

Exploring Provisions

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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

Minimum Alternate Tax (MAT) is one of the most discussed and deliberated provisions. This document provides an hands-on controversies and scuffles of MAT.

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1) OBJECT OF THE SECTION- TO TAX ZERO TAX COMPANIES

Only because the Government felt that companies availing of various deductions permitted under the Income-tax Act showed a low income for the purpose of income-tax but was able to show healthy net profits as per books on the basis of which dividends were distributed and to tax these types of companies that tax on book profits were introduced.

2) INTRODUCTION:

Normally, a company is liable to pay tax on the income computed in accordance with the provisions of the income tax Act, but the profit and loss account of the company is prepared as per provisions of the Companies Act. There were large number of companies who had book profits as per their profit and loss account but were not paying any tax because income computed as per provisions of the income tax act was either nil or negative or insignificant. In such case, although the companies were showing book profits and declaring dividends to the shareholders, they were not paying any income tax. These companies are popularly known as Zero Tax companies. In order to bring such companies under the income tax act net, section 115JA was introduced w.e.f assessment year 1997-98.

According to this section, if the taxable income of a company computed under this Act, in respect of previous year 1996-97 and onwards is less than 30 % of its

book profits, the total income of such company is chargeable to tax for the relevant previous year shall be deemed to an amount equal to 30 % of such book profits.

A new tax credit scheme is introduced by which MAT paid can be carried forward for set-off against regular tax payable during the subsequent five year period subject to certain conditions, as under:-

When a company pays tax under MAT, the tax credit earned by it shall be an amount which is the difference between the amount payable under MAT and the regular tax. Regular tax in this case means the tax payable on the basis of normal computation of total income of the company.

MAT credit will be allowed carry forward facility for a period of ten assessment years immediately succeeding the assessment year in which MAT is paid. Unabsorbed MAT credit will be allowed to be accumulated subject to the ten year carry forward limit.

In the assessment year when regular tax becomes payable, the difference between the regular tax and the tax computed under MAT for that year will be set off against the MAT credit available.

The credit allowed will not bear any interest.

The Finance Act 2000, introduced from FY 2000-01, Section 115JB that provides if the tax payable on the total income as computed under the Income-tax Act in respect of any previous year relevant to the assessment year commencing on or after April 1 2001, is less than 7.5% of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable for the

relevant previous year shall be 7.5% of such book which was revised 10% in 2006, 15% in 2010 and then 18% in 2011. Currently the rate stands at 18.5% (A Y 2012-13).

3) Circulars List

| No | Date | Subject |
|----------------|-----------|--|
| No. 13 of 2001 | 9.11.2001 | Liability for payment of advance tax under new MAT provisions of section 115JB of the Income-tax Act – Says that all companies are liable for payment of advance tax having regard to the provisions contained in new section 115JB |
| 680 | 21.2.1994 | Effect of Explanation (iii) to section 115J – Clarification- says that it is only the manner of computation specified in section 80HHC(3) or (3A) or 80HHD, and not the amounts themselves, that should be imported into Explanation (iii) under section 115J. |

4) Plus Adjustments

- (a) the amount of income-tax paid or payable, and the provision therefor ; or
- (b) the amounts carried to any reserves, by whatever name called other than a reserve specified under section 33AC ; or

- (c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities ; or
- (d) the amount by way of provision for losses of subsidiary companies ;
or
- (e) the amount or amounts of dividends paid or proposed ; or
- (f) the amount or amounts of expenditure relatable to any income to section 10 [other than the provisions contained in clause (38) thereof] or section 11 or section 12 apply ; or
- (g) the amount of depreciation,
- (h) the amount of deferred tax and the provision therefor,
- (i) the amount or amounts set aside as provision for diminution in the value of any asset,
- (j) the amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset,

if any amount referred to in clauses (a) to (i) is debited to the profit and loss account or if any amount referred to in clause (j) is not credited to the profit and loss account,

5) Minus Adjustments

- (i) the amount withdrawn from any reserve or provision (excluding a reserve created before the 1st day of April, 1997 otherwise than by way of a debit to the profit and loss account), if any such amount is credited to the profit and loss account :

