The Tax 'Mix' of IGAAP, Ind-AS, Normal Tax Provisions, MAT & ICDS

The recent times have seen a colossal of several tax and regulatory amendments one after the other. Some of these amendments have been brought directly to the tax provisions and also at places which have significant ramifications on tax landscape. The key changes are implementation of Ind-AS (and its parallel existence with the IGAAP regime), introduction of ICDS in the normal tax provisions and amendments made in MAT provisions of the Income-tax Act, 1961 ('the Act') vis-à-vis Ind-AS. Resultantly, there are changes brought to the way in which accounts are prepared, scope of tax audits done and in the manner of tax computations and filings. The existence of different accounting norms at the same time and parallel application of different tax provisions (normal tax and MAT) thereon opens up a very interesting mix of 'tax' positions. In the present article, the author has discussed all of this and much more. Read on to know more….

Ind-AS stands for Indian Accounting Standards, the same are named and numbered in the same way as corresponding International Financial Reporting Standards (IFRS). We had for last many years, accounting regime in the form of IGAAP (Indian Generally Accepted Accounting Practices); several Accounting Standards prescribed therein and Schedule III of the Companies Act, 2013. However, the Ministry of Company Affairs (MCA)[1] announced Companies (Indian Accounting Standard) Rules, 2015 and adopted 39 Ind-AS standards. Pursuant to Ind-AS, amendments have been brought to Schedule III of the Companies Act, 2013. Ind-AS has to be followed (in phased manner) by Companies that are: (i) listed/in process of listing; (ii) net worth of ₹500 crore or more; or (iii) holding/subsidiary of aforesaid Company. Companies that do not fall in the above-mentioned categories can continue to follow IGAAP.

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[1] Notification dated 16th February, 2015

Thus, the 2 Accounting Standards Ind-AS and IGAAP exist in parallel and it may happen that a Company's financials which are on IGAAP in one particular year translate to Ind-AS in subsequent year.

Under IND-AS, several new line items would appear in a Company's financials as compared to IGAAP. Resultantly, the Ind-AS compliant financials could reflect different line items and value of profits/loss as compared to IGAAP. The first time adoption of Ind-AS from the IGAAP regime will also throw up the 'transition amount' – arising due to application of Ind-AS on IGAAP financials of earlier years. The application of Ind-AS would bring in significant changes to the accounting policies/practices–for instance, compulsory application of fair value of ESOP as compared to the option of intrinsic or fair value provided under IGAAP. Ind-AS could also have new classifications reflected in the financials such as 'Other Comprehensive Income' comprising of prescribed items such as hedging reserve, revaluation reserve, actuarial gain/loss in respect of employee benefits and others. In the Ind-AS Balance Sheet, 'Other Equity' would reflect including pure equity, reserves and equity component of instruments convertible into equity like Compulsorily Convertible Debentures. For deferred tax computation, only the Balance Sheet approach is provided under Ind-AS; also it requires inclusion of Effective Tax Reco (ETR) in Deferred Taxes. Due to Ind-AS, certain transactions which would *per se* be non-existent, but due to accounting requirement, may appear in financials-for instance, on Preference Shares (which are issued at below Market Rate of Interest), an 'interest' expense could be recognised in financials relating to its debt component. Such expense would not exist in real sense & may be construed 'notional'.

For tax computation purposes, the tax payer would determine the profit/loss figures as per Ind-AS or IGAAP and would thereby carry out the tax computation. For determining income and tax under the normal tax provisions, the taxpayer has to (additionally) consider the impact of Income Computation and Disclosure Standards ('ICDS').

ICDS are the guidelines introduced to bring consistency in computation and reporting of taxable income. There are 10 ICDS prescribed which have to be followed for computation (and disclosure) of income by all taxpayers (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited under the Act[2]) following mercantile system of accounting. ICDS has to be followed for computation of income only under the heads: (a) Profits and Gains of Business and Profession; and (ii) Income from Other Sources. ICDS is *qua* normal provisions and tax computation under MAT provisions remain unaffected by ICDS. ICDS is a very refined version of the Accounting Standards prescribed by the Authorities earlier[3]. Through the (revised) tax audit report format, even the tax auditor is required to comment upon a taxpayer's compliance of ICDS.

