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MAT - MAT calculations - Methodology of set off -Overlapping interpretations in the matter of adjustment of BF

Losses/Depreciation – A Dichotomy

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Exploring Provisions

2012, November Issue

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0124-4061225/226



www.dailytaxreporter.com



PREFACE

In 1987-88, as a measure of equity, the government brought MAT on book profits. The memorandum explaining this provision stated that it is an accepted canon of taxation to levy tax on the basis of ability to pay. These provisions continue till date with a brief interregnum during the years 1990-91 to 1995-96

Under the existing provisions of the Income-tax Act, Minimum Alternate Tax (MAT) and Alternate Minimum Tax (AMT) are levied on companies and limited liability partnerships (LLPs) respectively. However, no such tax is levied on the other form of business organizations such as partnership firms, sole proprietorship, association of persons, etc.

In order to widen the tax base vis-à-vis profit linked deductions, it is proposed to amend provisions regarding AMT contained in Chapter XII-BA in the Income-tax Act to provide that a person other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading “C – Deductions in respect of certain incomes” or under section 10AA, shall be liable to pay AMT.

Purpose of this Document

MAT calculations - Methodology of set off -Overlapping interpretations in the matter of adjustment of BF Losses/Depreciation – A Dichotomy

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1. 115J scheme

Under the existing provisions of section 115JB of the Income Tax Act, 1961 (the Act) a company is liable to pay Minimum Alternate Tax (MAT) of eighteen and half percent of its book profits in case tax on its total income computed under the provisions of the Act is less than Minimum Alternate Tax liability. The concept of MAT was first introduced in the form of section 115 by the Finance Act, 1987 and further scope of the same was explained vide Explanatory Circular No. 495, dated 22-09-1987. The reason behind introduction of such tax was to levy tax on certain companies making huge profits and also declaring substantial dividends. By virtue of said section 115J, in the case of a company (other than a company engaged in the business of generation or distribution of electricity) whose total income as computed under the Act is less than 30 percent of the book profits computed under the section, the total income chargeable to tax was estimated at 30 percent of book profits as computed under the scheme of the section.

The net profit determined in accordance with Schedule VI to the Companies Act, 1956, has to be adjusted, inter alia, in accordance with clause (a) to (f) and sub-clause (i) to (iv) of the Explanation to section 115J(1). However, no adjustment in respect of clause (f) and sub-clause (ii) of the Explanation to section 115J(1) is to be made for the agricultural income earned by tea companies where income is derived from the sale of tea grown and manufactured by the seller from tea business. Therefore, only 40 per cent of

the adjusted amount arrived at in this manner will be the book profit of the tea company in accordance with rule 8 of the Income-tax Rules.

1.1. Developments in section 115J

Before amendment in section 115J, large number of companies misinterpreted the provisions u/s 115J that in case they are following an accounting year (under the Companies Act, 1956) which is different from the previous year under the Income-tax Act (i.e., period ending on 31st March) then the provisions of section 115J do not apply to them. This interpretation was based on the understanding that section 115J does not make it mandatory for a company to prepare its profit & loss account on 31st March of any year in case it is following an accounting year which ends on different date. Hence, it became mandatory from AY-1989-90 for all companies to prepare their profit & loss account for the year ending 31st March even if it is having a different accounting year under the Companies Act.

Further, under the existing provisions certain adjustments are made to the net profit as shown in the profit & loss account for the purpose of arriving at the book profits. One such adjustment stipulates that net profit is to be reduced by amount withdrawn from reserves or provisions if any, such amount is credited to the profit and loss account. Some companies have taken advantage of this provisions by reducing their net profit by amount withdrawn from reserve created or provision made in the same year itself, though when reserve created or provisions made it had not gone to

increase book profits. By amending section 115J w.r.e.f. from AY-1988-89 with a view to counteract tax avoidance device, it has been provided that for the assessment years commencing on or after AY-1988-89 “book-profits” will be allowed to be reduced by the amount withdrawn from reserves or provisions only if the reserve when created or provision made had gone to increase the book profits in any year when the provisions of section 115J applicable.

Section 115J had a short life and was operative for only three assessment years namely Assessment Years 1988-89, 1989-90, 1990-91. Section 115J had been amended to provide that its provisions shall not apply to AY-1991-92 and subsequent years.

1.2. Section 115J viz a viz section 205 of Companies Act, 1956

The Explanation to sub-section (1) of section 115J gives the definition of the “book profit” and further incorporate a provision requiring follow up of section 205 of the Companies Act in the determination of the book profit, by virtue of which the amount of brought forward losses or unabsorbed depreciation whichever is less is required to be set off against the profit of the relevant previous year in arriving at the book profits and such amount is to be worked out as if the provisions of clause (b) of the first proviso to sub-section (1) of section 205 of the Companies Act are applicable.

As per section 205 of the Companies Act under the first option, company has to set off the loss or depreciation, whichever is less, against the profits of the

relevant financial year. Under the second option, it can also set off the loss or depreciation whichever is less in respect of the years after the commencement of the Companies (Amendment) Act in which the loss was incurred against the profits of the previous financial years. In Commissioner of Income-tax v. Indo Marine Agencies (Kerala) P. Ltd. (2005) 279 ITR 372 the revenue held a contention that the assessee is not entitled to set off the amount of loss or the amount of depreciation whichever is less in respect of past years against the profits of the year ending on September 30, 1987, relevant to the assessment year 1988-89 which is the first year of application of mat section. The AO referred to the board circular to plead that the same does not refer to past losses. The Kerala High Court that the assessee is entitled for adjusting the loss or the unabsorbed depreciation of earlier years whichever is less in computation of the book profit under section 115J especially when the provisions of clause (b) of the proviso to sub-section (1) of section 205 of the Companies Act are applicable in section 115J and the object of such incorporation of the said provisions of the Companies Act in section 115J is to allow set off of the losses and unabsorbed depreciation.

