M P Lohia
Ex IRS

Convener
MAT – Ind AS Committee

Mumbai, the 18th March, 2016

Recd.
21/3/16
PS(Ch)

Shri Atulesh Jindal
Chairman,
Central Board of Direct Taxes,
North Block, New Delhi-110001

Sir,

Sub: Report regarding framework for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 for Indian Accounting Standards (Ind AS) compliant companies in the year of adoption and thereafter– reg.

Kindly refer to the Order of Central Board of Direct Taxes (CBDT) from F. No.133/23/2015-TPL dated 8th June, 2015 constituting this Committee to *inter alia* suggest the framework for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 ('the Act') for Indian Accounting Standards (Ind AS) compliant companies in the year of adoption and thereafter. The Committee discussed in detail the provisions of section 115JB of the Act, Ind AS and relevant sections of the Companies Act, 2013 during its meetings held for suggesting framework for computation of books profit of Ind AS compliant companies.

2. The provisions of section 115JB of the Act provide for levy of MAT on the basis of "book profit" i.e. the net profit disclosed in the profit and loss account prepared in accordance with the provisions of the Companies Act. For determining the book profit, section 115JB of the Act provides for certain adjustments mainly for items relating to income-tax, appropriation of profit, adjustment for brought forward loss/unabsorbed depreciation, revaluation of assets, distribution of dividend, etc. The adjustment for brought forward loss/unabsorbed depreciation is provided on the basis of the provisions contained in section 205 of the Companies Act, 1956 which provides computation machinery for determining the amount available for distribution of dividend. The adjustments indicate that the provisions of section 115JB of the Act seek to compute the realised profit before tax which is available for appropriation/distribution. Hence, there appears to be an implicit relation between the distributable profits which is available for payment of dividend under the Companies Act and the tax base for levying MAT under section 115JB of the Act.

3. Section 129 of the Companies Act, 2013 requires laying of financial statement in the annual general meeting. For an Ind AS compliant company, the financial statements shall include balance sheet, profit & loss account and statement of change in equity. An Ind AS compliant company shall be required to bifurcate its profit and loss account into following two parts:-

A. Net profit or loss for the year;

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

4. Section 123 of the Companies Act, 2013 contains provisions relating to declaration of dividend by a company. The section *inter alia* provides that the dividend shall be declared out of the profits of the company for the current year or out of the profits of the earlier year. It is further provided that in case of inadequacy of profits, the dividend can be declared out of the accumulated profits of the earlier year which has been transferred to the reserve. It is also specified that reserve for this purpose shall mean free reserves only. Section 2(43) of the Companies Act, 2013 provides that free reserve shall not include any amount representing unrealised gains, notional gains or revaluation of assets, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.Thus, section 123 read with section 2(43) prohibits distribution of dividend out of reserves containing notional/unrealised gains. The Committee noted that fair value accounting is predominant in Ind AS and accordingly the net profit and net other comprehensive income of the current year may include a sizeable amount of notional/unrealised gains or losses. Therefore, it appears that the dividend is allowed to be paid out of profits of the current year without any adjustments in respect of notional/unrealised gains.

5. Further, the definition of free reserve under section 2(43) of the Companies Act, 2013 provides for exclusion of notional/unrealised gains only and is silent about the treatment of notional/unrealised losses.

6. Section 197 of the Companies Act, 2013 provides that total managerial remuneration payable by a public company should not exceed 11% of the net profit for that year. Section 198 of the Companies Act which contains the mechanism for computation of profit for this purpose *inter alia* provides that profit for this purpose shall not include any changes in the carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

7. In view of the above differing requirements in the Companies Act for treatment of unrealised/notional gains and losses, the Committee issued a letter dated 27th July, 2015 (enclosed as Annexure A) requesting the CBDT for seeking clarifications on these issues from Ministry of Corporate Affairs (MCA).

