Query No. 2

Subject: Accounting treatment of Minimum Alternative Tax (MAT) Credit in case of carried forward losses.[1]

A. Facts of the Case

1. A company was incorporated in the year 1976 as a wholly owned Government of India enterprise under the administrative control of the Ministry of Power to plan, promote, investigate, survey, design, construct, generate, operate and maintain hydro and thermal power stations and to explore and utilise the power potential of North East in particular. The company is presently running three hydro projects and two thermal projects in North Eastern States and catering to the demand of North Eastern States only. The company's shares are not listed with any stock exchange. The turnover of the company for the year ending on 31/03/2010 is Rs. 1,02,213 lakh.

2. The querist has stated that the company is paying Minimum Alternative Tax (MAT) as per the Income-tax Act, 1961 due to carried forward losses of Rs. 92,048 lakh till 31st March, 2009 and the same is expected to be at Rs. 52,049.30 lakh approximately as on 31st March, 2010. During the year 2009-10, the company has provided MAT liability of Rs. 48,03.18 lakh. The Comptroller and Auditor General of India (C&AG) during the course of audit of the accounts of the company pertaining to the year 2009-10 has raised query on MAT credit as mentioned below:

> "Section 115JAA provides that credit in respect of MAT (minimum alternative tax) shall be allowed to the company which shall be carried forward and set off not beyond the fifth assessment year immediately succeeding assessment year in which tax credit becomes allowable.
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> The tax credit shall be allowed to be set off in a year when tax becomes payable on the total income computed in accordance with any other provisions other than section 115JA or 115JB of the Income-tax Act.
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> An amount of Rs. 4,803.18 lakh has been provided for in the accounts of the company for the financial year 2009-10 towards MAT in accordance with section 115JA of the Income-tax Act, 1961 calculated @ 16.995% of the book profit.
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> As MAT is in the nature of advance tax, which is adjustable from tax payable in future (within 5th assessment year), the amount should have been shown as recoverable on account of MAT. Non-compliance of this has resulted in understatement of profit after tax as well as reserve and surplus by Rs. 4,803.18 lakh with corresponding under-statement of loans and advances."

[1] Opinion finalised by the Expert Advisory Committee on 16.03.2011.

3. The company has given reply in the following manner:

According to paragraph 6 of Accounting Standards Interpretation (ASI) 6, 'Accounting for Taxes on income in the context of Section 115JB of the Income-tax Act, 1961', issued by the Institute of Chartered Accountants of India (ICAI), MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit and loss account in the year of payment of MAT. In the year in which the MAT credit becomes *eligible to be recognised as an asset*, the said asset should be created by way of a credit to the profit and loss account and presented as a separate line item therein (emphasis supplied by the querist).

As per the Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax under the Income-tax Act, 1961, issued by the ICAI, the MAT credit receivable can be recognised as an asset by crediting profit and loss account, and debiting MAT Credit Receivable A/c, if and only if, there exists a *virtual certainty* that the company will have to pay taxes as per normal rates within the specified period. MAT credit is an asset as it has expected future economic benefits in the form of its adjustment against the discharge of the normal income tax liability if the same arises during the specified period. But, it (asset) has to be recognised in the balance sheet only when it is probable that the future economic benefit associated with it will flow to the enterprise. At this point of time, according to the querist, the company cannot predict with any degree of certainty that profit subject to normal income tax will accrue during the remaining years of specified period provided in section 115JA of the Income-tax Act, 1961. In fact, for the purpose of consideration of probability of expected future economic benefits in respect of MAT credit, the fact that the company is paying MAT and not the normal income tax, provides a prima facie evidence that normal income tax liability may not arise within the specified period to avail MAT credit. In view of this, MAT credit should be recognised as an asset only when and to the extent there is *convincing evidence* that the company will earn sufficient profits in the near future, so that it is able to pay taxes as per the normal provisions of Income-tax Act, 1961, and not as per MAT regime. (Emphasis supplied by the querist.)

Since, the company is having unabsorbed carried forward losses of Rs. 92,048 lakh, there is very much an element of uncertainty that the company will be paying normal tax in near future within the specified period. Moreover, the uncertainty is further compounded with the impending implementation of IFRS and the Direct Tax Code with effect from 01/04/2011. Besides, there would be an impact of the revised tariff which is to be decided by the Central Electricity Regulatory Commission (CERC) for the tariff period 2009-14. Hence, in the view of the querist, it is not necessary to provide MAT credit during the year 2009-10.

4. The querist has stated that the company shall create MAT credit in the year when it will be able to pay normal tax as per the provisions of the Income-tax Act, 1961. Till then, the company shall be reviewing on each balance sheet date as to whether to create MAT credit as an asset or not.