2. Parliamentary view:

Section 115J in its original form made companies liable to payment of tax even when the income tax return in their case indicated a loss. And this happened when their accounts exhibited profits. The section found more or less an acceptance from the corporate community as in effect there is also provided in the Act a mechanism for allowance of tax credit in succeeding years. And then were formulated improved versions in sections 115JA and section 115JB

respectively. The computation of book profits proceeded on a laid down formula in each of such sections with adjustments for plus items and minus items to the net profit as shown in the profit and loss account.

Among the minus adjustments included the following adjustment for losses in the original section 115J:

“(iii) the amount of the loss or the amount of depreciation which would be required to be set off against the profit of the relevant previous year as if the provisions of clause (b) of the first proviso to sub-section (1) of section 205 of the Companies Act, 1956 (1 of 1956), are applicable.”

2) The Income tax Act offers no explanation in regard to the methodology/chronology of carry forward and set off of unabsorbed losses /depreciation other than the mere statement that lower of the two entitles to set off. Other than this there are varying views held by CBDT, ICAI , ITAT, AAR and the Courts. The view held by CBDT and AAR offer a narrow view with the Tribunal offering a view from out of the blue and the Courts view appear to be logical.

2.1. Critic

MAT is altogether a separate scheme and somehow a law by itself for determination of income under deeming method. And it is unfortunate that there is no rule appended in the Income tax Rules, 1962 that provide a methodology for determination of each adjustments especially the one on set off of brought forward unabsorbed losses or depreciation

3. ICAI view on what does the terms 'net profit', 'profit' or 'loss' mean?

The term loss has not been defined, as a result everyone borrowed an interpretation of such term from the scheme laid down under clause (b) of the first proviso to section 205 of the Companies Act, 1956. The Expert Advisory Committee of the ICAI in an opinion rendered on 2.5.1991 held a view that if for purpose of clause (b) of the first proviso to sub-section (1) of section 205, the term 'loss' is taken to mean 'loss before depreciation', then the depreciation for the previous financial years may not get set off against the profits of the company before it declares dividend as is clear from the following situations and that will go against the objective of section 205 which requires adjustment of depreciation before declaration of dividend.

Profit/Loss before depreciation	Depreciation	Loss after depreciation
NIL	5000	5000
-1000	5000	6000
+3000	5000	2000

The Committee thus held a view that the terms 'profit' and 'loss' used in the Companies Act, 1956 denote 'profit after depreciation and tax' and 'loss after depreciation and tax', respectively. The true and fair view of the 'profit' or 'loss' of a company can be ascertained only after providing for depreciation and income-tax. Section 115J which prevailed from A Y 1989- 90 to A Y1991-92

therefore read out loss as one including depreciation taking on from the interpretation held in the context of section 205 of the Companies Act. Thus in regard to provision for taxes the EAC held a view that loss shall refer to loss after depreciation and income-tax. This is also aligned to what is stated in paragraph 3 (vi) of Part II of Schedule VI as amount of charge for income tax.

Later the Supreme Court in the case of Surana Steels P. Ltd v. Deputy CIT reported in [1999] 237 ITR 777 has also held that "loss" includes depreciation. The following observations of the court merit attention (page 786):

"We are of the opinion that the term 'loss' as occurring in clause (b) of the proviso to section 205(1) of the Companies Act has to be understood and read as the amount arrived at after taking into account the depreciation. Then alone the formula prescribed in this clause would make sense and it would be consistent with the object sought to be achieved by enacting section 115J of the Income-tax Act, 1961. If loss were to be taken as pre-depreciation loss then the resultant computation will not be in conformity with the tenor of the provisions of section 205. The language of clause (b) of the proviso to section 205(1) is clear. It applies to those cases where the depreciation has been provided in accordance with the provisions of sub-section (1) of section 205. The depreciation is provided for in the profit and loss account. The loss is arrived at after taking into account the depreciation provided. It is, therefore, clear that the word loss as used in the proviso, clause (b) to section 205(1) signifies the amount arrived at after taking into account the amount of depreciation and it has to be so read and understood in the context of section

115J of the Income-tax Act, 1961. We do not agree with the view taken by the High Court that in case there is profit in a year but after adjustment of depreciation it results in loss, no adjustment in the book profit under section 115J can be allowed. The view taken by the High Court would partially defeat the object sought to be achieved by section 115J of the Income-tax Act, 1961. We also do not agree with the High Court saying that having lifted section 205(1), proviso clause (b) from the Companies Act into section 115J of the Income-tax Act, there is no occasion to refer to the Companies Act, 1956, at all."

The Calcutta High Court in *Peico Electronics and Electricals Ltd. v. Commissioner of Income-tax* (2011) 339ITR506 followed the view held in *Surana Steels* (supra). The P & H High Court too in *Laxmi Pipes P. Ltd. v. Commissioner of Income-tax (appeals)* (2008) 303ITR279 held that loss mentioned in clause (b) of the first proviso to sub-section (1) of section 205 of the Companies Act, 1956, read with section 115J of the Income-tax Act, 1961, includes unabsorbed depreciation. The MP High Court in *Sanghi Organics and Phytochem Pvt. Ltd. v. Commissioner of Income-tax* (2001) 252ITR295 held likewise. The Kerala High Court in *Chintha Printing and Publishing Co. (P.) Ltd. v. Commissioner of Income-tax* (2001) 247ITR95 held that "loss" refers to the amount of loss arrived at after taking into account the amount of depreciation provided in the profit and loss account. The Gauhati High Court in *Commissioner of Income-tax v. MechTechnik India (P.) Ltd.* (2000) 245ITR60 held that the loss is arrived at after taking into account the depreciation provided.