Provided that where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below second proviso to section 115JA, as the case may be ; or

- (ii) the amount of income to which any of the provisions of section 10 [other than the provisions contained in clause (38) thereof] or section 11 or section 12 apply, if any such amount is credited to the profit and loss account ; or
 - (a) the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets) ; or
 - (b) the amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (ii) (a) ; or
- (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 ; or

- (iv) the amount of profits eligible for deduction under section 80HHC, computed under clause (a) or clause (b) or clause (c) of sub-section (3) or sub-section (3A), as the case may be, of that section, and subject to the conditions specified in that section ; or
- (v) the amount of profits eligible for deduction under section 80HHE computed under sub-section (3) or sub-section (3A), as the case may be, of that section, and subject to the conditions specified in that section ; or
- (vi) the amount of profits eligible for deduction under section 80HHF computed under sub-section (3) of that section, and subject to the conditions specified in that section ; or
- (vii) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986), and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

Explanation.-For the purposes of this clause, "net worth" shall have the meaning assigned to it in clause (ga) of sub-section (1) of section 3 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986).

- (viii) the amount of deferred tax, if any such amount is credited to the profit and loss account.

6) Controversies

6.1 Impact of accounting deviations

a. 25.5.2012- KK Nag Ltd. Addl CIT (2012) 22taxmann.com37

The Pune bench held a view that in view of the statutory provision of s. 211(6) of the Companies Act, 1956, the net profit as shown in the Profit & Loss account for the purposes of Explanation 1 to the second Proviso to section 115JB is to be understood with reference to the Notes to accounts accompanying the annual accounts also.

In other words if there are any un-provided or short provisions say for depreciation etc. the same would admit of allowance for MAT purpose. In this case the notes stated that the company follow mercantile system of accounting and recognizes income and expenditure on an accrual basis except

in the case of leave encashment. Thus non-provision of the incremental liability towards leave encashment is considered as admissible deduction in this case.

Behind the Scene: Delhi High Court decision in the case of CIT v. Sain Processing & Weaving Mills (P.) Ltd. [2009] [176 Taxman 448](#)

On this very principle the Vizag bench of ITAT in Hindustan Shipyard Ltd. v. Deputy Commissioner of Income-tax (2010) 61TR TRib 407 held that waiver benefits earned from loan restructuring should form part of book profit even when so disclosed in notes only.

b. Apollo Tyres versus Power of AO to tinker the net profit

There is a general perception that once the accounts including the profit and loss account are certified by the authorities under the Companies Act, 1956, it is not open to the AO to contend that the profit and loss account has not been prepared in accordance with the provisions of the Companies Act, 1956. This is also reiterated in Commissioner of Income-tax v. Adbhut Trading Co. P. Ltd. (2011) 338ITR94 by the Bombay High Court.

However in Eastern Power Distribution Company of A. P. Ltd. v. Assistant Commissioner of Income-tax (2011) 10ITR ITAT 594 the Vizag bench of Tribunal explained that if on examination of the financial statements the Assessing

Officer finds that there is deviation from the established accounting practices then he shall be entitled to make suitable adjustments to the profit amount disclosed in the profit and loss account. As per the bench the Supreme Court in Apollo Tyres case (2002) 255 ITR 273 has only held that the Assessing Officer is having limited power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. Thus the AO can disregard certain entries if they are not in accordance with established accounting practices. In this case the assessee is found to have made certain entries for prior period adjustments in the very first year which nullified the net profit for which it had no valid explanations.

On the contrary, In Commissioner of Income-tax v. Adbhut Trading Co. P. Ltd. (2011) 338ITR94 the Bombay High Court held that once the accounts including the profit and loss account are certified by the authorities under the Companies Act, 1956, it is not open to the AO to contend that the profit and loss account has not been prepared in accordance with the provisions of the Companies Act, 1956.

Even further any qualifications in the report may be judged unfavorably by the AO. However the Delhi bench in Dune Leasing and Finance Ltd. v. Deputy Commissioner of Income-tax (2010) 4ITR AT 65 held that the Assessing Officer does not have any power to reopen the accounts which had been filed after due process before the Registrar of Companies to which neither the AO nor Registrar had taken any objection. In this case the interest income was not credited in the books of account but offered for taxation while computing the

income. The Assessing Officer added the interest income to the book profit under section 115JB of the Act.