B. Query

5. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to whether recognition of MAT credit entitlement is necessary in the year 2009-10 even with the presence of huge carried forward losses of Rs. 92,048 lakh at the beginning of the year and uncertainty in profitability due to upcoming events, like implementation of IFRS and Direct Tax Code from 1st April, 2011 or whether the company should create MAT credit as an asset in the year when there is virtual certainty that computation of income tax as per normal provisions of Income-tax Act, 1961 shall arise or earlier to that.

C. Points considered by the Committee

6. The Committee, while expressing its opinion, has considered only the issues raised in paragraph 5 above and has not examined any other issue that may arise from the Facts of the Case, such as, computation of MAT liability and credit receivable in respect thereof, etc. Further, the opinion of the Committee, expressed hereinafter is only from accounting point of view and not from the angle of interpreting of any legal provisions of statute, such as, Income-tax Act, 1961.

7. The Committee notes paragraphs 7 to 12 of the Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax under the Income-tax Act, 1961, issued by the Institute of Chartered Accountants of India, as follows:

> "7. The Framework for the Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India, defines the term 'asset' as follows:
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> > "An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise."
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> 8. MAT paid in a year in respect of which the credit is allowed during the specified period under the Act is a resource controlled by the company as a result of past event, namely, the payment of MAT. MAT credit has expected future economic benefits in the form of its adjustment against the discharge of the normal tax liability if the same arises during the specified period. Accordingly, MAT credit is an 'asset'.
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> 9. According to the Framework, once an item meets the definition of the term 'asset', it has to meet the criteria for recognition of an asset so that it may

be recognised as such in the financial statements. Paragraph 88 of the Framework provides the following criteria for recognition of an asset:

> "88. An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably."

10. In order to decide when it is 'probable' that the future economic benefits associated with the asset will flow to the enterprise, paragraph 84 of the Framework, *inter alia*, provides as below:

> "84. The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the enterprise. The concept is in keeping with the uncertainty that characterises the environment in which an enterprise operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared."

11. The concept of probability as contemplated in paragraph 84 of the Framework relates to both items of assets and liabilities and, therefore, the degree of uncertainty for recognition of assets and liabilities may vary keeping in view the consideration of 'prudence'. Accordingly, while for recognition of a liability the degree of uncertainty to be considered 'probable' can be 'more likely than not' (as in paragraph 22 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets') for recognition of an asset, in appropriate conditions, the degree may have to be higher than that. Thus, for the purpose of consideration of the probability of expected future economic benefits in respect of MAT credit, the fact that a company is paying MAT and not the normal income tax, provides a *prima facie* evidence that normal income tax liability may not arise within the specified period to avail MAT credit. In view of this, MAT credit should be recognised as an asset only when and to the extent there is convincing evidence that the company will pay normal income tax during the specified period. Such evidence may exist, for example, where a company has, in the current year, a deferred tax liability because its depreciation for the income-tax purposes is higher than the depreciation for accounting purposes, but from the next year onwards, the depreciation for accounting purposes would be higher than the depreciation for income-tax purposes, thereby resulting in the reversal of the deferred tax liability to an extent that the company becomes liable to pay normal income tax.

12. Where MAT credit is recognised as an asset in accordance with paragraph 11 above, the same should be reviewed at each balance sheet date. A company should write down the carrying amount of the MAT credit asset to the extent there is no longer a convincing evidence to the effect that the company will pay normal income tax during the specified period."

8. From the above, the Committee is of the view that the MAT Credit receivable should be recognised in the books of the company only when and to the extent that there is convincing evidence that the company will be able to avail the future economic benefits arising therefrom during the specified period in which tax credit is allowable. The Committee notes that the requirement regarding 'virtual certainty' does not exist in the Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax, issued by the Institute of Chartered Accountants of India, as erroneously mentioned by the querist in paragraph 3 above. The Committee also notes from the Facts of the Case that as on 31st March, 2009, carried forward losses were Rs. 92,048 lakh, and are expected to be at Rs. 52,049.30 lakh as on 31st March, 2010, thus, indicating that to the extent of difference (which is approximately Rs. 39,998.70 lakh), the losses will be set off during the financial year 2009-10. The Committee is of the view that this set-off of losses may be an indication that the company may be able to pay normal income taxes during the specified period. However, in the view of the Committee, considering the principle of 'prudence' and the provisions of the Guidance Note, the mere existence of such indication is not sufficient. For recognising the MAT credit, there has to be a convincing evidence that the company would be able to avail future economic benefits arising from the MAT credit during the specified period, which the company should determine keeping in view the facts and circumstances of the company. While determining this, in the view of the Committee, reversals of deferred tax liabilities, if any, arising during the specified period should also be taken into account.

D. Opinion

9. On the basis of the above, the Committee is of the opinion that MAT Credit entitlement should be recognised in the books of the company if there exists convincing evidence that the company would be able to avail the future economic benefits arising therefrom during the specified period, as discussed in paragraph 8 above.