MAT computation formulae for Ind AS companies

The Finance Act, 2017 provided a separate formulae for computation of book profit for the companies that prepare financial statements under Ind AS. Accordingly, MAT would be calculated using the profits as per the statement of profit and loss before Other Comprehensive Income (OCI), as the starting point. The Finance Act, 2017 also provides certain adjustments to book profits for MAT computation. These requirements should be read together with the existing provisions for computation of MAT under Section 115JB of the IT Act, in particular the adjustments discussed in Explanation 1 to sub-section 2. The new adjustments can be grouped into following two categories:

- Adjustments relating to annual Ind AS financial statements
- Adjustments relating to first-time adoption of Ind AS.

New development

The CBDT received a number of queries on various aspects of computation of MAT under Ind AS. These matters were referred to an expert committee. On 25 July 2017, CBDT issued clarifications in the form of Frequently Asked Questions (FAQs)[1] on issues relating to the levy of MAT for Ind AS compliant companies along with the proposed amendment in the IT Act.

This issue of IFRS Notes provides an overview of the following:

1. Clarifications in the form of Frequently Asked Questions (FAQs)[1] on issues relating to the levy of MAT for Ind AS compliant companies
2. Proposal for amendment to Section 115JB of the IT Act in relation to Ind AS compliant companies.

Overview of the clarifications comprised in FAQs

1. Starting point for computing book profits for Ind AS compliant companies

The CBDT has clarified that for the purposes of Section 115JB of the IT Act, starting point for computing book profits for Ind AS compliant companies would be profit before Other Comprehensive Income (OCI) item number XIII in Part 2 (statement of profit and loss) of Division II of Schedule III to the Companies Act, 2013.

An Ind AS compliant company should not consider 'Total Comprehensive Income (including OCI) item number XV in Part 2 (statement of profit and loss) of Division II of Schedule III' to the Companies Act, 2013 as the starting point for computing book profits.

2. Appropriate manner of computation of transition amount on convergence date

As per Explanation to Section 115 JB(2C), the convergence date is defined as the first day of the first Ind AS reporting period as defined in Ind AS 101, *First-time Adoption of Indian Accounting Standards*.

The Memorandum to the Finance Bill, 2017 mentioned that the adjustment as on the last day of the comparative period is to be considered. A question was raised regarding what would be the appropriate manner for computation of transition amount on convergence date, 1 April i.e. at the start of the day or at the end of the day.

According to Ind AS, in the first year of adoption of Ind AS, the companies would prepare Ind AS financial statements for reporting year with comparative financial statements 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 company 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 CBDT clarified that 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 1 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 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 should be considered i.e. the start of business on 1 April 2016 (or, equivalently, close of business on 31 March 2016) for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) and thereafter.

3. Items that would not require an adjustment for computing book profits for the purposes of MAT

Affects both transition amount and post Ind AS transition MAT computation

Mark to Market gains/losses on financial instruments at Fair Value Through Profit or Loss (FVTPL)

The profit for the period of a company may include Marked to Market (MTM) gains/losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where a view could have been considered that the losses on account of fair value adjustments could be added back in view of

[1]CBDT circular no. 24/2017 dated 25 July 2017

Overview of the clarifications comprised in FAQs (contd…)

clause (i) of Explanation 1 to Section 115JB(2) of the IT Act. A question arises whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT.

The CBDT has clarified that since MTM gains recognised through the statement of profit and loss on FVTPL classified financial instruments are included in book profits for MAT computation, therefore, MTM losses on such instruments recognised through statement of profit and loss would not require any adjustments as provided under clause (i) of Explanation 1 to Section 115JB(2) of the IT Act.

However, in case there is a 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 IT Act would be required.

For financial instruments where gains and losses are recognised through OCI, then CBDT has clarified that the amended provisions of MAT would continue to apply i.e. such items would be considered for MAT upon being debited/credited to statement of profit and loss or as otherwise provided.

Affects only transition amount computation

Proposed dividend

As per Indian GAAP, proposed dividend was required to be recognised 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 IT 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 recognised in the year in which it has been declared at the annual general meeting rather than the year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for FY 2015-16 which was recognised in the statement of profit and loss in FY 2015-16 is required to be reversed and credited to retained earnings.

A question was raised whether for the computation of MAT, these balances (reversal of proposed dividend) would form part of the transition amount and thus, be adjusted over a period of five years.