6.2 Prior period items

According to the Delhi High Court decision in Commissioner of Income-tax v. Khaitan Chemicals and Fertilizers Ltd. (2008) 307ITR150 prior period adjustments as per AS 5 shown separately in the profit and loss account would not be a subject to any exception or exclusion. However if they are debited or credited in the appropriation account then those would be subject to exception or exclusion per Kerala and Madras benches (Sree Bhagawathy Textiles Ltd. v. Assistant Commissioner of Income-tax (2012) 342ITR244 and Commissioner of Income-tax v. Swamiji Mills Ltd. (2012) 342ITR250. Further any adjustment on account of prior period items is a debatable issue so that the AO can be restrained on the basis of Delhi High Court decision in CIT v. RTCL Ltd. (2012) 23taxmann.434 for any s. 154 action. The Mumbai bench in Shivshahi Punarvasan Prkalp Ltd. V ITO (2011) 15taxmann.com352 held a view that there is no provision for any adjustment on account of prior period expenses in *Explanation-1* to Section 115JB(2) hence any addition on account of disallowance of prior period expenses while computing book profit is not permitted under the law.

The message is book all debit adjustments before appropriation stage to avoid any disallowance and never book credit adjustments as you cannot take them out otherwise than in the cases noted in minus adjustments above.

6.3 Change in method of computation of depreciation from SLM to WDV method

In Commissioner of Income-tax v. Tidel Park Ltd. (2011) 334ITR126 the assessee escaped adjustment for excess depreciation charge as the Madras High Court found that Explanation (iia) to section 115JB of the Income-tax Act, 1961, would have application with effect from April 1, 2007. In this case the assessee changed the rates of depreciation charge in the accounting year and in the notes to accounts it mentioned that due to change in depreciation rate charged on the assets in the books, there was a reduction in the book profits to the extent of Rs. 14.30 crores. As the year pertaining was A Y 2002-03 the assessee managed to escape from any adjustment under clause (iia) (supra).

6.4 Electricity companies/State Electricity Boards established under Electricity (Supply) Act, 1948

The Kerala High Court in Kerala State Electricity Board v. Deputy Commissioner of Income-tax (2010) 329ITR91 held that the companies engaged in the business of generation and distribution of electricity and enterprises engaged

in developing, maintaining and operating infrastructure facilities, as a matter of policy, are not brought within the purview of section 115JA for the reason that such a policy would promote the infrastructural development of the country. Such an understanding of the CBDT is binding on the Department. Section 115JB, which is substantially similar to section 115JA cannot have a different purpose and need not be interpreted in a manner different from the understanding of the CBDT of section 115JA. Refer to Circular No. 762 dated February 18, 1998.

Though this decision pertains to a statutory corporation established by an Act other than Companies Act yet this cause may hold good even otherwise in case of Indian companies engaged in the two activities perhaps on the same understanding.

6.5 Penalty in Book Profit Case Scenario

The Delhi High Court in Commissioner of Income-tax v. Nalwa Sons Investments Ltd. (2010) 327ITR543 held a view that penalty cannot be imposed on the basis of disallowances or additions made under the regular provisions where the final assessment is completed on book profits. The case involved dispute over excess claim for section 80HHC deduction and depreciation on assets not put to use. Further in this case the income computed as per the normal procedure was less than the income determined by the legal fiction, namely, "book profits" under section 115JB of the Act. On the basis of normal provision, the income was assessed in the negative, i.e., at a loss of Rs. 36.95 crs as against returned loss of Rs. 43.47 crs. On the other hand, assessment

under section 115JB of the Act resulted in calculation of profits at Rs. 4,01,63,180 as against returned figure of Rs. 3,86,82,128.