Further the committee also held a view that loss would mean loss before appropriation adjustments such as provision for investment allowance reserves. Later after the Apollo case decision of the SC in Apollo Tyres Ltd. v. Commissioner of Income-tax (2202) 255ITR273 the Madras High Court in Commissioner of Income-tax v. Swamiji Mills Ltd. (2012) 342ITR350 and Kerala High Court in SreeBhagawathy Textiles Ltd. v. Assistant Commissioner of Income-tax (2012) 342ITR244 also confirmed that the assessee is not entitled to have the deduction of amounts debited in the profit and loss appropriation account in the computation of net profit.

And in regard to surplus the view had been that any such surplus carried forward from earlier years should be deducted from the loss. In Commissioner of Income-tax v. Kongarar Spinners Ltd. (2007) 295ITR215 the Madras High Court held that while computing the book profit under section 115J of the Income-tax Act, 1961, the unabsorbed depreciation/business loss of earlier years should be taken after adjusting the profits earned in some of the intervening years against the unabsorbed depreciation and loss of other years.

3.1. Critic

The ICAI must suomotu provide an opinion in this regard as in true sense the method of set off and carry forward as per books must be guided on the basis of well laid down accounting principles and conventions rather than on any other basis or interpretation. This would settle the litigation on the subject once for all. And it is all the more necessary now since the Act is amended with reference to s. 205 out of it and Surana Steels (infra) being overtaken.

4. AAR ruling on Methodology of set off - Rashtriyaspat Nigam Ltd., In re (2006) 285ITR1

4.1 Applicant Stand

The applicant's contention before the AAR was that, for the purposes of quantification of income-tax liability under section 115JB, although the reduction from the current year's profits to be made is the lesser of book depreciation or book loss brought forward from earlier years, yet for the purposes of quantification of carry forward of unabsorbed book loss and book depreciation to the next assessment year, the applicant has the option to reduce from the current year's profit, either the book loss or the book depreciation, irrespective of which one is lower. It can exercise whichever option is beneficial to it. In other words the current year loss can be set off against unabsorbed depreciation no matter such figure is higher than unabsorbed business loss. The applicant further argued against application of department Circular on the ground that circular cannot be construed as a total statement of law on the subject, but is only one of the interpretations.

4.2 Revenue Stand

The Revenue, on the other hand, has taken the plea that if there is current profit as per the profit and loss account then the same would be reduced by either the book loss or the book depreciation, whichever happens to be less. Once such adjustment has been carried out, the unabsorbed book loss or the book depreciation brought forward, whichever had been the lesser, would stand further reduced by such adjustment. The reduced amount alone would

be available for carry forward, to the subsequent year.

The Department has relied on the Central Board of Direct Taxes Circular No. 495 dated September 22, 1987 [1987] 168 ITR (St.) 87) to determine the correct method of set off and carry forward of book loss and book depreciation from one year to the next. The circular advocate year wise basis for set off when losses once set off would exhaust.

4.3 AAR Stand

Dissenting the methodology adopted in this case by the applicant the AAR held that the contention of the applicant that although the reduction to be made from the current year's profits is the lesser of book depreciation or book loss brought forward from earlier years, yet for the purposes of quantification of carry forward of unabsorbed book loss and book depreciation to the next assessment year, the applicant company has the option to reduce from the current year's profit, either the book loss or the book depreciation, irrespective of which one is lower is without any basis and cannot be approved.

In this case the question before the hon'ble Authority was whether section 115JB imposes any restriction with regard to the discretion of an assessee in the matter of computation of book profit, in the absence of any specification therein as to the manner in which business loss or unabsorbed depreciation has to be adjusted. In the absence of any statutory prohibition as regards the methodology adopted by the applicant, any method of adjustment cannot be termed as a design to reduce the tax liability. To this the AAR replied that

where the statutory provision is silent regarding carry forward of business loss and unabsorbed depreciation after reduction against the current year's profit, the carry forward would be according to the general principles of law and accountancy meaning thereby that the assessee must follow a consistent method for set off and carry forward not like the one where it set off the profit against unabsorbed depreciation in one year and next year set off the profit against the business loss brought forward to maintain balance of the two which is what the assessee PSU projected in this case. The AAR held that it is not open to each taxpayer to opt for inconsistent method of accounting. Suffice it to say that no accounting is possible without following some "method of accounting" which is consistent and regular from year to year.

4.4 Critic

Even though the AAR admitted that the statutory provision is silent regarding carry forward of business loss and unabsorbed depreciation after reduction against the current year's profits it did not provide benefit of doubt to the assessee and rather went by narrow kind of view held by the Board.

