PwC ReportingInBrief

Clarifications on MAT for Ind AS reporters

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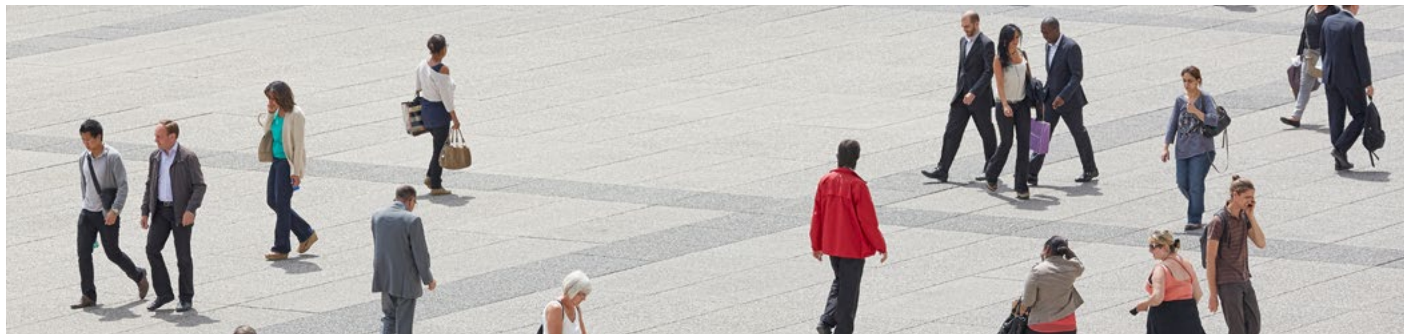

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In February 2015, the Central Government notified the Indian Accounting Standards (Ind AS) which are converged with the International Financial Reporting Standards (IFRS). Consequently, the Finance Act, 2017, amended the provisions of section 115JB of the Income-tax Act, 1961 (the Act), so as to provide the framework for the computation of book profit for the purpose of levying minimum alternate tax (MAT) in the case of companies required to comply with Ind AS in the year of adoption and thereafter. This framework was specified on the basis of the recommendations of the MAT Ind AS Committee (the Committee) constituted for this purpose.

In our previous publications, we provided a broad overview of the MAT framework for the computation of book profit for companies required to comply with Ind AS in the year of adoption and thereafter in the form of frequently asked questions (FAQs). The links to these are given below:

PwC ReportingInBrief: *Framework for computing book profit for the purpose of MAT levy for Ind AS compliant companies in the year of adoption and thereafter*

http://www.pwc.in/assets/pdfs/publications/2017/pwc-reportinginbrief.pdf

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PwC ReportingInBrief: *Amendment to the Finance Bill, 2017: Framework for MAT levy for Ind AS compliant companies*

http://www.pwc.in/assets/pdfs/publications/2017/pwc-reportinginbrief-mat-amendment.pdf

The Central Board of Direct Taxes (CBDT) received representations from various stakeholders regarding certain issues arising from the implementation of the provisions of the amended section 115JB of the Act. The CBDT referred these representations to the Committee and on the basis of the Committee's recommendations, the CBDT clarified some of the issues vide circular no. 24/2017 dated 25 July 2017 in the form of FAQs. We had identified many of these implementation issues in our previous publication. These have been addressed by the FAQs issued by the CBDT. The Committee has also recommended certain amendments to the provisions of section 115JB of the Act with effect from financial year 2016–17.

This *InBrief* gives an overview of the clarifications issued by the CBDT and proposed amendments to section 115JB of the Act.