The Delhi High Court in dropping penalty however admitted that there was concealment but also held that it had its repercussions only when the assessment was done under the normal procedure. As per the Court the assessment as per the normal procedure was, however, not acted upon as it found that the order at the end mentioned that assessment completed at book profits where tax is paid on the income assessed under section 115JB of the Act and the computation was made under section 115JB of the Act hence according it concealment had no role to play and further therefore the concealment as such did not lead to tax evasion at all for the reason that there is no element of tax that is sought to be evaded by reading of Explanation 4 of section 271(1)(c) of the Act.

Thus in this case on both the counts there was no effect on the book profit yet the AO levied penalty. Though the Supreme Court is yet to pronounce a final verdict on merits the department officers smartly also make such additions in the book profit computation. The subject is delicate and not free from controversy.

6.6 Foreign companies

The AAR in more than one ruling have held that foreign companies would not be liable to payment MAT unless they have a permanent establishment in India or found to have a place of business within India for which they are required

under the law to make out a balance-sheet and profit and loss account per the provisions of section 594 of the Companies Act:

- a. Praxair Pacific Ltd., In re (2010) 326ITR276
- b. Timken Company, In re v. (2010) 326ITR193

This view is universally accepted in other jurisdictions. In USA foreign persons are subject to AMT only on their income effectively connected with a U.S. trade or business.

6.7 Computation hitch

The computation rule is once a sum is included in the profit and loss account you cannot reduce it from the profit unlike in the case of computation of income under normal provisions. The Delhi Tribunal decision in Growth Avenue Securities P. Ltd. v. Deputy Commissioner of Income-tax (2010) 1ITR AT 807 is a reminder to this effect which says that only sums specifically referred to can be deducted. In this case the assessee earned some capital gains income and in order to seek exclusion of the same smartly appended a note to accounts stating the capital gain included in the profit and loss account prepared by the assessee was not otherwise includible in the net profit as per provisions of Parts II and III of Schedule VI to the Companies Act.

Interestingly the Mumbai bench of ITAT in Koprani Pharmaceuticals Limited v. Deputy Commissioner of Income-tax (2009) 309ITRAT 146 held that proposition that the assessing authority does not have the jurisdiction to make adjustments in the book profits certified by the statutory auditors of the

company other than the adjustment provided under the Explanation thereto is a general proposition laid down in Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC). Thus on the specific issue of capital gains that are directly credited to capital reserve account the bench however followed Bombay High Court decision in the case of CIT v. Veekaylal Investment Co. P. Ltd. [2001] 249 ITR 597 which says that while computing the total income under the Income-tax Act, the assessee is required to take into account income by way of capital gains, and therefore, in computing the book profit, the assessee cannot exclude any capital gains. The court in particular held that Schedule VI to the Companies Act requires disclosure of credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of an exceptional nature. It is thus also necessary to disclose the profits or losses arising from such transactions in the profit and loss account.

Yet further the Mumbai bench in Sumer Builders P Ltd. V. Dy CIT (2012) 19taxmann.com43 held that Assessing Officer has powers to go behind the accounts and see whether same have been prepared in accordance with the requirements of Part II and Part III of Schedule VI of the Companies Act, 1956. *In this case the assessee had earned profit on sale of shares/industrial units which admittedly have not been credited to the profit & loss account which is found to be contrary to the significant accounting policy of the assessee itself which stated that income from investments was to be credited to the revenue account. Also the treatment was found to be against the requirements of Accounting Standard AS-13 and requirements of Part II and Part III of Schedule VI of the Companies Act, 1956. As a result the AO brought these items to taxation under the MAT provisions of section 115JB.*

Thus once there is a disclosure either by way of note or qualification there is bound to be a repercussions. So it is better to consider effect thereto beforehand only.

6.8 Concept of real or notional income- Not relevant for MAT

For MAT calculations the concept of real income or notional income does not hold any ground so that even notional incomes taken to the credit of profit and loss account as per accounting standards would not call for any exclusion. It so happened that in City Gold Media Ltd. V. ITO (2012) 17taxmann.com232 a notional income was credited in the Profit & Loss account, following Accounting Standard-11 (AS-11) of which adjustment was made by the assessee in the computation by reducing the same from the net profit. Rejecting such plea the Ahmedabad bench of ITAT held that *if on one hand the revenue authorities are stopped from any adjustment then, in the like manner, the assessee is also not expected to reduce the 'book profit' while filing the income-tax return as was done by the assessee.* The bench further held that the only exception prescribed is where the company had adopted the accounts, however, those were different from the accounting policies, then they should be adjusted, so that they should correspond to the accounting policies and accounting standards.