5. S.115JA/115JB Scheme

5.1. SC decision in Surana Steels (P.) Ltd. v DCIT (1999) 237ITR 777-whether loss to mean including or excluding depreciation

The question involved in this case was whether term 'loss' as occurring in clause (b) of the proviso to section 205(1) of the Companies Act has to be understood in context of section 115J and read as amount arrived at after

taking into account depreciation. Explanation to sub-section (1) of section 115J incorporates the provisions of clause (b) of the first proviso to sub-section (1) of section 205 of the Companies Act, 1956 in arriving at the brought forward loss or unabsorbed depreciation. Supreme Court held that, 'loss' as used in proviso clause (b) to section 205(1) signifies the amount arrived at after taking into account the amount of depreciation and it has to be so read and understood in the context of section 115J. The High Court in the previous instance held that the term "loss" as used in section 205(1), first proviso, clause (b), of the Companies Act, 1956, read with section 115J of the Income-tax Act, 1961, does not mean "including depreciation". The High Court thus held that the assessee is entitled to deduct depreciation or loss whichever is less only in the eventuality when in a given year there is loss as well as depreciation. In such a case, the lesser of the two amounts will be available for deduction as per the provisions of the Income-tax Act. In case there is profit in a year but after adjustment of depreciation it results in loss, no adjustment in the book profit under section 115J can be allowed.

Thus after the SC ruling the view taken by the High Court that in case there was profit in a year but after adjustment of depreciation it resulted in loss, no adjustment in the book profit under section 115J could be allowed, was not found correct.

5.2. Freedom from MAT only for short time-MAT reintroduction in the form of section 115JA by Finance(No.2) Act-1996- Circular No. 762 dated 16-02-1998

Subsequent to the decision of the Apex Court in Surana Steels (supra) the law was amended by introducing section 115JA, which was in operation for the period April 1, 1997, to March 31, 2001. From the first day of April, 2001 onwards section 115JB is operative. Under both these sections the relevant sub-clause (iii) pertaining to the amount of loss brought forward or unabsorbed depreciation includes an Explanation, which states that the loss shown shall not include depreciation. Sub-clause (iii) therein is reproduced hereunder:

“(iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account.

Explanation.-For the purposes of this clause,-

(a) the loss shall not include depreciation ;

(b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation, is nil.”

Finance (No.2) Act, 1996 inserted a new section 115JA in the Act from 01-04-1997 under the caption “Deemed income relating to certain companies”, provisions of which will apply in relation to assessment year commencing from 1997-98.

The scheme envisages the payment of a minimum tax by deeming 30 per cent of the book profits computed under the Companies Act, as taxable income, in a case where the total income as computed under the provisions of the Income-tax Act is less than 30 per cent of the book profit. Where the total income as computed under the normal provisions of the Income-tax Act, is more than 30

per cent of the book profit, tax shall be charged on the same. The reason for re-introducing the MAT u/s 115JA has been explained as under:

“In recent times, the number of zero-tax companies and companies paying marginal tax has grown. Studies have shown that inspite of the fact that companies have earned substantial book profits and have paid handsome dividends, no tax has been paid by them to the exchequer.”

Further income arising from free trade zone (FTZ), export oriented undertakings (EOUs), charitable activities, investment by a venture capital company and other exempted incomes (section 10) are excluded from the purview of the minimum alternate tax.

Since the alternate tax is applicable only where the normal total income computed under the act is less than 30 per cent of the book profits, so long as the enterprises (other than FTZ units and EOUs) earning income from export profits do not have their component of export income higher than 70 per cent of the book profits, the provisions of section 115JA will not be attracted. In other words, MAT will apply only to such cases where export profits forming part of book profits of an assessee exceed 70 per cent of the total profits.

Also Companies engaged in the business of generation and distribution of power and those enterprises engaged in developing, maintaining and operating infrastructure facilities under sub-section (4A) of section 80-IA are exempted from the levy of MAT, so that the incentive given to infrastructure development is not affected.

6. Courts Speak

6.1. Kerala High Court on FIFO Method application

In Commissioner of Income-tax v. Carbon and Chemicals India Ltd. (2012) 344ITR252 it was found that in the preceding assessment year there was a profit and that profit was sufficient to absorb the entire brought forward business loss in that assessment year whereby the whole loss got set off leaving no carried forward business loss for the relevant assessment year i.e. the next year. The assessee however smartly managed to set off profits partly against the loss and partly against the depreciation brought forward in the following manner which was resisted by the revenue which is also upheld by the Court:

PY	AY	Loss before depreciation	Dep
934	945	107744461- (a)	57804819 (c)
945- actual position	956	117161492	-
945- assessee's method of set off	956	73668187 (b)	43493305 (d)
956	967	34076274 (a-b)	14311514 (c-d)

The Court noticed that the profit in 945 was sufficient to absorb the total loss of 107744461 so that there was no losses carry forward in A Y 956 for which reason the assessee's theory of FIFO method drowned. Thus the assessee's method failed. The Kerala High Court further held that FIFO method of setting off applies only when more than one year's brought forward business loss or unabsorbed depreciation is set off against profit available in later years. In case there are profits in between the FIFO method may derail. The Court pointed out that what is referred to in clause (b) of Explanation (iii) to section 115JA is about the brought forward business loss or unabsorbed depreciation available at the end of the previous year and it is for the assessee to first set off the profit against brought forward business loss and then to set off the balance profit, if any, against brought forward depreciation. In this case if the brought forward business loss of Rs. 10,77,44,461 is set off against the profit of 117161492, then the balance brought forward business loss available will be nil. The Court thus objected to what the Tribunal wrongly allowed brought forward business loss to be bifurcated and permitted set off only for some years while retaining a balance of Rs. 3,40,76,274 for future set off.

