MAT Ind AS Committee Report—MAT Framework for Ind AS Compliant Companies

Central Board of Direct Taxes had constituted a committee, i.e. MAT Ind AS Committee, to suggest a framework for the computation of book profit for the purposes of levy of minimum alternate tax under Section 115JB of the Income-tax Act, 1961 for the companies compliant with Indian Accounting Standards in the year of adoption and thereafter. MAT Ind AS Committee discussed in detail the provisions of Section 115JB of the Income-tax Act, 1961, Indian Accounting Standards and relevant Sections of Companies Act, 2013, and submitted a draft report regarding a framework for the computation of book profit for the Ind AS compliant companies compliant with Indian Accounting Standards. The author in this article attempts to summarise the key findings and recommendations of the MAT Ind AS Committee. Read on…

MAT-Ind AS Committee-Recommendations

Background

Central Board of Direct Taxes (CBDT) had constituted a Committee (hereinafter referred to as *MAT Ind AS Committee or the Committee*) to suggest framework for the computation of book profit for the purposes of levy of minimum alternate tax (MAT) under Section 115JB of the Income-tax Act, 1961 for the companies compliant with the Indian Accounting Standards (Ind AS) in the year of adoption and thereafter. The MAT Ind AS Committee discussed in details the provisions of Section 115JB of the Income-tax Act, 1961, Ind AS and relevant Sections of the Companies Act, 2013 ('the Act'), and submitted a draft report regarding framework of computation of book profit for the companies compliant with the Ind AS.

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Observations

MAT Ind AS Committee noted that an Ind AS compliant company has to bifurcate its profit and loss account into two parts:

(i) Net profit or loss for the year;

(ii) Net other comprehensive income (this will include both (a) items to be reclassified into profit or loss in subsequent periods, and (b) items not to be reclassified to profit or loss in subsequent periods).

The Committee also noted that the adjustments (such as income-tax, appropriation of profit,

revaluation of assets, brought forward loss, distribution of dividend, etc.) provided by Section 115JB of the Income-tax Act, 1961 indicate that the MAT provisions seek to compute realised profit before tax which is available for appropriation/distribution. Hence, there is an implicit relation between the distributable profits available for the payment of dividend under the Act and the tax base for levying MAT under the Income-tax Act, 1961.

The Committee further noted that fair value accounting is predominant in Ind AS and accordingly the net profit and net other comprehensive income of Ind AS compliant companies may include a sizeable amount of notional gains or losses. The Committee analysed the provisions of Companies Act; 2013 with respect to (i) free reserves (Section 2(43) of the Act), (ii) declaration of dividend (Section 123 of the Act) and (iii) managerial remuneration (Section 198 of the Act), to understand the nature of the notional gains/losses that needs to be excluded from the book profits for MAT purposes. The Committee observed that there are differing requirements under provisions of the Act for treatment of unrealised/notional gains and losses and approached the Ministry of Corporate Affairs (MCA) for clarity on this matter.

MCA Clarifications

The Ministry of Corporate Affairs (MCA) clarified that all notional/unrealised gains included in Net other comprehensive income are required to be excluded for the purposes of arriving at distributable profits for payment of dividend as well as for calculation of profit for managerial remuneration. The MCA further suggested that this principle may be extended for reckoning book profits for MAT purposes.

List of items, which the MCA recommended for exclusion, are:

(a) changes in revaluation surplus (Ind AS 16, Property, Plant and Equipment and Ind AS 38, Intangible Assets);

(b) remeasurements of defined benefit plans (Ind AS 19, Employee Benefits);

(c) gains and losses arising from translating the financial statements of a foreign operation (Ind AS 21, The Effects of Changes in Foreign Exchange Rates);

(d) gains and losses from investments in equity instruments designated at fair value *through other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109, Financial Instruments*;

(da) gains and losses on financial assets measured at fair value *through other comprehensive income in accordance with paragraph 4.1.2A of Ind AS 109.*

(e) the effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109;

(f) for particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk (paragraph 5.7.7 of Ind AS 109);

(g) changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value (Chapter 6 of Ind AS 109);

(h) changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument (Chapter 6 of Ind AS 109).

[Note the text in italics in clause (d) and (da) quoted above is not present in the MCA clarification. However, the intention of MCA is to exclude items which are covered within the definition of other comprehensive income as prescribed in Ind AS 1-presentation of financial statements. Hence the same has been included above for a better understanding.]

The Ministry of Corporate Affairs (MCA) clarified that all notional/unrealised gains included in Net other comprehensive income are required to be excluded for the purposes of arriving at distributable profits for payment of dividend as well as for calculation of profit for managerial remuneration.

Since net comprehensive income includes certain items that will permanently be recorded in reserves and hence never be reclassified to the statement of profit and loss account, the Committee recommended that these items should be included in book profits for MAT purposes at an appropriate point of time.

Recommendations of MAT Ind AS Committee

Initial Recommendations

Considering the clarifications received from MCA, MAT Ind AS committee recommended[1] the following vide its report dated 18th March 2016:

1. Book profit for the purpose of MAT for Ind AS compliant companies will be based on current year profits, excluding net other comprehensive income. Current adjustments under Section 115JB of the Income Tax Act; 1961 to continue.
2. Since net comprehensive income includes certain items that will permanently be recorded in reserves and hence never be reclassified to the statement of profit and loss account, the Committee recommended that these items should be included in book profits for MAT purposes at an appropriate point of time. An illustrative list of such items along with the recommended treatment for MAT is given below:

No.	Items	Recommended treatment
1	Changes in revaluation surplus (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realisation/disposal/ retirement.
2	Re-measurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the re-measurements gains and losses arise.
3	Gains & losses from investments in equity designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation.