The CBDT has clarified that the adjustment of the proposed dividend (including dividend distribution taxes) would not form part of the transition amount.

Deferred taxes

Under Ind AS, adjustments on the transition date may have a corresponding impact on deferred taxes. A question was raised whether the deferred taxes on Ind AS adjustments should be considered for the purpose of computing transition amount.

The CBDT has clarified that the deferred taxes adjustments recorded on the transition date of Ind AS should be ignored for the purpose of computing 'transition amount'.

Bad and doubtful debts

Section 115JB already 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.* Transition date adjustments may include adjustment for 'provision for bad and doubtful debts (expected credit loss adjustment) at the time of transition. A question was raised whether such provision for bad and doubtful debts adjustments would form part of the transition amount.

The CBDT clarified that the adjustments relating to provision for diminution in the value of any assets should not be considered for the purpose of computation of the transition amount. However, MTM gains/losses in value of assets forming part of FVTPL financial instruments would form part of the transition amount.

Reclassification of capital reserves or securities premium reserve under Ind AS

The capital reserves or securities premium reserves 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, should not be considered for the purposes of computation of transition amount.

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

Changes to share application money

Under Section 115JB of the IT 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. A question was raised whether changes in share application money on reclassification to 'other equity' would form part of the transition amount.

The CBDT clarified that share application money pending allotment which is reclassified to 'other equity' on transition date should not be considered for the purpose of computing transition amount.

Overview of the clarifications comprised in FAQs (contd…)

4. Items that would be included in profit/ transition amount

Interest/dividend on preferences shares (liability)

Under Ind AS, investments in preference share is considered to be a liability and the corresponding dividend expense is debited to the statement of profit and loss as an interest cost. A question was raised whether such interest expenses on preference shares should be deducted for the purpose of MAT computation.

The CBDT clarified that for the purpose of computation of MAT, profit/transition amount should be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

Equity component of financial instruments

Certain financial instruments like Non-Convertible Debentures (NCDs), interest-free loans, etc. include an equity portion as per Ind AS. A question was raised whether such equity portion designated as 'other equity' under Ind AS would be included in transition amount.

The CBDT clarified that items such as equity component of financial instruments like NCDs, interest free loans, etc. would be included in the transition amount.

Service concession arrangement adjustments

The adjustments for service concession arrangements would be included in the transition amount and also on an ongoing basis.

5. Revaluation or fair value model of property, plant and equipment

Under Ind AS, if a company follows revaluation/fair value model for its items of property, plant and equipment, then as per Section 115JB, the book profit of the previous year in which the items of property, plant and equipment are retired, disposed or realised should be increased or decreased, as the case may be, by the revaluation amount relatable to such items of property, plant and equipment.

A question was raised whether the revaluation amount should be considered for adjustment as the gross amount of the revaluation or as the amount after adjustment of the depreciation on the revaluation amount.

The CBDT clarified that the book profit of the previous year in which the items of PPE are retired, disposed, realised or otherwise transferred should 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.

The CBDT has explained this concept with the following illustration:

Particulars	Erstwhile Indian GAAP	Ind AS (considering fair value/ revaluation adjustment on property, plant and equipment)	Fair Value/ revaluation adjustments and corresponding depreciation
WDV/Deemed Cost as on 1 April 2015	100	1,000	900
Depreciation at 10% for FY 2015-16	10	100	90
WDV as on 1 April 2016	90	900	810
Depreciation at 10% for FY 2016-17	9	90	81
WDV as on 1 April 2017	81	810	729[3]
Sale value as on 1 April 2017	900	900	
Profit on sale credited to statement of profit and loss	819	90	
Adjustment for MAT - revaluation amount after adjustment of the depreciation	0	729[3]	
Profit on sale to be considered for MAT	819	819	

[2]Written Down Value

[3]This showcases same amount in both the columns

Overview of the clarifications comprised in FAQs (contd…)

6. Deduction for brought forward losses and unabsorbed depreciation

Existing clause (iii) of explanation to Section 115JB(2) of the IT 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.

On transition to Ind AS, in case where, on adjustment of transition amount, the losses as per books of account are wiped off, a question was raised whether deduction for the said amount would be available for Assessment Year 2017-2018 onwards.

The CBDT has clarified that for Assessment Year 2017-2018, the deduction of lower of depreciation or losses would be allowed based on the position as on 31 March 2016. For the subsequent periods, the position as per books of accounts drawn as per Ind AS would be considered for computing lower of loss brought forward or unabsorbed depreciation.