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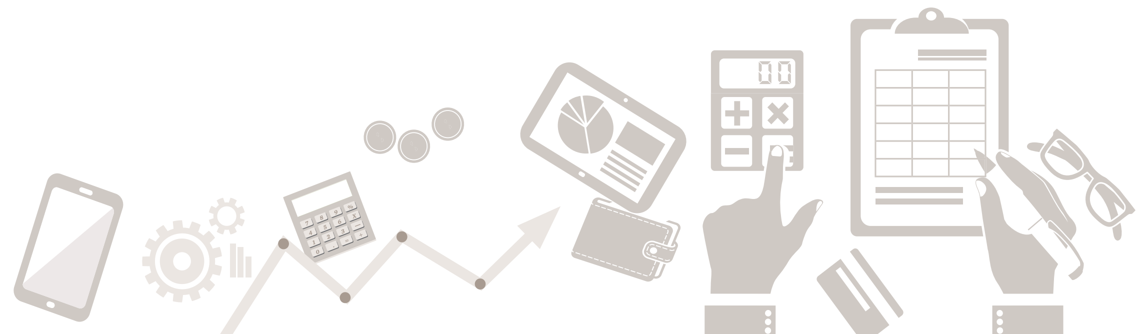
Summary of clarifications issued by the CBDT on the MAT provisions applicable to Ind AS reporters:

1. The starting point for MAT computation is profit before other comprehensive income (OCI) and not the total comprehensive income.
2. Any loss arising out of fair value adjustments of financial instruments measured at fair value through profit or loss (FVTPL) is not required to be added back to book profit.
3. Dividend on preference shares, whether classified as interest costs or dividend under Ind AS, would be considered as dividend for the purpose of MAT computation and needs to be added back to book profit for the purpose of MAT computation.
4. Book profit of the financial year, in which the asset is retired, disposed, realised or otherwise transferred, is required to be adjusted by the revaluation amount after adjustment of the depreciation on the revaluation amount.
5. Brought forward loss or unabsorbed depreciation, as appearing in the financial statements prepared under the Companies (Accounting Standard) Rules, 2006 (Indian GAAP), for the year ended 31 March 2016, would be considered while ascertaining the deduction of the lower of the amount of loss brought forward or unabsorbed depreciation under clause (iii) of the explanation to section 115JB(2) of the Act for the financial year 2016–17, even though the Ind AS financial statement for the financial year 2016–17 may depict different amounts of brought forward losses/unabsorbed depreciation for the financial year 2015–16 as comparatives.

   For subsequent periods, the said deductions shall be allowed as per Ind AS accounts.



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6. The amounts credited or debited to other equity *(subject to certain adjustments)* on the convergence date at the time of transition to Ind AS are to be included in book profit over a period of five years starting from the year of Ind AS adoption as transition amount. In this regard, it has been clarified that the amounts as on the start of the opening date of the first year of adoption should be considered for the purpose of computation of transition amount. For instance, the amount of adjustments to other equity as on 1 April 2016 *(equivalent to close of business on 31 March 2016)* should be considered for the purpose of computing the transition amount for an entity which has adopted Ind AS from financial year 2016–17.
7. On transition to Ind AS, any adjustments made to other equity on account of provision for bad and doubtful debts, proposed dividend *(including dividend distribution tax),* deferred taxes, share application money pending allotment, capital reserves and securities premium should not form part of the transition amount for computing book profit over a period of five years starting from the year of Ind AS adoption.

   It has also been clarified that any adjustments made to other equity on transition to Ind AS in connection with the equity component, if any, of compound financial instruments like non-convertible debentures and interest-free loans be included in transition amount.
8. An entity following December year end, will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the remaining period. Therefore, it would prepare two sets of accounts for the purpose of MAT computation.
9. Adjustments on account of service concession arrangements would be included in transition amount and also on an ongoing basis.

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1. Starting point of MAT computation

At the time of bringing out the amendments to the MAT provisions for Ind AS compliant companies, it was clarified in the memorandum explaining the Finance Bill, 2017, that adjustments under section 115JB of the Act are required to be made in the net profit before OCI. However, it was not clear in the text of section 115JB of the Act that the starting point for MAT computation is profit before OCI and not the total comprehensive income. This clarification has now been provided and is consistent with our understanding of the MAT provisions as reflected in our previous publication on the framework for the computation of MAT for Ind AS companies.