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ICDS would govern alongwith the normal provisions of the Act. For instance, in a matter involving capitalisation of interest cost relating to the pre-construction period of an asset, it will have to be determined in light of Section 36(1)(iii) and Section 43(1) Explanation 8 of the Act. Additionally, the provisions of ICDS – IX (Borrowing Costs) will have to be seen and given effect to in terms of determining qualifying asset(s) and treatment of general/specific purpose borrowings. Similarly, a matter involving a taxpayer's receipt of Government Grants would have to be seen as per Section 2(24)(xviii) of the Act and ICDS-VII (Government Grants). Likewise, for depreciation purposes, the value of asset(s) will have to be determined as per Section 43/43A of the Act along with provisions of ICDS-V (Fixed Assets). In case of conflict between the Act and ICDS, the Act will prevail. However, in respect of the authority of case-laws over ICDS, it has been clarified[4] that ICDS shall be applicable to the transactional issues dealt therein in relation to AY 2017-18 and subsequent AYs. ICDS does not require separate books of accounts to be maintained.

ICDS also provides for certain situations that could prepone the recognition and taxability of income. For instance, ICDS provides for recognition

[2] Section 44AB of the Act
[3] Section 145(2) of the Act
[4] CBDT Circular dated 23th March, 2017

of Government Grants in the year of receipt for tax purposes, whereas the taxpayer (let's call Company XYZ) can avail the option to recognise only a portion of such income every year in its accounts on deferred income basis. Thus, derivation of income/losses under tax and financials can get very different due to ICDS. Also, since the normal tax provisions (and also ICDS) tend to follow real income theory, the aforesaid 'notional items' which would reflect in IGAAP and plentiful in Ind-AS Accounts (of both income and expense) may have to be disregarded in tax. Thus, by implication of ICDS and normal provisions on IGAAP or Ind-AS financials, it may so happen that the profits/losses reflected in financials differ substantially from the taxable income of the assessee.

Recently the Hon'ble Delhi High Court[5] dealt with the constitutional validity of ICDS. The Hon'ble High Court dealt with specific provisions of the ICDS which are contrary to or seek to overcome binding judicial precedents and held that such provisions are to be struck down as the same are contrary to the law settled by various decisions of the Hon'ble Courts. Accordingly, the below-mentioned ICDS have been held as *ultra vires* to the Act:

- ICDS– I on Accounting Policies (which has done away with the concept of 'prudence');
- ICDS– II on Valuation of Inventories (contrary to decision of Hon'ble Supreme Court in case of Shakti Trading[6]);
- ICDS– III on Construction Contracts (to the extent ICDS III is contrary to law settled in several case-laws);
- ICDS– IV on revenue recognition (Para 5 and 6 of this ICDS dealing with income from export incentives and service transactions held *ultra vires*);
- ICDS– VI on Effects of changes in foreign exchange rates (contrary to decision of Hon'ble Supreme Court in *Sutlej Cotton Mills*[7]);
- ICDS– VII on Government Grants (contrary to and in conflict with accrual system of accounting);
- ICDS– VIII on Valuation of Securities (CBDT adopted separate approaches at different places for valuation)

In respect of applicability of MAT on Ind-AS financials, *vide* Finance Act, 2017 sub-Section(s) 2A, 2B & 2C and CBDT Notification, provisions have been incorporated into the Act for governing the tax treatment of different items appearing in Ind-AS financials.

In respect of the above, an interesting issue may arise as to whether or not, the decision of the Hon'ble Delhi High Court is binding precedent outside Delhi jurisdiction and what positions could assessees adopt in such situation.

Concerning the inter-play between the aforesaid and MAT provisions, the profits/losses reflected in Ind-AS or IGAAP financials will have to be adjusted as per Section 115JB of the Act and higher of the taxes (as determined under normal provisions r/w ICDS and Section 115JB of the Act) will have to be paid. For the purposes of MAT derivation, Section 115JB of the Act remain a self-sustained code and there is no implication of ICDS or any other guideline thereon. As far as the IGAAP financials are concerned, the existing provisions of Section 115JB of the Act Explanation 1 will continue to apply like in the past.