6.2. Delhi High Court at par with Kerala View

The Delhi High Court in Commissioner of Income-tax v. Eli Lilly and Co. India P. Ltd. (2011) 334 ITR 186 upheld the following methodology in the matter of carry forward and set off of losses/unabsorbed depreciation for that purpose and did not find any apparent mistake in this regard requiring correction u/s 154:

Assessment year 1999-2000 as on 1.4.1998 (as per books)Rs.

(i) unabsorbed depreciation 1,39,36,000

(ii) brought forward business loss (excluding depreciation) 14,21,44,000

mat computation done by assessee

Profit as per profit and loss account 58,98,000

Less : Lower of unabsorbed depreciation and brought forward business loss [as per Explanation (ii) of the second proviso to section 115JA(2)] (1,39,36,000)

Book profit (80,38,000)

As on 31-3-1999 (as per books)

(iii) unabsorbed depreciation 1,39,36,000

(iv) business loss (excluding depreciation) to be carried forward 13,62,46,000

*[Rs. 14,21,44,000 - Rs. 58,98,000]

Aggregate loss 15,01,82,000

Assessment year 2000-01

MAT computation done by assessee

Profit as per profit and loss account 1,23,00,504

Add : Provision for doubtful debts 3,49,292

Add : Provision for doubtful advances 3,21,696

Less : Lower of unabsorbed depreciation and brought forward business loss [As per Explanation (ii) of the second proviso to section 115JA(2)] (1,39,36,000)

Balance profit 9,64,508

As on 31-3-2000 (as per books)

(v) Unabsorbed depreciation 1,39,36,000

(vi) Business losses (excluding depreciation) to be carried forward 12,39,45,496

*[Rs. 13,62,46,000 - Rs. 1,23,00,504]

Aggregate loss 13,78,81,496

Assessment year 2001-02

MAT Computation Done By Assessee

Profit as per profit and loss account 1,19,99,177

Less : Lower of unabsorbed depreciation and brought forward (1,39,36,000)

forward business loss [As per Explanation (ii) of the second proviso to section 115JA(2)]

Book profit (19,36,823)

As on 31-3-2001

(vii) Unabsorbed depreciation 1,39,36,000

(viii) Business losses (excluding depreciation) to be carried forward 11,19,46,319

*[Rs. 12,39,45,496 - Rs. 1,19,99,177]

Aggregate loss 12,58,82,319

As per the Assessing Officer the unabsorbed depreciation available for set off in A Y 1999-00 against the profits in the A Y 2000-01 is just Rs. 80,38,600 whereas the figure of Rs. 1,39,36,000 is taken as unabsorbed depreciation.

The Delhi High Court decision thankfully goes contrary to what is held by AAR in Rashtriyalspat Nigam (supra) where following methodology was adopted by the revenue:

Financial year 2002-03 (assessment year 2003-04)

i) Book profits as per audited accounts - 521 cr.

As reduced by :

Aggregate book loss for the last 12 years (-) Rs.1,755 cr.

Or

- ii) Aggregate unabsorbed dep. for the last 12 years as per the books (-)
Rs. 3,227 cr.

Whichever is less (I or ii) 1,755 cr.

Adjusted book profit (-) 1,234 cr.

The adjusted book profit being negative, no tax liability arises under the MAT provision for this year. However, for the next financial year the applicant is entitled to carry forward the following amounts :

(a) unabsorbed book loss = 1,234 cr

(b) unabsorbed book dep. = 3,227 cr

Financial year 2003-04 (assessment year 2004-05)

- i) Book profit as per audited accounts 1,547 cr.

As reduced by :

Brought forward unabsorbed business dep. (-) Rs. 3,227 cr.

Or

- ii) unabsorbed loss (-) Rs. 1,234 cr.

Whichever is less 1,234 cr.

Adjusted book profit 313 cr.

Less : Profit attributed to export turnover as
computed by the applicant 233.45 cr.

Balance adjusted book profit subject to levy of minimum alternative tax under
section 115JB- 79.55 cr.

As per the above computed for the purpose of section 115JB(2) in respect of
the next f.y. the applicant is entitled to carry forward the following amounts :

(a) Business dep. 3,227 cr.

(b) Unabsorbed loss Nil

Financial year 2004-05 (assessment year 2005-06)

Estimated book profit as per the applicant 2,250 cr.

As reduced by

i) Brought forward unabsorbed loss as computed for earlier year Rs. Nil

Or

ii) Brought forward business dep. as computed for earlier year (-) Rs.
3,227 cr.

Whichever is less Nil

Adjusted book profit on which the applicant is required to pay advance tax on
account of MAT liability is Rs. 2,250 cr.

On such adjusted book profit, total advance tax payable by the applicant would
amount to Rs. 176.42 cr.

The Delhi High Court view thus goes even contrary to the CBDT view for better. This decision thus mandate that once an adjustment has been carried out, the unabsorbed book loss or the book depreciation brought forward, whichever had been the lesser, would not stand reduced by such adjustment but rather such adjustment is to be made from the higher of the two amounts and not necessarily against the brought forward business loss . Hence to this extent this Court somehow provides a liberal view over what is decided by Kerala High Court in Carbon and Chemicals case (supra).

6.3.Out of the blue view from Mumbai bench

In Amline Textiles (P.) Ltd. v. ITO (2008) 27SOT152 the assessee reduced aggregate amount of loss brought forward and unabsorbed depreciation relating to earlier years for purpose of computing book profit under section 115JB. Revenue, however, by relying on provisions of sections 71 to 73, held that loss brought forward or unabsorbed depreciation, was to be considered on year-to-year basis and not as an aggregate figure for all years in unison and, accordingly, disallowed claim of assessee.