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- The profit before OCI will first be adjusted for items which are specified in the existing provisions of section 115JB of the Act and thereafter, adjustments shall be made for transition amount, if any.
- Book profit will be increased/decreased by all amounts credited/debited to OCI that will not be reclassified to profit or loss, except for certain specified exclusions.
- OCI items that will be reclassified to profit or loss will get included in book profit in the year of reclassification of such items from OCI to profit or loss.

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2. Fair value of financial instruments measured at FVTPL

An entity may elect to measure its investment in subsidiaries, associates and joint ventures at FVTPL. Further, there are certain financial instruments which are required to be measured at FVTPL in accordance with Ind AS 109, *Financial instruments*. Such fair value changes will form part of the Ind AS profit or loss and therefore will be included in book profit for MAT purposes.

Clause (i) to explanation 1 to section 115JB of the Act specifically disallows the provision for diminution in the value of an asset. In our previous publication, we had highlighted the lack of clarity on whether fair value loss on financial instruments measured at FVTPL would represent the provision for diminution in the value of an asset for MAT purposes and, therefore, whether or not it needed to be added back to book profit. It has now been clarified that such fair value loss is not required to be added back to book profit.

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The clarification states that changes in the fair value do not represent diminution in the value of the investment so as to attract disallowance as per clause (i) to explanation 1 to section 115JB. We believe that the same position would also apply to mark-to-market gains/(losses) on derivative financial instruments not designated as hedging instruments and recognised in profit and loss. Accordingly, such gains/(losses) should not be adjusted in the determination of book profit for MAT purposes.

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3. Computation of transition amount which is to be included in book profit equally over a period of five years starting from the year of Ind AS adoption

Proposed dividend

Under Indian GAAP, proposed dividend was to be recognised as a liability in the period to which it related irrespective of when it was declared. Under Ind AS, proposed dividend is recognised as a liability in the period in which it is declared by a company *(i.e. when the dividend is approved by the shareholders)*. Accordingly, any proposed dividend existing on the date of transition will be reversed to retained earnings/other equity at the time of transition. With effect from 1 April 2016, Indian GAAP also prescribes the aforesaid accounting treatment for proposed dividend and therefore, currently, there is no difference in accounting of dividend under Indian GAAP and Ind AS.

Section 115JB(2C) of the Act provides that any amount debited or credited to other equity *(transition amount)*, subject to certain adjustments, shall be included in book profit over a period of five years starting from the year of Ind AS adoption. It was not clear if such reversal of proposed dividends credited to other equity would form part of transition amount, since proposed dividend is not an item of income or expense but an appropriation of profit. It has now been clarified that proposed dividend *(including dividend distribution tax)* shall not form part of transition amount.

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In our previous publication, we had highlighted that credit in other equity on account of the reversal of proposed dividend upon transition to Ind AS may ideally not be subject to MAT, as proposed dividend is not an item of income or expense but an appropriation of profits. The clarification by the CBDT is consistent with our previous view.

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Deferred taxes

An entity should apply Ind AS 12, *Income taxes,* to temporary differences between the carrying amount of the assets and liabilities and the corresponding tax bases as at the date of its opening Ind AS balance sheet. These deferred tax impacts would also be accounted for as part of the adjustments made on transition to Ind AS, against retained earnings or another appropriate category of equity.

The clarification provides that such deferred taxes recorded on the transition date shall be excluded for the purpose of computing transition amount.

Provision for doubtful debts

As per section 115JB, diminution in the value of any assets is added to profit for the purpose of computing book profit. However, as per the Finance Act, 2017, transition adjustment to other equity shall be included in book profit for MAT purposes over a period of five years starting from the year of Ind AS adoption. Accordingly, it appeared that the amount reduced from other equity in connection with provision for doubtful debts would be deductible from book profit equally over a period of five years starting from the year of Ind AS adoption.

In our previous publication, we had highlighted that this could have resulted in an unintended outcome and inconsistency, whereby the same item would be treated differently at the time of transition and thereafter. It has now been clarified that adjustments relating to the provision for diminution in the value of any assets will not be considered for the purpose of computation of transition amount.

