

## Query No. 15

Subject: Off-setting of various components of tax and disclosure of tax expenses.<sup>1</sup>

### A. Facts of the Case

1. A company is a public sector company under the administrative control of the Ministry of Mines, Govt. of India and is engaged in mining of bauxite, manufacturing of alumina and aluminium, generation of power in Captive Power Plant for use in Smelter Plant and selling alumina and aluminium both in domestic and international market. It has a capacity to produce 15,57,000 MT of calcined alumina, 3,41,000 MT of aluminium ingots per annum and 960 MU of power.

2. Paid-up share capital of the company is Rs. 644.31 crore and 12.85% of its shares are listed in Bombay Stock Exchange and National Stock Exchange. As per the provisions of clause 42 of SEBI Guidelines, the quarterly un-audited financial results are to be furnished to stock exchanges and be published in news papers. The un-audited financial results of the company for the quarter ended 30<sup>th</sup> September, 2009 were taken on record by its Board of Directors at 238<sup>th</sup> meeting held on 30<sup>th</sup> October, 2009. Thereafter, the financial results were submitted to the auditors for limited review and report.

3. The querist has stated that in un-audited financial results for the quarter ended 30<sup>th</sup> September, 2009, a sum of Rs. 110.51 crore was considered towards tax expenses, consisting of:

(a)	Provision for taxation current year	-	Rs. 117.01 crore
(b)	Provision for taxation-deferred	-	Rs. 21.51 crore
(c)	Provision for taxation for earlier year written back	-	(Rs. 28.01 crore)
			=====
			Rs. 110.51 crore
			=====

Provision for taxation for earlier year written back, included Rs. 14.77 crore on account of reversal of liability provided for the financial year 2008-09. Liability of Rs. 43.44 crore was made on account of leave encashment on the basis of actuarial valuation. For the assessment year 2009-10, corresponding to the previous year 2008-09, provision for income tax liability was

---

<sup>1</sup> Opinion finalised by the Expert Advisory Committee on 12.8.2011.

made considering inadmissibility of provision of Rs. 43.44 crore on account of leave encashment under section 43 (B)(f) of the Income-tax Act, 1961 and tax payment was made.

4. The querist has further stated that as per the practice followed by the company, provision for tax liability is made as per annual accounts. After tax audit, the provision for taxes made is adjusted as per Income Tax Return. Excess or short of tax between provision made as per annual accounts and Income Tax Return is either claimed as refund or paid.

5. The querist has stated that for accounting, as stated at paragraphs 3 and 4 above, the following facts/judgments were considered:

(a) As per hon'ble Calcutta High Court decision vide judgment dated 27.06.2007 in Exide Industries Ltd & Another vs Union of India & Ors, section 43(B)(f) relating to leave encashment is struck down being arbitrary, unconscionable and de hors the Apex court decision in the case of Bharat Earth Movers Ltd.

(b) Subsequent to above, petition for special leave to Appeal (Civil) No.22889/2008 was filed by Commissioner of Income Tax and as per the interim judgment order dated 08.05.2009, the Hon'ble Apex court made it clear that the assessee would, during the pendency of this civil appeal pay tax as if section 43(B)(f) is on the statute book but at the same time it would be entitled to make a claim in its returns.

6. In support of the above, a note was appended at paragraph 4 of un-audited financial results for the quarter ending 30<sup>th</sup> September, 2009 furnished to stock exchanges and also published in news papers, which reads as follows:

“The tax expense is net of the provision written back amounting to Rs. 28.01 crore (Rs. 14.77 crore on account of admissibility of leave encashment, based on interim order of Hon'ble Supreme Court in another case and Rs. 13.24 crore on account of employer's related expenses) for which refund have been claimed while filling Income Tax Return.”

7. In review report on un-audited financial results for the quarter ending 30<sup>th</sup> September, 2009, the auditors made the following qualification:

“We report that subject to para-4 of the Notes to Un-audited financial results for the period ended 30.09.2009 on the matter regarding write back of Rs. 14.77 crore on account of related tax provisions made during previous year and netting off the same with current tax provisions, considering the liability on account of leave encashment as an admissible expenditure is not in line with the provisions of section 43 B of the Income Tax Act, where such provisions are considered as inadmissible resulting in overstatement of profit after tax to that extent”.

8. In view of the qualification, the company considered it prudent to obtain an opinion from tax consultant on taking credit of Rs. 14.77 crore, as detailed at paragraphs 3, 4 and 5 above.

9. The auditors, while reviewing the un-audited financial results for the quarter ending 31<sup>st</sup> December, 2009 raised an objection as to whether an opinion of tax consultant can be obtained on the qualification of auditors and advised to seek opinion from the Expert Advisory Committee of the Institute of Chartered Accountants of India.