The Tribunal held that computation of ‘book profit’ is to be done strictly as per Explanation 1 to section 115JB, and no assistance from any other section of Act can be taken for that purpose. In specific it held that when clause (iii) of Explanation 1 of section 115JB, clearly states that amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account is liable to be reduced, there was no authority for falling upon command of section 72, for holding that business loss or unabsorbed depreciation was to be considered on year-to-year basis and not as an aggregate figure for all years in

unison. If there is loss brought forward and unabsorbed depreciation for more than one year, then one combine figure each of unabsorbed depreciation and brought forward loss for such years is to be determined for consideration

The Mumbai bench held that business loss or unabsorbed depreciation is to be considered as an aggregate figure for all years in unison. In this case the assessee claimed set off of 15115393 as per the following aggregate/cumulative basis of calculation:

Year	Depreciation as per books	Loss as per books excluding depreciation	Total (Rs.)
A.Y. 1999-2000	42,25,696	94,88,756	1,37,14,352
A.Y. 2000-2001	44,42,777	1,30,33,168	1,74,76,945
A.Y. 2001-2002	44,53,565	(7,30,402)	37,23,163
A.Y. 2002-2003	19,93,456	22,84,195	42,77,650
	1,51,15,393	2,40,75,717	3,91,91,110

The revenue insisted that the depreciation amount of 4453565 for A Y 2001-02 is to be ignored in view of profit figure before depreciation. It therefore calculated set off at 10661929.

Year	Depreciation as per books	Loss as per books excluding depreciation	Total (Rs.)
A.Y. 1999-2000	42,25,696	94,88,756	1,37,14,352
A.Y. 2000-2001	44,42,777	1,30,33,168	1,74,76,945
A.Y. 2002-2003	19,93,456	22,84,195	42,77,650
	1,06,61,929	2,48,06,119	3,54,68,947

The Tribunal referred to clause (iii) of Explanation (i) to section 115JB, which states that the amount of loss brought forward or unabsorbed depreciation, whichever is less as per the books of account, is to be reduced from the net profit. On their reading of the plain language of such clause, it noted that the word employed in the provision is the 'amount' and not the 'amounts' of loss brought forward or unabsorbed depreciation, whichever is less. It therefore held that the reference to the 'amount of' brought forward loss or unabsorbed depreciation whichever is less shows the intention of the Legislature for considering one consolidated figure of brought forward loss or unabsorbed depreciation for the earlier years in totality and not on year-to-year basis.

The bench confirmed the stand of the assessee and further held that if there is loss brought forward and unabsorbed depreciation for more than one year, then one combined figure each of unabsorbed depreciation and brought

forward loss for such years is to be determined for consideration. The bench found much rationale in the same

6.4. CBDT circular no. 495 dated 22-09-1987 Vs.Mum. Tribunal judgment in the case of AmlineTextiles(P.) Ltd. V. ITO

Section 115J was introduced by Finance Act, 1987 vide circular no. 495, dated 22-09-1987 and further illustrated by one example. Taking on such illustration the provisions of sec. 115 J relating to carry forward of business losses or unabsorbed depreciation when considered in the light of the above mentioned judgment of Mumbai Tribunal in the case of Amline Textiles (P.) Ltd. V. ITO result in the following cumulative amount of losses/depreciation:

AY	Loss	Depreciation	Total
1984	300000	100000	400000
1985	(500000)	200000	(300000)
1986	1000000	200000	1200000
Total	800000	500000	1300000

Hence for the AY 1987 when we have profit of Rs 10,00,000 we can set off an amount of Rs 500000 from the profits available after calculation of depreciation as against the amount of Rs. 200000 advocated under board circular.

Further the above circular of department has not captured the cases where company is having a profit before depreciation and loss after depreciation

,which is not to be ignored in the light of ratio of the decision of the Mumbai bench.

7. Conclusion

Assessee must have freedom to set off current year profits either against unabsorbed losses or unabsorbed depreciation. And there can be no two doubts in this regard as there is no accounting principle that could set any mandatory pattern of set off. Even in s. 205 scheme there is only one necessity i.e. to provide depreciation including arrears before any payout of dividend. The ICAI must suo motu issue a guidance note and provide various case studies to explain the same methodology and clear the air. The Delhi High Court perhaps provides an optimum basis in this regard. However an assessee can follow the view as it suits better in the absence of any clear cut methodology provided in the section.

Appendix 1

Circular No 495 dated 22.9.1987 -The Finance Act, 1987-Explanatory Notes on the provisions relating to direct taxes

New provisions to levy minimum tax on “book profit” of certain companies

36.1 It is an accepted canon of taxation to levy tax on the basis of ability to pay. However, as a result of various tax concessions and incentives certain companies making huge profits and also declaring substantial dividends, have been managing their affairs in such a way as to avoid payment of income-tax.