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Other adjustments to other equity

It has been clarified that any adjustments made to other equity on account of reclassification of share application money pending allotment will not be considered as transition amount.

Reclassification of capital reserve or securities premium to retained earnings or other reserves

The reclassification of capital reserve or securities premium to retained earnings or other reserves on the convergence date and vice versa shall not be considered as transition amount.

However, it has been clarified that even after such reclassifications, the amount of revaluation reserve will continue to be considered as revaluation reserve for the purpose of computation of book profit and will also include transfer to any other reserve by whatever name called or capitalised.

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An entity had revalued certain items of property, plant and equipment (PP&E) under previous GAAP and elected the deemed cost exemption to carry all of its PP&E at the previous GAAP carrying values. PP&E is subsequently measured at cost. In such a situation, the revaluation reserve disclosed under Indian GAAP will be transferred to retained earnings (or if appropriate, another category of equity) on the date of transition. On a literal reading of the MAT provisions, it appeared that only the amount standing in the revaluation reserve on the retirement or disposal of revalued assets would be included in book profit. In the given situation, since there would be no amount standing in the revaluation reserve on the date of disposal or retirement of the revalued PP&E, it appeared that no adjustment would be required to book profit for MAT purposes on the disposal or retirement of such an asset.

In our previous publication, we had highlighted that a clarification on this aspect from the CBDT may help remove any ambiguity on this matter because the above interpretation could have resulted in an unintended outcome and is inconsistent with a situation where an entity uses a revaluation model to subsequently measure certain classes of PP&E.

It has now been clarified that, even after such reclassifications, the amount of revaluation reserve will continue to be considered as revaluation reserve for the purpose of computation of book profit.

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Compound financial instruments

Transition amount has been defined as the *amount or the aggregate of amounts adjusted in other equity (excluding capital reserve and securities premium reserve) on the convergence date but excluding certain items.* The definition did not omit the term 'equity component of compound financial instruments' from the exclusions given in the definition. Therefore, any adjustment to other equity on account of the equity component of compound financial instruments will be considered for the purpose of computation of transition amount.

It has now been further clarified that any adjustments made to other equity on transition to Ind AS in connection with the equity component, if any, of financial instruments like non-convertible debentures and interest-free loans will be included in transition amount. It is not clear whether this will apply to all types of compound financial instruments (including mandatorily convertible debentures/preference shares) or only to compound financial instruments which are tax neutral. Clarifications on this aspect would be helpful.

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We believe that this clarification could have different implications depending on the nature of the compound financial instrument, and clarifications from the CBDT on this aspect will be helpful. This is illustrated below with the help of two examples.

Example 1: Interest-free loans

In the case of an interest-free loan, the off-market component (consideration received minus the present value of the loan) would be credited to other equity and, therefore, would be included in transition amount. The unwinding of interest would get debited to profit and loss and would consequently be deductible for MAT purposes. Therefore, on an aggregate level, the treatment would be tax neutral. This is further explained by means of a numerical example:

Parent A has given an interest-free loan of 10,000 INR to its subsidiary on 31 March 2016. The loan is repayable at the end of three years and the fair value of the loan on initial recognition is 8,640 INR, assuming a market rate of interest of 5%.

	Liability	Equity component	Total
Initial recognition	8,640	1,360	10,000
Year 1 – interest	432		
Year 2 – interest	454		
Year 3 – interest	474		
Repayment	(10,000)		

In this example, the equity component of 1,360 INR would be included in transition amount. This transition amount would be included in book profit equally (1,360/5 = 272) over a period of five years starting from the year of first-time adoption of Ind AS (2016–17). The interest on such a loan shall be recognised based on the effective interest method over the tenure of the loan and, therefore, the total interest cost of 1,360 INR (432+454+474) would affect the book profits of three years. On an overall basis, such an instrument would be tax neutral for the purpose of MAT computation.