7. Accounting period other than March 2017

Companies which follow accounting year other than March 2017 ending for the Companies Act, 2013 purposes and 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. A question was raised whether such companies should compute MAT on transition to Ind AS.

The CBDT has clarified that in view of second proviso to Section 115JB(2), 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 year end will be required to prepare, accounts for MAT purposes under Indian GAAP for nine months upto December 2016 and under Ind AS for three months thereafter. The transition amount will be calculated with reference to 1 January 2017.

Overview of of the proposal for amendment to Section 115JB

Under Ind AS, if there are transactions with shareholders/related parties which are at lower or higher than fair value, then as per Ind AS 109, *Financial Instruments*, a corresponding adjustment is made to equity. Subsequently, when these assets are either depreciated or disposed of, the value adopted at the time of receipt of such assets (fair value) would be considered for depreciation or profit or loss on disposal, as the case may be.

If loans/advances are received or given at a concessional rate of interest, a similar adjustment to equity will take place and there would be corresponding impact on the statement of profit and loss during the term of such loans/advances.

While debit/credit to the statement of profit and loss 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.

The draft amendment to this effect to Section 115JB(2A) recommended by the committee is as under.

The book profit as computed in accordance with explanation 1

"(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.

The above adjustments for similar items at the time of transition to Ind AS has already been incorporated in the amendment 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 with effect from 1 April 2017 i.e. the effective date of the amendment made by the Finance Act, 2017.

The CBDT has invited comments on these proposals by 11 August 2017.

Our comments

The Ind AS 101 adjustments are envisaged to provide companies with ease in transitioning to Ind AS, especially when restating information relating to historical books. While selecting accounting policies under Ind AS, companies have been conscious of the impact of MAT due to adjustments arising from such selection.

The CBDT on its part has continued to positively consider the concerns of the stakeholders. It continues with its efforts to simplify MAT implications rather than providing a complex formula which could create permanent differences and reconciliations of first-time adoption matters. Through these FAQs, the CBDT has

i. provided clarifications on certain aspects, and

ii. on certain other matters, prescribed how the companies should interpret the requirements of the Act, which are highlighted below:

- **Pragmatic approach**: The CBDT has brought clarity on certain important areas by bringing few of the clarifications such as the starting point for computation book profits, meaning of convergence date, excluding deferred taxes, etc. some of which were explained in the memorandum to the Bill. Additionally, the CBDT has also provided clarity vide these FAQs by prescribing that certain items would not be part of the transition amount. While some of these may provide relief to companies, certain other adjustments may need further consideration by companies.
- **Revaluation model of property, plant and equipment**: Regarding property, plant and equipment and intangible asset on revaluation model, the treatment outlined in the Finance Act, 2017 indicated that the aggregate revaluation till the year of sale is to be adjusted for computing book profit for the year in which the asset is retired/disposed/realised/transferred. However, a combined reading of the existing requirements of Section 115JB of the IT Act, the Finance Act, 2017 and the memorandum to the Bill suggested that the amount to be adjusted to book profit in the year of sale/disposal, etc. is to be determined after considering the impact of the differential depreciation on account of such revaluation. Now CBDT has explained this calculation with the help of an illustration to help remove the ambiguity on this matter.
- **Convergence date for phase II companies of Ind AS corporate road map**: Based on the CBDT clarifications, the first-time adoption adjustments as at 31 March 2017 (convergence date) would be considered (i.e. the start of business on 1 April 2017 (or equivalently close of business on 31 March 2017)) for computation of MAT liability for previous year 2017-18 (assessment year 2018-19).
- **Interest/dividend on preference shares**: The CBDT has clarified that any interest/dividend (dividend distribution taxes) on preference shares would be adjusted for computation of MAT/transition amount.

  However, certain challenges and implementation issues will remain. Following areas could be of concern to stakeholders:
- **Convergence date for retrospective common control business combinations**: In a situation where a parent P has filed a court scheme for amalgamation of its subsidiary S with itself and the court approves such scheme on 15 April 2017 with an appointed date of 1 April 2016.

