AMCHAM SUGGESTIONS ON

FRAMEWORK FOR COMPUTATION OF BOOK PROFIT FOR THE PURPOSES OF LEVY OF MAT UNDER SECTION 115JB OF THE INCOME-TAX ACT, 1961 FOR INDIAN ACCOUNTING STANDARDS (IND AS) COMPLIANT COMPANIES.

We support Committee's recommendation on exclusion of notional/unrealised profits from MAT levy and consequential MAT pick up at the stage of actual realisation.

(i) We are in agreement with core principle recommended by the Committee that MAT cannot be levied on notional/unrealised profits. We believe that this is a fundamental principle which applies not only to MAT but also to normal computation.

(ii) Based on above principle, we support the Committee's recommendations that items forming part of other comprehensive income (OCI) should be excluded from 'book profit' for MAT computation.

(iii) We are also in agreement with Committee's recommendation that OCI items should be picked up for MAT levy at an appropriate point of time when they are realised.

Our recommendations on MAT framework for Ind-AS Companies: MAT should be discontinued in the light of tax policy of present Government or alternatively, levied on a different basis.

(i) There is need for fundamental re-think on MAT at a conceptual level. We believe, MAT is inconsistent with the current tax policy of low corporate tax rate of 25% and withdrawal of corporate tax incentives. MAT has no rationale under this policy and hence it may be either withdrawn or significantly modified, at the earliest.

(ii) Even if Government wants to persist with MAT as a policy imperative for minimum tax collection, following may be considered:-

- Government should announce a roadmap for reduction in MAT rates to 7.5% of book profit (from current rate of 18.5%) over a period of five years.

- MAT may be made applicable to only those entities who avail specified tax incentives in normal computation (like s.115BA introduced by Finance Bill, 2016 which provides for 25% corporate tax rate to new domestic manufacturing companies who are willing to sacrifice specified tax incentives)

- Still alternatively, MAT may be levied in the form of Alternate Minimum Tax (AMT) currently applicable for non-corporates which is a simple basis involving merely add-back of tax incentives in the

computation of total income and allowance of depreciation at normal rates.

- Still alternatively, if MAT is to be levied on 'book profit', in the interest of simplicity, consistent with philosophy of ease of doing business, and with a view to reducing litigation, corporates may be given an option to compute MAT based on IGAAP accounts (i.e. accounting standards formulated by Institute of Chartered Accountants of India and notified by Ministry of Corporate Affairs in 2006) during phase out of tax incentives.

Committee should reconsider the recommendation on MAT pick up for adjustments to Retained earnings on first time adoption in the year of first adoption of Ind-AS.

(i) We are not in agreement with Committee's recommendation that adjustments made to Retained Earnings on first time adoption of Ind-AS and which are subsequently not reclassified to P&L should be picked for MAT in the first year of Ind-AS adoption itself.

(ii) Committee's recommendation that there may be upfront levy of MAT on adjustments recorded in Retained earnings on first time adoption of Ind-AS is harsh, unjust and unacceptable. It is inconsistent with core principle embodying other recommendations on exclusion of OCI items as also exclusion of notional/unrealised items included in P&L (based on clarifications by Ministry of Corporate Affairs in future). Committee's recommendation will discourage enterprises from full scale adoption of Ind-AS philosophy.

(iii) Consistent with core principle of avoiding MAT on notional/unrealised profits, levy of MAT on adjustments recorded in Retained earnings on first time adoption should be deferred to the year of realisation of such profits for which taxpayer may be asked to furnish a reconciliation statement in the first year followed up by an updated statement every subsequent year which may be audited by the Tax Auditor or Chartered Accountant (CA) issuing MAT computation certificate in Form No. 29B.

(iv) If there is any upfront taxation, care should be taken to clarify that there will be no duplicated taxation when asset is sold.

Notional/unrealised profits recognised under Ind-AS should be excluded for normal computation as well.