8. The MCA vide letter from File No. 17/134/2015 CL V dated 11th January, 2016 (enclosed as Annexure B) intimated that all notional/ unrealized 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 items listed by the MCA are reproduced below –

i. Changes in revaluation surplus (Ind AS 16 and Ind AS 38);
ii. Remeasurements of defined benefit plans (Ind AS 19);
iii. Gain and losses arising from translating the financial statements of a foreign operation (Ind AS 21);
iv. Gains and losses from investments in equity instruments designated at fair value (Ind AS 109);
v. Gains and losses on financial assets measured at fair value (Ind AS 109);
vi. 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 (Ind AS 109);
vii. 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 (Ind AS 109);
viii. 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);
ix. 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).

The MCA suggested that the above principle may be extended for reckoning book profits for the purposes of MAT provisions.

9. The Committee deliberated on the issue and recommends the following –

I. Based on the inputs from the MCA that current year profits (excluding net other comprehensive income) will be available for distribution as dividends, and considering the implicit relation between the distributable profits which is available for payment of dividend under the Companies Act and the tax base for levying MAT, no further adjustments are required to be made to the net profits (excluding net other comprehensive income) of Ind AS compliant companies, other than those already specified under section 115JB of the Act.
II. As discussed, the net profits (excluding net other comprehensive income) under Ind AS may include a sizeable amount of notional/unrealised gains or losses. In the event that the MCA prescribes any further adjustments to the current year profits (excluding net other comprehensive income) for computation of distributable profits, the requirement for any additional adjustments to the book profit under section 115JB may be examined.

III. As discussed in para 3 above, the net other 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/ included in the computation of book profits. The Committee recommends 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 –

Sl. 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	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the remeasurements gains and losses arise
3	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109)	To be included in book profits at the time of realisation

10. The Committee also deliberated the impact of first time adoption of Ind AS. 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 these 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 recommends the following -

I. Those adjustments recorded in reserves and which would subsequently be reclassified to the profit and loss account, should be included in book profits in the year in which these are reclassified to the profit and loss account;

II. Those adjustments recorded in net other comprehensive income and which would never be subsequently reclassified to the profit and loss account (as discussed in para 9.III above), should be included in book profits as provided in para 9.III above;

III. All other adjustments recorded in retained earnings and which would otherwise never subsequently be reclassified to the profit and loss account, should be included in book profits in the year of first time adoption of Ind AS;

Section 115JB already provides for certain adjustments for computation of book profit.The above adjustments would be subject to the existing provisions of Section 115JB (e.g. the amount set aside as provision for diminution in the value of any asset is required to be added to book profits and accordingly would not be included in any of the adjustments mentioned above).

11. It may be noted that due to widening of the scope of the terms of reference of the Committee from time to time, the Committee in the given time has not been able to complete its deliberation on

examining the Ind AS/ ICAI guidance notes for the purpose of identifying the areas where additional ICDS need to be notified.

M.P. Lohia
(M P Lohia)
Convener of MAT – Ind AS Committee

O/C

Encl: as above

Copy to:

1) Member (L & C), CBDT 3/2/13
2) JS (TPL – I), CBDT

ANNEXUR-A

M.P. LOHIA
Ex IRS

Convenor
MAT – Ind AS Committee

Mumbai
27th July, 2015

Smt. Anita Kapur
The Chairperson
Central Board of Direct Taxes
North Block, New Delhi-110001.

Madam,

Sub: Request for seeking clarification/guidance from MCA in respect of application of certain provisions of Companies Act, 2013 to Ind As compliant companies – reg.

Kindly refer to the Order of Central Board of Direct Taxes (CBDT) from F. No.133/23/2015-TPL dated 8th June, 2015 constituting this Committee to *inter alia* suggest the framework for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-tax Act, 1961 ('the Act') for Indian Accounting Standards (Ind AS) compliant companies in the year of adoption and thereafter. The Committee discussed in detail the provisions of section 115JB of the Act, Ind AS and relevant sections of the Companies Act, 2013 during its meetings held for suggesting framework for computation of books profit of Ind-As compliant companies. During the discussion, it was felt by the Committee that it is not possible to recommend the framework without getting clarity/guidance on certain issues relating to application of certain provisions of the Companies Act, 2013 to Ind-AS compliant companies.