  If the parent P transitions to Ind AS from 1 April 2015, then for computation of book profits for MAT purposes on the convergence date (1 April 2016), the impact of such approved scheme would not be considered, given the CBDT clarification in the FAQs. The effect of such scheme would be taken into account in the previous year 2016-17. This interpretation is in line with the Ind AS Transition Facilitation Group (ITFG) clarification as well.
- **Equity component of compound financial instrument:** Many companies that have issued compound financial instruments, would have also credited certain portion as deemed equity in their 'other equity' upon transition to Ind AS. The FAQ continues to re-affirm the CBDT's position that such amounts would be included in the transition amount and would be taxed for MAT purposes over a period of five years. This would cause one time burden for many companies depending on the nature of instruments.
- **Taxation of unrealised gains and losses**: Some of the concerns raised by various stakeholders in relation to the two draft reports issued earlier were addressed. However, the profits reported under Ind AS may include the impact of unrealised gains or losses (especially in relation to financial instruments), therefore, the approach suggested by the Finance Act, 2017 for determining book profit without any adjustment for such unrealised gains and losses may result in cash outflows on account of MAT without any actual realisation of the related gains.
- **Parallel records**: Companies are not generally required to maintain parallel books of accounts for tax purposes. However, the requirements of the Act specifically relating to PPE and investments will require companies to maintain memorandum accounts to compute the depreciation charge, when determining book profits for levy of MAT.

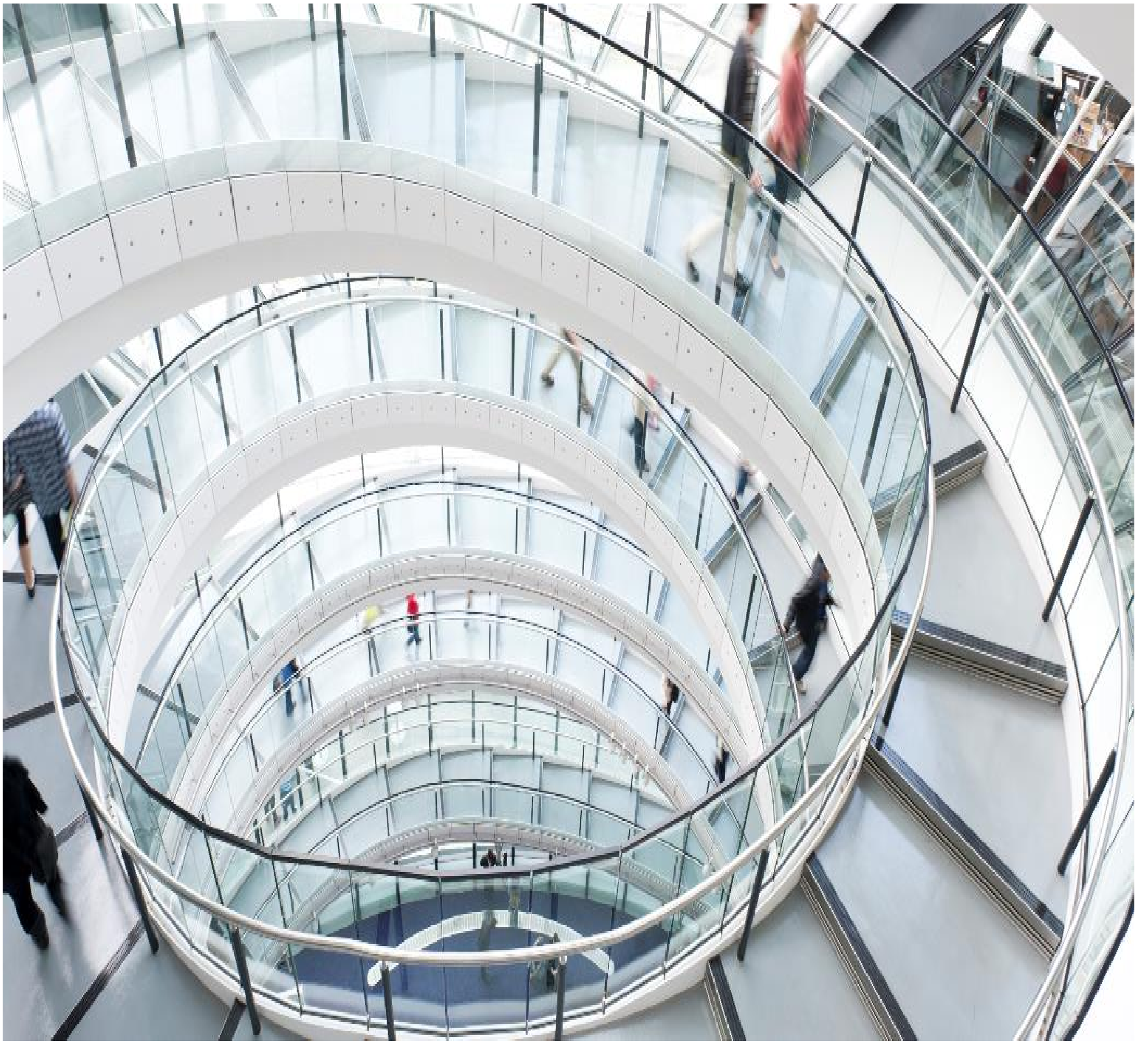
Our comments (contd…)