(i) Even in normal computation, the tax law or Income Computation Disclosure Standards (ICDS) should be so framed that no tax is levied on notional/unrealised profits like fair valuation of assets or liabilities or discounting of future receivables or payables.

Given the above, our submissions to the Government are as under:

There is need for fundamental re-think on a conceptual level. We believe, MAT is inconsistent with the current tax policy and may be either withdrawn or significantly modified, at the earliest.

(i) It may be recollected that MAT was introduced in 1987 to make companies which declare dividends to shareholders based on 'book profit' but pay NIL or negligible amount of tax by availing different tax incentives, pay a minimum amount of tax based on 'book profit'.

(ii) The present Government is committed to a policy of lowering corporate tax rate to 25% over the next five years available under normal computation.

(iii) With lowering of corporate rates over next five years and withdrawal of tax incentives, there is no rationale for MAT within the current tax policy framework.

(iv) The current effective MAT rate (which was 7.5% against then prevalent normal rate of 35%) is around 20% (inclusive of surcharge and cess). Thus the gap between MAT rate and intended corporate tax rate is merely 5%. No wonder MAT is perceived as virtual denial of tax incentives. Whereas the compliance burden on corporate taxpayers and scope for litigation on interpretation of several upward and downward adjustments provided in MAT is huge.

(v) The exercise of implementing Committee's recommendations by providing specific upward and downward adjustments is likely to be a daunting exercise. Since there will be two classes of companies viz. those covered by IGAAP and those covered by Ind-AS, MAT will need to be appropriately divided into two segments. Also, CBDT will need to appropriately factor in all the items which will be impacted by fair valuation adjustments (either on compulsive basis or optional basis) under Ind-AS. While ensuring that MAT pick up is made at appropriate point of time, it will also need to be ensured that there is no double taxation of the same item[1]. Since Ind-AS is a new accounting framework and accounting practices will evolve over a period of time, we believe it may be too premature for CBDT to visualise and provide comprehensive set of adjustments in MAT provisions at this juncture.

(vi) In spite of the inconsistency, if the Government wants to persist with MAT, it is recommended that MAT regime may be conceptually modified as under:

- Consistent with the philosophy of reducing the rates of tax, there should also be a gradual reduction in the rates of MAT. The roadmap to reduction of MAT to 7.5% of book profit, over a period of 5 years, may be announced upfront.

[1] Currently, MAT provisions do provide for such adjustments for REIT units held by sponsor by converting shares of SPV. However, scope of adjustments which may be required for other items under Ind-AS will be much more comprehensive and complex.

- Instead of making MAT regime applicable to all the corporates, the applicability may be restricted only to those corporates who avail of any significant tax incentives which may be specified in the section.

  Reference may be made to s.115BA introduced by Finance Bill 2016 which provides for 25% corporate tax rate to new domestic manufacturing companies who are willing to sacrifice specified tax incentives.

  Similarly, all those corporates who do not claim any tax incentive or who, under declaration, refrain from claiming incentive, may be kept out of MAT regime. In this behalf, availing depreciation or amortization can, in no case, be considered as a tax incentive.

- Still alternatively, if the Government persists with MAT regime, the implementation thereof may be structured in the manner in which there is, currently, levy of Alternate Minimum Tax (AMT) from non-corporate taxpayers who are entitled to tax incentive. Under a much simpler computation, MAT may be computed by adding back to the total income, the incentives which go to reduce the taxable base. This will restrict the application of regime to those who actually claim incentives. It is also much simple computation compared to the computation based on several upward and downward adjustments which will only get further compounded by Ind-AS regime.

Assuming Government were to persist with MAT, in the interest of simplicity; consistent with philosophy of ease of doing business, and with a view to reducing litigation, corporates may be given option to compute MAT with reference to Ind-AS or IGAAP financial statements during phase out of tax incentives.