36.2 Accordingly, as a measure of equity, section 115J has been introduced by the Finance Act. By virtue of the new provisions, in the case of a company whose total income as computed under the provisions of the Income-tax Act is less than 30 per cent of the book profit computed under the section, the total income chargeable to tax will be 30 per cent of the book profit as computed. For the purposes of section 115J, book profits will be the net profit as shown in the profit and loss account prepared in accordance with the provisions of Schedule VI to the Companies Act, 1956, after certain adjustments. The net profit as above will be increased by income-tax paid or payable or the provision thereof, amount carried to any reserve, provision made for liabilities other than ascertained liabilities, provision for losses of subsidiary companies, etc., if the amounts are debited to the profit and loss account. Liabilities relating to expenditure which has been incurred or which has accrued in respect of expenses which are otherwise deductible in computing income will not be added back. The amount so arrived at is to be reduced by—

(i) amounts withdrawn from reserves if any, such amount is credited to the profit and loss account ;

(ii) the amount of income to which any of the provisions of Chapter III applies, if any such amount is credited to the profit and loss account ; and

(iii) the amount of any brought forward losses or unabsorbed depreciation whichever is less as computed under the provisions of section 205(1)(b) of the Companies Act, 1956, for the purposes of declaration of dividends. Section 205 of the Companies Act requires every company desirous of declaring dividend to provide for depreciation for the relevant accounting year. Further, the company is required under section 205 to set off against the profit of the relevant accounting year, the depreciation debited to the profit and loss account of any earlier year(s) or loss whichever is less.

36.3 Section 115J, therefore, involves two processes. Firstly, an assessing authority has to determine the income of the company under the provisions of the Income-tax Act. Secondly, the book profit is to be worked out in accordance with the *Explanation* to section 115J(1) and it is to be seen whether the income determined under the first process is less than 30 per cent of the book profit. Section 115J would be invoked if the income determined under the first process is less than 30 per cent of the book profit. The *Explanation* to sub-section (1) of section 115J gives the definition of the “book profit” by incorporating the requirement of section 205 of the Companies Act in the computation of the book profit. Brought forward losses or unabsorbed depreciation whichever is less would be reduced in arriving at the book profits. Sub-section (2), however, provides that the application of this provision would

not affect the carry forward of unabsorbed depreciation, unabsorbed investment allowance, business losses to the extent not set off, and deduction under section 80J, to the extent not set off as computed under the Income-tax Act.

36.4 In the case of a tea company where income is derived from the sale of tea grown and manufactured by the seller, only 40 per cent of such income is liable to tax under rule 8 of the Income-tax Rules, 1962. 60 per cent of the income, which is disregarded for the purposes of taxation is considered to be agricultural income and is, therefore, exempt under the provisions of Chapter III. The net profit determined in accordance with Schedule VI to the Companies Act, 1956, has to be adjusted, *inter alia*, in accordance with clause (f) and sub-clause (ii) of the *Explanation* to section 115J(1). In the case of the tea companies, the book profit should be computed by making all the adjustments referred to in the *Explanation*. However, no adjustment in respect of clause (f) and sub-clause (ii) of the *Explanation* is to be made for the agricultural income earned by tea companies from tea business. 40 per cent of the adjusted amount arrived at in this manner will be the book profit of the tea company in accordance with rule 8 of the Income-tax Rules.

36.5 The following examples illustrate how the amended provisions relating to the new section will be applied :

NEW COMPANIES

Book profits for the purposes of the Companies Act, 1956 *Profit under the Income-tax Act*

Year 1984

Rs.

Rs.

Loss excluding

Loss excluding

depreciation

3,00,000

Depreciation

80,000

Depreciation

1,00,000

Depreciation

4,00,000

Year 1985

Profit before

Profit before

depreciation

5,00,000

Depreciation

5,00,000

Less : Depreciation as

per books

2,00,000

Less :

4,00,000

Depreciation

3,00,000

1,00,000

Less : Deduction

Less : Business

loss for

under section 205(2) for the

1,00,000

1984

80,000

year 1984

2,00,000

20,000

C.F. Business loss 1984	3,00,000	<i>Less :</i>	
		Unabsorbed	
		Depreciation	20,000
			<i>Nil</i>
		C.F. unabsorbed	
		depreciation	3,80,000
		1985	
	<i>Year 1986</i>		
Net loss as per		Business loss	(—) 10,00,000
books before	(—)	<i>Add :</i>	
depreciation	10,00,000	Depreciation as	
Depreciation	2,00,000	per Income-tax	
Business loss to be		Rules	(—) 4,00,000
carried forward	(—)		
Unabsorbed	10,00,000		
depreciation to be			
carried forward	(—)		

	2,00,000		
			Year 1987
Net profit	10,00,000		Profit before
			Depreciation 10,00,000
Book depreciation	2,00,000		Less :
			Depreciation as
			per Income-tax <u>8,00,000</u>
			Rules
			2,00,000
			Less : Carried
			forward
			business loss
			for 1986
			to the extent <u>2,00,000</u>
			adjusted
			Assessed Nil
			income

Application of section 115J

	Rs.
Profit before depreciation	10,00,000
Less : Book depreciation	<u>2,00,000</u>
	8,00,000
Less : Deduction under section 205(2)	<u>2,00,000</u>
	6,00,000
Out of the amount whichever is less:	
- 1984 : Business loss	3,00,000
- 1986 : Business loss	<u>10,00,000</u>
Total loss	13,00,000
1986 : Depreciation	2,00,000
Assessable income 30% of Rs. 6 lakhs, i.e., Rs. 1.8 lakhs	
Amount to be carried forward as per sub-section (2) of section 115J	
-1984 : Unabsorbed depreciation	3,80,000
-1986 : Business loss	8,00,000
Unabsorbed depreciation	4,00,000

36.6 These amendments will come into force with effect from 1st April, 1988, and will, accordingly, apply in relation to the assessment year 1988-89 and subsequent years.