While companies are likely to benefit from deferring certain first-time adoption adjustments in book profits over a period of five years, additional efforts are expected to be required for maintaining these parallel records.

- **Companies with year end other than March**: Companies which have year end other than March would need to put additional efforts to compute their book profit in the first year of convergence to Ind AS.
- **Proposals of amendment to Section 115JB of the IT Act**: The proposals require that the book profits post transition to Ind AS should also be adjusted with certain adjustments debited or credited in other equity. The Finance Act, 2017 had brought such adjustments in relation to Ind AS transition amount. However, there was no such provision in the IT Act for adjustment of such transactions on an ongoing basis. Therefore, CBDT has proposed an amendment to the IT Act. It is important to note that the Ind AS adjustments on transition to Ind AS would be considered in book profits over a period of five years while any adjustment to 'other equity' post convergence date, would have an impact on book profits in the year in which the transaction takes place.

Next steps

The companies should assess the impact of the clarifications provided by the CBDT while computing MAT liability. Additionally, we urge companies to provide comments on the proposals of amendment to Section 115JB of the IT Act by 11 August 2017.



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Voices on Reporting - Quarterly update publication

Voices on Reporting – quarterly update publication (for the quarter ended 30 June 2017) provides summary of key updates from the Ministry of Corporate Affairs, the Securities and Exchange Board of India, the Reserve Bank of India and the Central Board of Direct Taxes.

We will continue to provide a summary of relevant updates in future also. We hope you find this summary to be of use and relevance.

The publication is available to download from KPMG in India website. Click here

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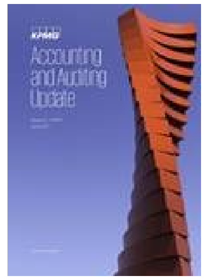

Issue no. 11/2017 – June 2017

This edition of Accounting and Auditing Update (AAU) explains the concept of a business model assessment to be undertaken by banks on transition to Ind AS for their financial instruments. Our article covers two scenarios: loans advanced and investments made in debt instruments by banks. The accounting for these two scenarios has been explained with the help of case studies.

While transitioning to Ind AS under Phase I of Ind AS corporate road map, many companies have opted for deemed cost exemption in relation to the accounting of PPE. Our article explains the deemed cost exemption and also highlights the challenges/ implications in accounting on Ind AS transition when a company chooses to apply the deemed cost exemption for its PPE. This article also covers the implication on Minimum Alternate Tax (MAT) computation both on transition and in subsequent annual financial statements.

Under the Companies Act, 2013 (2013 Act) section, we describe the key responsibilities of directors. .

This month's edition also carries an article on the accounting of lease of land under Ind AS. Our article emphasises the need to assess all of the lease classification indicators before classifying a lease as an operating or a finance lease.

Our publication also carries a regular synopsis of recent regulatory updates in India and internationally.

First Notes: MCA proposes to notify the provisions relating to restriction on layers of subsidiaries under the Companies Act, 2013

14 July 2017

The Ministry of Corporate Affairs (MCA) has pointed out that it has been receiving reports that certain companies could create shell companies for diversion of funds or money laundering. Therefore, MCA decided to operationalise the provisions relating to the restriction on number of layers for holding companies (Section 2(87)) and the requirements of Section 186(1) regarding the number of layers of investment companies although the Companies (Amendment) Bill, 2016 proposes to remove the restrictions in these two sections.

Accordingly, MCA through a notice (no.3/3/2017-CL-I) dated 28 June 2017 proposed the following:

- Notification of the proviso to Section 2(87) of the 2013 Act
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- Insertion of new sub-rule 5 '*Restriction on number of layers for certain holding companies*' to the Companies (Specification of Definitions Details) Rules, 2014.

Comments to the proposals could be submitted up to 20 July 2017.

This issue of First Notes provide an overview of the MCA proposals.

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