## **B. Query**

10. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) The format prescribed by SEBI for submitting un-audited financial results mention “Tax Expenses” only. It does not specify (i) current tax liability (ii) deferred tax liability and (iii) previous years’ tax liability/income. In such a situation, whether netting off all the tax expenses and putting under one head, i.e., ‘Tax Expenses’ (as prescribed in format) is in contravention of the provisions required for publication of un-audited financial results.

(ii) Whether the opinion obtained from tax consultant on the qualification given by auditors is proper.

### **C. Points considered by the Committee**

11. The Committee notes that the basic issues raised in the query relate to appropriateness of netting off all the tax expenses, viz., current tax liability, deferred tax liability and previous year tax liability and putting under one head, i.e., 'Tax Expenses' for publication of un-audited financial results in view of the formats prescribed by SEBI for the same. The Committee has, therefore, considered only this issue and has not examined any other issue arising from the Facts of the Case, such as, appropriateness of recognition of provision on account of leave encashment or reversal thereof, its admissibility as per the provisions of Income-tax Act, 1961, preparation of interim financial statements, provisioning requirements in respect of income taxes, deferred tax effect of provision for leave encashment or any other item arising from the Facts of the Case, etc. Further, the Committee has opined purely from accounting point of view and not from interpreting any legal enactments, such as, Income-tax Act, 1961 or decision of any Court of law, etc.

12. The Committee notes paragraph 27 of Accounting Standard (AS) 25, 'Interim Financial Reporting', which provides as follows:

*“27. An enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, the frequency of an enterprise's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.”*

On the basis of the above, the Committee is of the view that for interim financial statements, the same accounting policies as adopted for annual financial statements should be applied. The Committee further notes that as per the requirements of SEBI (SEBI Circular SMDRP/Policy/Cir-44/01 dated August 31, 2001), “Companies shall be required to comply with

the accounting standard on “Accounting for Taxes on Income” in respect of the quarterly un-audited financial results with effect from the quarters ending on or after September 30, 2001”. Thus, the companies have to follow the requirements of AS 22 in the quarterly financial results.

13. The Committee notes the definitions of the terms ‘tax expense’ and ‘current tax’, as defined in paragraphs 4.3 and 4.4 of AS 22 and paragraph 9 thereof, which provide as follows:

***“4.3 Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.***

***4.4 Current tax is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.”***

***“9. Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period.”***

From the above, the Committee is of the view that deferred tax and current tax are part of the ‘tax expense’. Tax expense is an expense determined on the pre-tax income of the period for which results are being drawn. Accordingly, the Committee is of the view that asset/liability representing deferred tax and current tax can be netted off to determine a net figure of ‘tax expense’ for a period. However, the Committee is of the view that previous year’s tax liability being not related to tax expense for the current period cannot be netted off against the ‘tax expense’ for the current period. In this regard, the Committee also notes that clause 3(ix)(a) and (b) of Part II, ‘Requirements as to Profit and Loss Account’ of Schedule VI to the Companies Act, 1956 requires the aggregate, if material, of the amounts withdrawn from the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments, as no longer required, to be arranged under the most convenient heads and in particular, to be disclosed in the profit and loss account. Accordingly, the Committee is of the view that for the purposes of reporting in un-audited interim financial results as per the formats prescribed by SEBI, additional separate line item for provision for tax no longer required, related to previous year would be

technically more appropriate. However, netting off of such provision for tax related to previous year against the current year's provision for tax may also be acceptable for the purposes of such interim un-audited results for reporting to SEBI provided adequate disclosure thereof is made either in the inner column or through a separate note to the financial results.

14. As regards the issue on obtaining opinion of tax consultant on the qualification in the auditor's report, the Committee is of the view that there is no bar for the company on obtaining any opinion on any issue from anybody. However, it may also be mentioned that the opinion given by the auditor in his limited review report stands, irrespective of a different opinion expressed on that issue by any other professional.

#### **D. Opinion**

15. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 10 above:

- (i) Although asset/liability representing deferred tax can be netted against the current year's tax to disclose the tax expense for the period, the previous years' tax liability/asset cannot be netted against the current year's tax as discussed in paragraph 13 above. Accordingly, for the purposes of reporting in un-audited interim financial results as per the formats prescribed by SEBI, additional separate line item for provision for tax no longer required, related to previous year would be technically more appropriate. However, netting off of such provision for tax related to previous year against the current year's provision for tax may also be acceptable for the purposes of such interim un-audited results for reporting to SEBI provided adequate disclosure thereof is made either in the inner column or through a separate note to the financial results.

- (ii) There is no bar for the company on obtaining any opinion on any issue from anybody. However, it may also be mentioned that the opinion given by the auditor in his limited review report stands, irrespective of a different opinion expressed on that issue by any other professional.

---