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Appendix 2

Query: Issues relating to section 115J of the Income Tax Act 1961'

1 A deemed public limited company under section 43A of the Companies Act, 1956, is closely held domestic company under the provisions of the Income-tax Act 1961. Since the inception, the company has not declared any dividend. There are no reserves in the books of the company other than Capital Reserve and Investment Allowance Reserve. Its profit and loss account for the year ended 31st March, 1989, and 31st March, 1990, are as follows:

Profit & Loss Account for the year ended 31.03.1989

Profit & Loss Account for the year ended 31.03.1989

	Rs. (In lakhs)
Profit before depreciation	(+ 24.78
Depreciation	45.50
	<u> </u>
Loss after Depreciation	(-) 20.72
Income-tax	0.06
	<u> </u>
Loss after Income-tax	(-) 20.78
Investment Allowance Reserve	5.64
	<u> </u>
Loss after Investment Allowance Reserve	(-) 26.42
Less: Surplus b/d (1-4-88)	11.40
	<u> </u>
Debit balance in profit and loss account	(-) 15.02
	<u> </u>

Profit & Loss Account for the year ended 31.03.1990

	Rs. in lakhs
Profit before depreciation	(+ 36.68
Depreciation	24.04
	<u> </u>
Profit after depreciation	(+ 12.64
Investment Allowance Reserve	1.15
	<u> </u>
Profit after Investment Allowance Reserve	(+ 11.49
Less: Debit balance in profit and loss account b/d (01.04.89)	15.02
	<u> </u>
Debit balance in profit and loss account	(-) 3.53
	<u> </u>

2. It is the practice of the company to create investment Allowance Reserve in the year in which machineries is installed.
3. A dispute has arisen in the computation of book profit for the purpose of section 115J of the Income-tax Act, 1961, for the previous year ending 31'03.90 insofar as it relates to deduction allowable under sub-section (1A) (iv) of the section. The Income Tax Department, relying upon Circular No' 495 dated 22.09.81, issued by The Central Board of Direct Taxes, contends that no deduction is permissible under section 115J(1A)(iv) as there is profit before depreciation for the year ended 31.03.1989.
4. The contention of the assessee company, relying upon the illustration given in Final Study Material of Auditing (FSPAUD-3) issued by the Institute of chartered Accountants of India, is that loss means loss after providing for depreciation.
5. The relevant provisions of section 115J are as under:

"The book profit has to be reduced by -

The amount of the loss or the amount of depreciation which would be required to be set of against the profit of the relevant previous year as if the provisions of clause (b) of the first proviso to subsection (1) of section 205 of the Companies Act 1956 (1 of 1956) are applicable."
6. Clause (b) of the first proviso to section 205(1) states:-

"If the company has incurred any loss in any previous financial year or years' which falls or fall after the commencement of the Companies (Amendment)

Act, 1960, then the amount of the loss or an amount which is equal to the amount provided for depreciation for that year or those years whichever is less shall be set off against the profits of the company for the year for which dividend is proposed to be declared or paid or against the profits of the company for any previous financial year or years, arrived at in both cases after providing for depreciation in accordance with the provisions of sub-section (2) or against both."

7. According to the querist, the illustration given in the Final Study Material (FAP ALID-3) is contrary to the views expressed by the CBDT in the illustration on given in the Circular under reference.

8. The querist has referred the following issues for the opinion of the Expert Advisory Committee:

(a) What is the true meaning of the word "loss" appearing in clause (b) of the first proviso to section 205(1) of the Companies Act, 1956:

(b) In particular -

(i) Is it loss of the previous year prior to depreciation?

(ii) Is it loss of the previous year after depreciation?

(iii) Is it loss after depreciation, provision for taxes and Investment Allowance Reserve?

(iv) Should surplus carried forward from the earlier year be deducted from such loss?

Opinion - May 2nd 1991

1. The Committee is of the view that the terms 'profit' and 'loss' used in Companies Act, 1956 denote 'profit after depreciation and tax' and 'loss after depreciation and tax', respectively. The true and fair view of the 'profit' or 'loss' of a company can be ascertained only after providing for depreciation and income tax. Hence, the term 'loss' referred to in clause (b) of the first proviso to sub-section (1) of section 205 of the Companies Act, 1956, means 'loss after providing for depreciation'.

2. The Committee is also of the view that if for purposes of clause (b) of the first proviso to sub-section (1) of section 205, the term 'loss' is taken to mean 'loss' before depreciation', then the depreciation for the previous financial years may not get set off against the profits of the company before it declares dividend as is clear from the following situations and that will go against the objective of section 205 which requires adjustment of depreciation before declaration of dividend.

<i>Profit/Loss before depreciation</i>	<i>Depreciation</i>	<i>Loss after depreciation</i>
Nil	5000	5000
-1000	5000	6000
+ 3000	5000	2000

3. The Committee is also of the view that creation of a reserve is an appropriation of profits and is not a charge against the profits. The investment allowance reserve is required to be created only in case an assessee intends to

claim deduction under section 32A of the Income-tax Act, 1961. The Committee is, therefore, of the view that the term "loss" referred to in clause (b) of the first proviso to sub-section (1) of section 205 of the Companies Act, 1956, means the 'loss before investment Allowance Reserve '.

4. The Committee is accordingly of the following opinion in respect of issues raised in paragraph 8 of the query:

(a) The word "loss" appearing in the clause (b) of the first proviso to section 205(1) means the 'loss after depreciation and tax',

(b) (i) Same as (a) above.

(ii) Same as (a) above.

(iii) The loss referred to in (a) above is loss after depreciation and income-tax. Investment allowance reserve is not to be considered for the purpose of computing the loss.

(iv) The surplus carried forward from earlier years should be deducted from such loss.

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