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Example 2: Compulsorily convertible (fixed-for-fixed) instrument with mandatory coupons

In the case of an instrument that is convertible into a fixed number of equity shares which meet the definition of equity but carry mandatory coupons/dividends during the life of the instrument, only the present value of the mandatory coupons/dividends would be classified as a liability and the majority of the component would be classified as equity. In such a situation, the amount credited to other equity as on the date of transition would be included in transition amount. However, the unwinding of interest would be a marginal amount as compared to the equity component. In such cases, it appears that there would be a mismatch between the amounts credited to other equity and included in transition amount and the amount that can be claimed as an interest expense. Such instruments are not expected to be tax neutral for the purpose of MAT computation. This is further explained by means of a numerical example:

Entity A has issued 1,000 8 % compulsorily convertible debentures of 10 INR each on 31 March 2016. These debentures are convertible into 1,000 equity shares at the end of three years. Interest is mandatorily payable on an annual basis.

	Liability component			Equity component	Total
	Unwinding of interest	Interest payment	Balance		
Initial recognition	2,062			7,938	10,000
Year 1 – interest	165	(800)	1,427		
Year 2 – interest	114	(800)	741		
Year 3 – interest	59	(800)	-		

In this example, the equity component of 7,938 would be included in transition amount. Applying the CBDT's clarification, this transition amount shall be included in book profit equally (7,938/5 = 1,587) over a period of five years starting from the year of first-time adoption of Ind AS (2016–17). However, the interest on the liability component shall be recognised using the effective interest method over the tenure of the instrument, resulting in a total interest cost of 338 INR (165+114+59) and impacting book profits over a period of three years. Accordingly, on an overall basis, accounting for such an instrument based on the CBDT clarification would not result in a tax-neutral position for the purpose of MAT computation.

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4. Treatment of dividend on preference shares classified as liability

Explanation 1 to section 115JB(2) of the Act disallows *'any dividend paid or proposed'* while computing book profit. If preference share capital is classified as a liability, dividend distribution on such capital is debited to profit or loss as interest cost under Ind AS.

It was not clear if the aforesaid interest costs were to be added back in determining book profit, considering its character as dividend. It has now been clarified that such interest costs recorded in connection with preference shares should be added back while determining book profit for the purpose of MAT computation.

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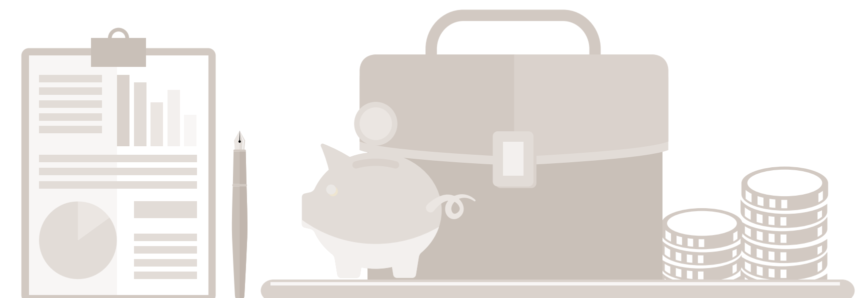
In our previous publication, we had highlighted that although dividend on redeemable preference shares would be classified as interest expense under Ind AS for accounting purposes, it would be added back to book profit for computation of MAT liability, considering it is in the nature of dividend from the Companies Act point of view. The clarification by the CBDT is consistent with our previous view.



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5. Revaluation of PP&E

Section 115JB of the Act states that when a revalued asset is retired or disposed, the amount standing in the revaluation reserve, relating to the asset, is included in the computation of book profit for MAT purposes. Accordingly, for companies following Indian GAAP, the amount of the adjustment to book profit is the amount standing in the revaluation reserve *(i.e. net of any transfer to retained earnings to compensate the additional depreciation on account of revaluation)*.