(i) The entities which are covered by first time adoption will need to pay first instalment of advance tax before 15 June 2016. The actual implementation in the form of legislative amendment to MAT provisions is likely to be a time consuming process. Also, since IGAAP and Ind-AS regimes are fundamentally different, comprehensive changes to MAT provisions to fully ensure elimination of notional gain or losses will need to be done cautiously. Un-intended consequences and hardships may get avoided if corporates are provided an option of computing book profit and paying MAT based on IGAAP despite the fact that they may have adopted Ind-AS for statutory compliance under Cos Act 2013.

(ii) This will facilitate ease of compliance with MAT for corporates as also provide comfort to the Tax Authority on levy of MAT on realised profits.

Committee's recommendation that there may be upfront levy of MAT on adjustments recorded in retained earnings on first time adoption of Ind-AS is harsh, unjust and unacceptable: It is inconsistent with Committee's own recommendation of exclusion of

notional/unrealised profits from MAT levy. Committee's recommendation will also discourage enterprises from full scale adoption of Ind-AS philosophy.

(i) The philosophy of Ind-AS is geared to presentation of financial health to the shareholders on the basis of fair value of assets. The enterprises are encouraged to present their assets (including tangible and intangible assets, and investments) on the basis of the fair value, as a measure of revaluation of existing assets.

(ii) MCA was keen to introduce Ind-AS since 2010 when Ind-AS were published by MCA but not notified under Cos Act in view of tax challenges arising from its implementation. The final MCA notification in February 2015 gives option to companies to early adopt Ind-AS. It also provides option to companies who are not covered by Ind-AS roadmap to voluntarily adopt Ind-AS. This is because globally, India has been perceived as an outlier on IFRS convergence. Even smaller countries like Philippines, Taiwan, Singapore, etc. have already transitioned to IFRS. This shows that MCA is keen that corporates adopt Ind-AS philosophy at the earliest. Any tax proposal which attracts upfront taxation on first time adoption is bound to discourage the enterprises from fair value accounting in its full measure.

(iii) On first time adoption of Ind-AS, at its option, the company is permitted to fair value its assets such as property, plant and equipment (PPE) or intangibles or equity shares in subsidiary/associate/joint venture companies, etc. The difference in value (whether positive or negative) is placed in Retained earnings account which, as acknowledged by the Committee and confirmed by MCA, does not represent distributable or divisible profit. As rightly understood by the Committee, the fair value difference represents notional and unrealised profit. No dividend can be declared out of such amount.

(iv) A company which, on adoption of Ind-AS fair values the asset is unlikely to gain any tax advantage as a result of such adoption. Such process of first time adoption being a process of revaluation, the company, in computing its MAT liability, may neither be able to claim any amortization nor be able to avoid the tax liability in the year in which the asset is sold or retired[2].

(v) In this background, the Committee's recommendation to levy MAT on adjustments recorded in Retained earnings on first time adoption of Ind-AS and which would otherwise never subsequently be reclassified to P&L is unjust and will result in duplicated taxation.

(vi) The proposal which envisages payment of tax on notional profit in the form of Retained earnings is, contrary to the approach adopted by the Committee itself when the Committee considers levy of MAT on notional gains and losses embedded in OCI as unjust. Both these adjustments are characteristically no different from OCI items which are acknowledged to be notional/unrealised in

[2] If view adopted is that amount credited to Retained Earnings on first time adoption does nevertheless represent Revaluation Reserve since it cannot be distributed as dividend.

nature and for which Committee has recommended levy of MAT at an appropriate point of time when the profits are realised.

(vii) The recommendation is inconsistent with principle of parity with 'distributable profits' embodying other recommendations of the Committee. It may be noted that such adjustments being notional/unrealised will need to be excluded for determining 'free reserves' for payment of dividend and/or payment of managerial remuneration.

(viii) Acceptance of Committee's recommendation will be a huge drain on the liquidity of taxpayers who may opt for fair valuation of their assets. There could be serious doubt on the legality of such norms of taxation. The tax will be payable on revaluation difference in respect of assets which, for a long long time, not be in the contemplation of asset realisation plan. This will also discourage taxpayers from adopting fair value accounting, thereby frustrating the underlying object of portraying fair values of assets and liabilities to stakeholders by preparing financial statements as per Ind-AS.

