KPMG

TAX FLASH NEWS

11 August 2016

# Revisions to the Framework proposed by the MAT-Ind AS Committee

## Background

The Central Board of Direct Taxes (CBDT) issued a press release on 5 August 2016, announcing certain modified recommendations/suggestions on select matters submitted by the Minimum Alternate Tax (MAT) – Indian Accounting Standards (Ind AS) Committee (the Committee) in its report dated 23 July 2016 (the report).

On 18 March 2016, the Committee issued a report proposing a framework for computation of book profits for Ind AS compliant companies (the Framework) for the computation of book profit for the purpose of levy of MAT under Section 115JB of the Income-tax Act, 1961 (the Act).

In this report (issued on 18 March 2016) the Committee had made the following key recommendations:

- No further adjustments should be made to the net profits of Ind AS compliant companies, other than those specified in Section 115JB of the Act,
- Certain items included in net Other Comprehensive Income (OCI), that are permanently recorded in reserves and never reclassified into the statement of profit and loss, be included in book profits for MAT at an appropriate point of time, and
- Certain adjustments recorded in retained earnings on first-time adoption of Ind AS, that would never subsequently be reclassified into the statement of profit and loss should be included in book profits (for the purpose of levy of MAT) in the year of first-time adoption of Ind AS.

## Overview of the recommendations in the report (issued on 5 August 2016)

The Committee received several responses from stakeholders, specifically on its recommendations relating to first-time adoption of Ind AS. These were examined and the recommendations of the Committee on the issues raised are as follows.

## Property, plant and equipment – adjustments to retained earnings

### *Requirements of Ind AS 101, First-Time Adoption of Ind AS*

Ind AS 101 permits an entity to measure items of Property, Plant and Equipment (PPE) at the date of transition at their recomputed values, measured in accordance with Ind AS 16, Property, Plant and Equipment, from inception. 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*

The initial recommendation of the Committee (in the report issued on 18 March 2016) was to 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 Act 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.

## Leases – straight-lining of lease rentals

### *Requirements of AS 19, Leases and Ind AS 17, Leases*

Under Indian GAAP, AS 19 requires straight-lining of operating lease rentals even if payments to the lessor are structured to increase in line with expected general inflation. A corresponding lease equalisation liability/asset is recognised under AS 19. However, Ind AS 17 states that operating lease payments shall not be recognised on a straight-line basis in this scenario. Accordingly, any existing lease equalisation liability/asset shall be adjusted to retained earnings on the 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, i.e., over three financial years.

Companies should include the applicable portion of the retained earnings adjustment relating to first-time adoption of Ind AS when computing their book profits for MAT purposes in these three years.

## Investments – fair value adjustments through profit and loss account

### *Requirements of Ind AS 109, Financial Instruments*

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:

- Investments in equity instruments or mutual fund units

- 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
.
- Investment in debt instruments that do not meet the criteria for amortised cost measurement

- Derivative assets or liabilities, or

- 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*

On examining several options and considering the dual aspects of taxation of unrealised gains/losses and maintenance of records, the Committee has 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.

### *Other issues - recommendation*

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.

## Our comments

It appears that the concerns of the stakeholders have been positively considered by the committee. There seems to be an attempt to simplify the MAT implications rather than providing a complex formula which could create permanent differences and reconciliations of first-time adoption matters.

The general principles outlined in the earlier report (issued on 18 March 2016) have not been changed. The recommendations introduce certain exceptions to the general principles outlined in the report (issued on 18 March 2016) with regard to property, plant and equipment and intangible assets. Additionally, for all other adjustments on the date of transition to Ind AS that are recorded in the retained earnings (which would never subsequently be reclassified to the statement of profit and loss), the committee has proposed the impact of such adjustments be spread over three years while computing book profit for the purposes of MAT calculations.

However, some concerns remain as follows:

- Companies are not generally required to maintain parallel books of accounts for tax purposes. However, the recommendations of the Committee, specifically relating to PPE, investments and leases will require companies to maintain memorandum accounts to compute the depreciation charge, and lease expense when determining book profits for levy of MAT. This requirement is similar to maintenance of records when companies carried out revaluations in the past. While companies are likely to benefit from deferring the first-time adoption adjustments in book profits over a period of three years, additional efforts are expected to be required for maintaining these parallel records.

- Several unrealised gains and losses may be charged to the statement of profit and loss under Ind AS on an ongoing basis; for example, changes in fair value of derivatives and certain investments. The Committee may consider an adjustment for these in the computation of book profits for levy of MAT.

- Impact on MAT for entities where the date of transition to Ind AS is 1 April 2015 should be clarified by the Committee. Since all the adjustments relating to first-time adoption would be made in retained earnings on the date of transition, clarity is required on how these adjustments should be considered for MAT in the Financial Year (FY) 2016-17, when the framework proposed by the Committee is expected to come into effect.

- Additionally, the companies should consider the impact of this report on their expected advance tax payment in the current financial year.

The Committee is continuing to examine other issues raised by stakeholders and evaluate various alternative approaches to the issues discussed above. Accordingly, the CBDT has invited suggestions and comments from stakeholders and members of the public on the recommendations discussed above by 20 August 2016.

**www.kpmg.com/in**

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010



© 2016 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.