For companies following Ind AS, the literal interpretation of the proviso to section 115(2A) *(applicable to Ind AS compliant companies)* seems to suggest that the amount of such adjustment will be the aggregate amount of revaluation surplus recorded in OCI related to that asset for the current and preceding financial years *(irrespective of the carrying amount of the revaluation reserve in the book)*. This interpretation resulted in higher book profit for MAT purposes for companies following Ind AS compared to those following Indian GAAP to the extent of depreciation computed on the revaluation amount in the current and preceding years. It has now been clarified that book profit is required to be adjusted by the revaluation amount after the adjustment of the depreciation on the revaluation amount related to the asset.

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In our previous publication, we had highlighted that the literal interpretation of the Finance Act, 2017, could have resulted in higher book profit for MAT purposes for companies following Ind AS compared to those following Indian GAAP to the extent of the amount of revaluation reserve transferred to retained earnings discussed above. This has now been clarified by the CBDT.

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6. Deduction of the lower of brought forward losses or unabsorbed depreciation

Brought forward loss or unabsorbed depreciation as appearing in the Indian GAAP financial statements prepared for the year ended 31 March 2016 would be considered while ascertaining the deduction of the lower of the amount of loss brought forward or unabsorbed depreciation under clause (iii) of the explanation to section 115JB(2) of the Act for financial year 2016–17, even though the Ind AS financial statements for financial year 2016–17 may depict different amounts of brought forward losses/unabsorbed depreciation for financial year 2015–16 as comparatives.

For subsequent periods, the said deductions shall be allowed as per Ind AS accounts.

7. Date for computation of transition

The amounts credited or debited to other equity *(subject to certain adjustments)* on the convergence date at the time of transition to Ind AS are to be included in book profit over a period of five years starting from the year of Ind AS adoption as transition amount. In this regard, it has been clarified that the amounts as on the start of the opening date of the first year of adoption should be considered for the purpose of computation of transition amount. For instance, the amount of adjustments to other equity as on 1 April 2016 *(equivalent to close of business on 31 March 2016)* should be considered for the purpose of computing the transition amount for an entity which has adopted Ind AS from financial year 2016–17.

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8. Companies following accounting year other than March

In view of the second proviso to section 115JB(2) of the Act, companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the remaining period.

For example, a company following December year end will be required to prepare accounts for MAT purposes under Indian GAAP for nine months up to December 2016 and under Ind AS for three months thereafter. Transition amount will be calculated with reference to 1 January 2017.

Proposed amendments to section 115JB for the purpose of MAT for Ind AS compliant companies:

Further to the above, the Committee has recommended certain amendments vide report dated 17 June 2017 in the MAT provisions of the Act with effect from financial year 2016–17, which is the date of applicability of the newly inserted MAT provisions for Ind AS compliant companies. The background and impact of the proposed amendments are outlined below:

The Committee noted that there are certain transactions with shareholders/related parties which are lower or higher than fair value and which need to be accounted for at fair value with corresponding adjustments to equity. For example, loans/advances are received or given at a concessional rate of interest and an adjustment to equity will take place and there would be a corresponding impact to profit or loss during the term of such loans/advances. While debit/credit to the profit or loss would affect book profit, the corresponding adjustment in the equity would not be captured in the computation of book profit.

The adjustments for such items at the time of transition to Ind AS had already been incorporated in the amendment made to section 115JB *vide* the Finance Act, 2017. Therefore, to have parity between the transition adjustment and ongoing adjustments on account of items adjusted to other equity, the Committee has recommended the following amendment with effect from 1 April 2017 (the Finance Act, 2017).

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The draft amendment includes subclause (e) to section 115JB(2A). It states that book profit will be increased by all amounts or the aggregate of the amounts credited during the previous year to any item of other equity, or decreased by all amounts or aggregate of the amounts debited during the previous year to any item of other equity, as the case may be, but not including:

1. Profit/(loss) for the period as per the statement of profit and loss transferred to other equity;
2. Items relating to OCI;
3. Share application money pending allotment;
4. Money received against share warrants;
5. Capital reserve in respect of business combinations of entities under common control as per Appendix C of Ind AS 103; and
6. Securities premium reserve collected in cash and cash equivalent.