An alternative approach: Defer taxation of fair valuation differences to the year of realisation.

(i) What is highly objectionable is the proposal that tax may be imposed on valuation difference upfront without the asset having been disposed and without profit having been realised.

(ii) Taxpayer may be reconciled to the proposal that, at par with the treatment suggested by the Committee in relation to fair value difference which is accounted on an year to year basis through OCI, the levy of MAT on fair valuation of assets which is directly credited to Retained Earnings may also be deferred to the year of realisation of asset.

(iii) Any such treatment would be consistent with the well-established tax treatment adopted in respect of revalued assets. It is well settled that, when an asset is revalued, there is no upfront taxation in respect of the fair valuation difference. The taxpayer cannot claim amortization with reference to book entry for revaluation. However, in the year of disposal of the asset, the surplus will be captured ignoring the impact of revaluation.

Care should be taken to clarify that there is no duplicated taxation when asset is sold, if there has been upfront taxation.

(i) As per current provisions of clause (j) of Explanation 1 to s.115JB(2), in the year in which an asset (which was revalued) is sold or transferred, the amount standing in revaluation reserve is required to be added back as book profit.

(ii) Process of first time adoption of Ind-AS is the process which involves revaluation of assets. The reserve in the form of retained earnings may, to the extent of fair value difference, be considered by Tax Authority as constituting

revaluation reserve. As per the Committee's recommendation, such amount may be taxed in the year of revaluation. As per current provisions of s.115JB, an attempt may be made to add back the self-same amount to book profit in the year of retirement of the asset considering it as revaluation reserve. Indeed, any attempt at double taxation is unlawful and it would be utmost desirable that the legislative amendment takes care of such eventuality.

MAT should not be levied on notional/unrealised profits forming part of P&L.

(i) The Committee has acknowledged that fair value accounting is predominant under Ind-AS and P&L is also likely to include notional/unrealised profits.

(ii) However, since the MCA did not provide any specific clarification on which items will need to be excluded from P&L for ascertaining 'distributable profits' for the purpose of dividend payment, the Committee recommended as follows:-

- No further adjustments are required to be made to the net profits of Ind AS compliant companies, other than those already specified u/s. 115JB of the Act

- In the event that MCA prescribes any further adjustments to the current year's profits for computation of distributable profits, the requirement for any additional adjustments to the book profit u/s. 115JB may be examined.

(iii) The P&L under Ind-AS is likely to include notional/unrealised profits/losses in following illustrative circumstances:-

- Fair valuation of derivatives;

- Fair valuation of financial instruments like shares or debentures held for trading purposes;

- Discounting of interest free loan/advance/deposit received or given by the company (e.g. sales tax deferral loan from state government);

- Discounting of trade receivables (like retention money) which are contractually receivable on deferred basis;

- Recognition of notional construction profit on BOT projects executed by the company under Service Concession agreements with public authorities.

(iv) Levy of MAT on above illustrative items will be inconsistent with core principle of levying MAT on realised profits only. Hence, we recommend that, pending MCA clarification, CBDT should clarify that MAT will not be levied on such items.

Out of abundant caution, clarify that normal computation under ITL will also exclude taxation in respect of notional / unrealised gains or losses emerging on account of Ind-AS including first time adoption.

(i) We appreciate unequivocal statement on the part of Committee that tax base needs to exclude notional / unrealised gains or losses. This is certainly consistent with principle of taxation of real income. It may, therefore, be clarified that no part of notional/unrealised gain or losses whether forming part of P&L A/c or OCI or retained earnings will be subjected to normal tax liability. Specific clarification in this behalf will significantly allay fear / apprehensions on the part of taxpayers and will avoid unnecessary litigation should zealous tax officer were to harbour a different view. Even otherwise, there needs to be a parity between the basis of MAT taxation and normal computation.