2. The provisions of section 115JB of the Act provide for levy of MAT on the basis of "book profit" i.e. the net profit disclosed in the profit and loss account prepared in accordance with the provisions of the Companies Act. For determining the book profit, section 115JB of the Act provides for certain adjustments mainly for items relating to income-tax, appropriation of profit, adjustment for brought forward loss/unabsorbed depreciation, revaluation of assets, distribution of dividend, etc. The adjustment for brought forward loss/unabsorbed depreciation is provided on the basis of the provisions contained in section 205 of the Companies Act, 1956 which provides computation machinery for determining the amount available for distribution of dividend. The adjustments indicate that the provisions of section 115JB of the Act seek to compute the realised profit before tax which is available for appropriation/distribution. Hence, there appears to be an implicit relation between the distributable profits which is available for payment of dividend under the Companies Act and the tax base for levying MAT under section 115JB of the Act.

3. Section 123 of the Companies Act, 2013 contains provisions relating to declaration of dividend by a company. The section *inter alia* provides that the dividend shall be declared out of the profits of the company for the current year or out of the profits of the earlier year after providing for depreciation in accordance with the provisions of Schedule II of the Companies Act, 2013. It is further provided that in case of inadequacy of profit, the dividend can be declared out of the accumulated

profits of the earlier year which has been transferred to the reserve. It is also provided that reserve for this purpose shall mean free reserves only. Section 2(43) of the Companies Act, 2013 provides that free reserve shall not include any amount representing unrealised gains, notional gains or revaluation of assets, or any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

4. Section 129 of the Companies Act, 2013 requires laying of financial statement in the annual general meeting. For an Ind AS Compliant company, the financial statements *shall* include balance sheet, profit & loss account and statement of change in equity. An Ind AS compliant company shall be required to bifurcate its profit and loss account into following three parts:-

A. Net profit or loss for the year;

B. Net other comprehensive income to be reclassified to profit or loss in subsequent periods (the items included in this part shall be routed to the profit and loss account of the future period on happening of certain events); and

C. Net other comprehensive income not to be reclassified to profit or loss in subsequent periods (the items included in this para shall never be routed to the profit and loss account of the future period).

5. Section 123 of the Companies Act, 2013, as discussed above, prohibits distribution of dividend out of reserves containing notional/unrealised gains. However, the dividend is allowed to be paid out of profits of the current year/earlier year without any restriction in respect of notional/unrealised gains. The fair value accounting is predominant in the Ind AS, therefore, the net profit/net other comprehensive income of the current year/earlier year shall include a sizeable amount of notional/unrealised gains or losses. As there is no restriction on distribution of profit from notional/unrealised gains included in the net profit/net other comprehensive income of the current year/earlier year, there appears to be inconsistency in the treatment of notional/unrealised gains for the purposes of distribution of dividend out of net profit/net other comprehensive income of the current year/earlier year as compared to dividend payment from accumulated reserves. The rationale behind this differential treatment could not be appreciated by the Committee. The Committee was also of the view that as far as possible the view taken for the unrealized / notional gains / losses for MAT and distribution of dividends should be on consistent basis. In view of this, it is requested that the Ministry of Corporate Affairs (MCA) may be requested to communicate the underlying principles for providing different treatment to notional/unrealised gains for distribution of dividend so that the Committee can take an informed view in this matter.

6. Further, section 197 of the Companies Act, 2013 provides that the total managerial remuneration payable by a public company should not exceed 11% of the net profit for that year. Section 198 of the Companies Act which contains the mechanism for computation of profit for this purpose *inter alia* provides that profit for this purpose shall not include any changes in the carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value. In view of this requirement and treatment of notional/unrealised gains for the purposes of dividend discussed above, it appears that a company has to calculate the profits excluding the notional/unrealised gains for the purposes of determining the distributable surplus for dividend payment and for determining the base for managerial remuneration. This would require re-writing of accounts especially for an Ind AS compliant company. In view of this, it is requested that the MCA may be requested to intimate that whether the MCA is proposing to

issue any guidance for calculating the said distributable surplus or base for managerial remuneration for ensuring uniformity in application by Ind AS compliant companies.