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1. We believe that the proposed amendment aims to bring in neutrality in tax treatment of compound financial instruments issued/to be issued after the date of transition to Ind AS and to ensure parity between the transition adjustment and subsequent adjustments on account of items adjusted in other equity. However, the proposed amendment may result in an unintended outcome in certain situations. As explained in point no. 3 above, tax treatment of certain compound financial instruments would not necessarily be tax neutral. Further, there could be a mismatch in the timing of adjustments in the case of compound instruments, though otherwise expected to be tax neutral.

   For example, the loans/advances received from the parent at a concessional rate of interest would require an adjustment to equity and there would be a corresponding impact to profit or loss in the form of notional interest during the term of such loans/advances. While the tax treatment of such instruments would be neutral, there would be a mismatch in the timing. In the above example, the credit to equity will result in an increase in book profit in the year of initial recognition of the loans; however, the deduction of notional interest would only be available over the term of such loans using an effective interest method.

2. Equity-settled share-based payments are credited to other equity as a separate reserve with a corresponding debit to employee expenses. Based on the proposed amendment, it appears that book profit will have to be increased by amounts credited to the stock options outstanding reserve. Therefore, there will not be any benefit available to Ind AS reporters with respect to share-based payment charge for MAT purposes.

3. Further, the amendment does not deal with transactions such as the issue of bonus shares where share capital is capitalised by debiting reserves. On a literal interpretation of the proposed amendment, it appears that such adjustments may result in a decrease in book profit for the purpose of MAT.

4. The amendment excludes securities premium reserve collected in cash and cash equivalents; however, it appears to cover non-cash adjustments to the securities premium reserve. For example, an entity may have to credit the securities premium reserve on issue of shares for the acquisition of a business. In such situations, on a literal interpretation of the proposed amendment, it appears that book profit shall be increased by the amount credited to the securities premium reserve for MAT purposes.

A clarification from the CBDT on the above would be helpful as some of these matters may have a significant impact on the computation of MAT liability for Ind AS reporters.

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The clarifications provided by the CBDT address many of the common issues which were faced by stakeholders and provide guidance on the interpretation of the MAT provisions. The clarifications are intended to achieve tax neutrality in most aspects and will be helpful for stakeholders to comply with the MAT provisions. However, interpretation issues and ambiguity still exist in a few areas, which may require further clarifications from the CBDT. Accordingly, entities should carefully evaluate the impact of the MAT provisions on their transactions.

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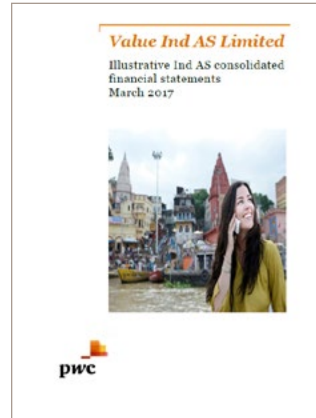

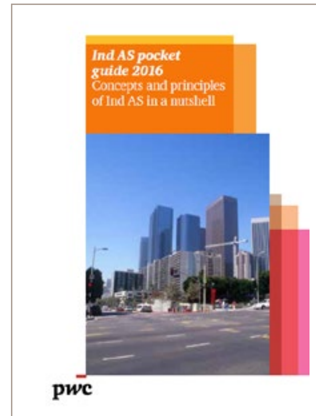

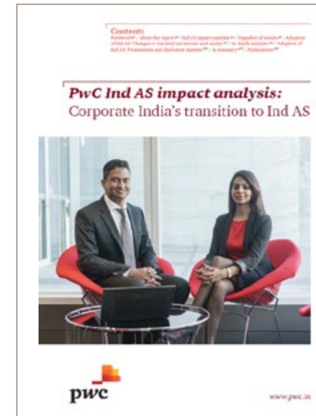

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