7) MAT applicable even to the following companies:

(a) Insurance company

- (b) Banking Company
- (c) Power generation or power distribution company –state owned or privately owned
- (d) any other class of company for which a form of Balance Sheet and Profit and Loss account has been specified in or under any other Act governing such class of company;
- (e) Government Company;
- (f) Foreign company.

In such cases the provisions of the Companies Act, 1956 together with the provisions of the relevant Act applicable to each of such companies and the rules made there under in regard to the preparation of profit and loss account and in case of any inconsistencies the provisions of the special Act would have application.

8) Direct Taxes Code 2010

Chapter V

Computation of book profit

104. Computation of book profit.—

- 1) Notwithstanding anything in this Code, where the normal income-tax payable for a financial year by a company is less than the tax on book profit, the book profit shall be deemed to be the total income of the

company for such financial year and it shall be liable to income-tax on such total income at the rate specified in Paragraph A of the Second Schedule.

- 2) Subject to the provisions of this Chapter, the book profit referred to in sub-section (1) shall be computed in accordance with the formula—

$$A + B - (C + D)$$

Where,

A = the net profit, as shown in the profit and loss account for the financial year prepared in accordance with the provisions of section 105 ;

B = the aggregate of the following amounts, if debited to the profit and loss account:

- a. the amount of any tax paid or payable under this Code, and the provision therefor ;
- b. the amount carried to any reserves, by whatever name called ;
- c. the amount set aside as provision for meeting unascertained liabilities ;
- d. the amount by way of provision for losses of subsidiary companies ;
- e. the amount of dividends paid or proposed ;
- f. the amount of depreciation ;
- g. the amount of deferred tax and the provision therefor ;
- h. the amount set aside as provision for diminution in the value of any asset ;

- i. the amount of any expenditure referred to in clause (a) of sub-section (1) of section 18 ;

C = the aggregate of the following amounts:

- a. the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets) ;
- b. the amount withdrawn from the revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (a) ;
- c. the amount withdrawn from any reserve or provision if any such amount is credited to the profit and loss account and such amount has been taken into account for computation of the book profit of any preceding financial year ;
- d. the amount of profits of a sick industrial company for any financial year comprised in the period commencing from the financial year in which the said company has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and ending with the financial year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses ;
- e. the amount of any income referred to in section 10 read with the Sixth Schedule, if credited to the profit and loss account ;
- f. the amount of deferred tax, if any such amount is credited to the profit and loss account ;

D = the amount of loss brought forward.

- 3) In sub-section (2), the loss brought forward shall be—
 - a. nil, if such loss brought forward (excluding depreciation) or unabsorbed depreciation as per books of account, as the case may be is nil ; or
 - b. the amount of loss brought forward (excluding depreciation) or unabsorbed depreciation as per books of account, whichever is less, in any other case.
- 4) In sub-section (2), the amount of tax shall include—
 - a. any interest charged or chargeable under this Code ;
 - b. any tax on distributed profits under section 109 ;
 - c. any tax on distributed income under section 110 ;
 - d. any tax paid on branch profits under section 111 ; and
 - e. any tax on wealth under section 112.
- 5) Every company to which this section applies shall obtain a report in such form as may be prescribed from an accountant certifying that the book profit has been computed in accordance with the provisions of this section.
- 6) In this Chapter—
 - a. "normal income-tax" means the income-tax payable for a financial year by a company on its total income in accordance with the provisions other than the provisions of this Chapter ;
 - b. "tax on book profit" means the amount of tax computed on book profit at a rate specified in Paragraph A of the Second Schedule.

I. Way forward

Implications under the MAT will be fact-specific and may vary from company to company. There are certain precautions which could be exercised by corporate taxpayers to mitigate the MAT exposure. It appears that the government is resorting to extensive use of MAT provisions to achieve the objectives of equity and levying tax on the basis of ability to pay. There is an equal scuffle amidst controversies from the taxpayers.

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