7. Further, the definition of free reserve under section 2(43) of the Companies Act, 2013 provides for exclusion of notional/unrealised gains only and is silent about the treatment of notional/unrealised losses. Hence, the MCA may also be requested to provide clarity for treatment of notional/unrealised losses for the purposes of computation of free reserve. With introduction of Ind AS, the computation of the profits after excluding the unrealized / notional gains / losses would involve complex computations. It is therefore necessary also to ascertain from MCA that whether they are considering any change in the law for avoiding such complex computations for determining the profits for distribution of profits or managerial remuneration, etc.

8. As per the order dated 8th June, 2015 referred to above, the Committee was supposed to submit its interim report on the issue of MAT calculation of Ind AS compliant companies by 31st July, 2015. The Committee had deliberated this issue in detail in its three meetings, however, due to uncertainty on the issues relating to application of certain provisions of the Companies Act, 2013 mentioned above, the interim report could not be finalised. In view of this, it is requested that the timeline for submission of interim report on the issue of MAT calculation may be extended suitably.

(M.P. Lohia)
Convenor of MAT-Ind AS Committee

ANNEXURE-B

File No. 17/134/2015 CL V

भारत सरकार /Government **of India**

कॉर्पोरेट कार्य मंत्रालय /**Ministry of Corporate Affairs**

पांचवीं मंजिल, ए विंग, शास्त्री भवन,
5th Floor, A Wing, Shastri Bhawan,
डॉ. राजेन्द्र प्रसाद रोड, नई दिल्ली - 110001
Dr. Rajendra Prasad Road, New Delhi - 110001
Dated: 11th January, 2016

OFFICE MEMORANDUM

Subject: Computation of Minimum Alternate Tax (MAT) liabilities for companies migrating to Ind-AS -reg.

The undersigned is directed to refer to letter no. 133/23/2015-TPL dated 15.09.2015 on the captioned subject and to state as follows:

2. That the issue flagged by the Department of Revenue is as to what should be the 'Book Profit' for the purposes of application of MAT provisions i.e. Section 115 JB of the Income Tax Act, 1961 for the Ind AS compliant companies in the light of the fact that the book profit as per proposed Schedule III of the Companies Act, 2013 (which is yet to be notified) is arrived at after considering/taking into account notional/unrealized gains which is termed as 'Net Other Comprehensive Income' of the year.

3. This aspect is also desired to be examined in the context of Section 123 of Companies Act, 2013 (dealing with Declaration of Dividend) and Section 198 of Companies Act, 2013 (dealing with calculating profits for the purpose of Managerial Remuneration) as the underlying principle of these provisions also appears to be similar as that of Section 115 JB of the Income Tax Act, 1961.

4. The above issue has been examined, in consultation with ICAI and the following observations are made:-

(i.) The Ind AS compliant Schedule III of the Companies Act, 2013 has been recommended by NACAS and is under consideration of Ministry. The said Schedule III is enclosed for your reference. Items at serial number XIII, XIV and XV may be of relevance.

(ii.) The total Comprehensive Income as per proposed Schedule III (Part II) i.e. proposed revised form of Profit & Loss Account for Ind AS compliant companies, is the aggregate of the "Profit for the period" and "Other Comprehensive income" (i.e. Aggregate of items XIII and XIV of Part II of Schedule III).

(iii.) That the components of "Other comprehensive income" include:
(a) changes in revaluation surplus (Ind AS 16 and Ind AS 38); (b) remeasurements of defined benefit plans (Ind AS 19); (c) Gains and losses arising from translating the financial statements of a foreign operation (Ind AS 21); (d) gains and losses from investments in equity instruments designated at fair value (Ind AS 109), (da) gains and losses on financial assets measured at fair value (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 (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 (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).

5. The items mentioned at 3 (iii) above are all notional/ unrealized gains and hence, these 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 Department of Revenue may, therefore, like to extend the above principle for reckoning book profits for the purposes of MAT provisions.

6. This issues with the approval of the competent authority.

Yours faithfully,

(M R Bhat)
Joint Director

To,
Shri Rajesh Kumar Bhoot,
Director (TPL-III),
M/o Finance, D/o Revenue,
Central Board of Direct Taxes,
North Block, New Delhi-10001.
2. Guard File