In respect of applicability of MAT on IND-AS financials, *vide* Finance Act, 2017 sub-Section(s) 2A, 2B & 2C and CBDT Notification[8], provisions have been incorporated into the Act for governing the tax treatment of different items appearing in Ind-AS financials. As per the newly inserted provisions, for a Company whose financial statements are drawn up as per Ind-AS, the 'book profits' reflected in financials need to be further adjusted in prescribed manner *i.e.*

a) increased by (i) amount(s) credited to other comprehensive income in financials under the head 'items that will not be re-classified to profit or loss'; and (ii) amounts debited to profit & loss account on distribution of non-cash assets to shareholders in a demerger as per Ind-AS 10;
b) reduced by (i) amount(s) debited to other comprehensive income in financials under the head 'items that will not be re-classified to profit

[5] Chamber of Tax Consultants and Anr (Petitioners)
[6] (2001) 250 ITR 871 (SC)
[7] (1979) 116 ITR 1 (SC)
[8] CBDT Circular No 24 / 2017 dated 25th July, 2017

or loss' and (ii) amounts credited to profit & loss account on distribution of non-cash assets to shareholders in a demerger as per Ind-AS 10;

The above shall not be applicable to the amounts credited/debited in respect of asset's revaluation surplus as per Ind-AS 16 or gains/losses from investment in equity instruments designated at fair value as per Ind-AS 109.

An example of the above-mentioned item of 'other comprehensive income under the head 'items that will not be re-classified to profit or loss" could be of value of actuarial gain/loss that is included in other comprehensive income but will not be re-classified to profit or loss a/c. There are certain items such as hedging reserves which are included in other comprehensive income but get classified to profit or loss a/c subsequently (at the time of actual settlement of transaction).

In respect of the book profit of the year of convergence and each of the following four years, it shall be increased/reduced by 1/5th of the 'transition amount'. The term 'transition amount' is defined to mean the amount or the aggregate of the amounts adjusted in other equity (excluding capital reserve, and securities premium reserve) on the convergence date but excluding few specified items such as – (i) revaluation surplus for assets as per Ind-AS 38; (ii) gains/losses from investment in equity instruments designated at fair value as per Ind-AS 109; (iii) adjustments on property, plant and intangible assets recorded at fair value as deemed cost as per Ind-AS 101; (iv) amounts adjusted in other comprehensive income on convergence date which shall be subsequently reclassified to profit and loss a/c and (v) others specified.

By virtue of the above, the MAT provisions have been amended as a result of which it will imply on several Ind-AS related adjustments. Firstly, the book profits which are derived as per Ind-AS will form the basis of MAT computation. Such book profits can include several items such as of 'capital'/'notional' nature. Subsequently, it needs to be adjusted in the prescribed manner to increase/reduce the book profits with items of other comprehensive income and others. Furthermore, it requires increase/reduction by 1/5th of the transition amount (comprising of several specified items).

The above-mentioned application of (different) tax provisions & accounting norms at the same time requires an effective and clear inter-linkage(s) and reconciliation between financials and tax (though it may not be required to maintain separate books for tax purposes). The Accountants, Auditors, Tax Advisors and even Assessing Officers will have to start performing business as usual on the new (and translated) accounts from IGAAP to Ind-AS and must comprehend with intricacies involved in it. It would add to complexity and may also lead to several untested positions.

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By implication of different tax provisions (normal and MAT), it may happen that under normal provisions, the items of notional or capital nature reflected in accounts are clearly dis-regarded in computation of taxable income, however for MAT purposes, the so called notional items continue to be included in 'book profits'. Whether items of 'capital' nature can be included in book profits or not remains debatable. The above could also lead to a situation wherein a taxpayer could be doubly taxed on the same income/receipt. In our aforesaid example involving Company XYZ, it may happen that while the Company spreads over such income over years proportionately in its accounts, it however, pays tax on Government Grants in first year (of receipt) itself (as per normal tax provisions and ICDS). However, it can happen that in subsequent year(s), on the proportionate amount of same income reflected in its financials, the same Company would have to pay MAT thereon again. Thereby, the tax 'Mix' could become a tax 'Fix'.

The Hon'ble Authorities have made several attempts to bring in (much needed) clarity on the subject matter. However, the positions emerging through inter-play of several accounting and tax norms are likely to remain vague for the time being and would open up several unique and untested positions. The aforesaid is a reality now and it will require a highly proactive approach to comprehend and deal with it effectively. ■