3. The committee also deliberated the impact of first time adoption of Ind AS. Since the accounting policies that an entity uses in its opening Ind AS balance sheet at the time of first time adoption may differ from those that it previously used in its Indian GAAP financial statements, an entity is required to record transition adjustments directly in retained earnings/reserves at the date of transition to Ind AS. The Committee noted that several of these items would subsequently never be reclassified to the statement of profit and loss account/ included in the computation of book profits. Accordingly, the Committee recommended the following:

(i) Adjustments recorded in reserves and which would subsequently be reclassified to the profit and loss account (P&L) should be included in book profits in the year in which these are reclassified to the P&L.

(ii) Adjustments recorded in net other comprehensive income and which would never be subsequently reclassified to the P&L should be included in book profits as per guidance discussed in recommendation 2 above.

(iii) All other adjustments recorded in retained earnings and which would otherwise never subsequently be reclassified to the P&L should be included in book profits in the year of first time adoption of Ind AS.

Additional Recommendations

The Committee, after examining the comments/ suggestions received from stakeholders to its draft report discussed above, issued the following additional recommendations[2] on 23rd July 2016 relating to first time adoption of Ind AS.

1. **Property, Plant and Equipment– Adjustments to Retained Earnings**

   Ind AS 101- first time adoption of Ind AS permits an entity to measure items of Property, Plant and Equipment (PPE) at the date of transition retrospectively in accordance with Ind AS 16, Property, Plant and Equipment. Alternatively, a first-time adopter of Ind AS can opt to apply the 'deemed cost' exemption and measure items of PPE either at their fair value or at carrying value as per the previous GAAP, on the date of transition. At the date of transition the resulting adjustments in the carrying value of existing PPE are recorded in retained earnings.

   Recommendation:

   As mentioned in 3(iii) above, the initial recommendation of the Committee was to

[1] http://www.incometaxindia.gov.in/news/mat-indas-committee-report-28-04-2016.pdf
[2] http://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/57/Report-regarding-framework-for-computation-05-08-2016.pdf

include the amount of this adjustment in the book profit of the year of first-time adoption of Ind AS, since these amounts would never be reclassified to the statement of profit and loss. However, based on responses received from stakeholders, the Committee has now recommended the following:

- Following the principles in Sections 115JB of the Income Tax Act; 1961 that are applicable for revaluation of assets, the adjustments in retained earnings relating to PPE, on first-time adoption of Ind AS, should be ignored for computation of book profits
- Depreciation as well as gains or losses on disposal of such assets (for computation of book profits) should be computed by ignoring the retained earnings adjustment on first-time adoption, and
- Other adjustments to PPE such as decommissioning liability, foreign exchange capitalisation, borrowing costs, etc., on the date of transition should also be ignored in a similar manner.

  The Committee has also stated that the same principle be applied to items of intangible assets on the date of transition to Ind AS.

2. **Leases –Straight-Lining of Lease Rentals**

According to Ind AS 17, Leases, lease payments under an operating lease shall not be recognised as an expense/income on a straight-line basis over the lease term if the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. According to Indian GAAP, AS 19, Leases, require straight lining of such lease rentals and recognition of corresponding lease equalisation liability/asset, including cases where straight lining is not permitted under Ind AS 17. In such cases any existing lease equalisation liability/asset shall be adjusted to retained earnings on date of transition.

Recommendation:

After consideration of several options, the Committee has recommended that this retained earnings adjustment should be included in the book profits for levy of MAT, over a period of three years starting from the year of first-time adoption of Ind AS.

3. **Investments–Fair Value Adjustments through Profit and Loss Account**

Ind AS 109 requires or permits measurement of certain financial assets or financial liabilities at fair value through profit or loss in specific circumstances. Examples include:

1. Investments in equity instruments or mutual fund units;
2. Investments in subsidiaries/associates/joint ventures where the entity has opted to measure these at fair value through profit or loss in their separate financial statements;
3. Investment in debt instruments that do not meet the criteria for amortised cost measurement
4. Derivative assets or liabilities;
5. Any other financial asset or liability designated at fair value through profit or loss under Ind AS 109.

   Adjustments arising from recognition of such items at fair value on the date of transition to Ind AS are recognised in retained earnings.

Recommendation:

The Committee evaluated several options and recommended that the retained earnings adjustment should be included in book profit over a period of three years starting from the year of first-time adoption of Ind AS.

4. **Other Issues/Recommendations**

The Committee also considered issues relating to all other adjustments relating to first-time adoption of Ind AS recorded in retained earnings, which would never subsequently be reclassified to the statement of profit and loss. It recommended that these should be included in the book profit over a period of three years starting from the year of first time adoption of Ind AS.

Conclusion

The above recommendations of the Committee are helpful as it addresses some of the issues raised by the stakeholders. The committee is also looking at other issues raised by the stakeholders and expected to issue further clarification on the same.

These recommendations are yet to be notified by CBDT and hence entities need to keep a close watch on further development in this space. ■

The unhappy derive comfort from the misfortunes of others. - Aesop