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Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax under the Income-tax Act, 1961

Foreword

Tax-revenue is the most important source of income for the government. It is also the most important instrument in the hands of the government for bringing equity by reducing disparities of income. It is always desired by the government to increase its revenue without putting burden of fresh taxes on the existing classes of taxpayers but to broaden the base of taxpayers. The concept, behind the introduction of Minimum Alternative Tax (MAT) in the direct tax system of India, is to make sure that the companies having large profits and declaring heavy dividends to shareholders but which are not contributing to the exchequer by taking advantage of various incentives and exemptions provided in the Income-tax Act, should be brought under the tax net. Such companies have to pay a fixed percentage of book profit as minimum alternative tax.

The amendment to section 115JAA of the Income-tax Act, 1961 by the Finance Act, 2005 has raised many technical issues regarding the accounting treatment of credit available on MAT paid. I am happy to note that the Research Committee, realising the need for providing guidance on this issue, has formulated this Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax under the Income-tax Act, 1961, on a very timely basis before the closing of financial year 2005-06.

I wish to place on record my deep appreciation of Shri Pawan Kumar Sharma, Chairman, Research Committee, other esteemed members of the Research Committee and officers of the Technical Directorate who have made invaluable contribution in the finalisation of this Guidance Note.

I am confident that this Guidance Note will be immensely useful not only to the members but also to others concerned.

New Delhi
March 24, 2006

T.N. Manoharan
President

Preface

The concept of Minimum Alternative Tax (MAT) was introduced by the Finance Act, 1987. The motive was to widen the tax net by bringing more and more taxpayers under the umbrella of direct tax system of the country. Since its introduction, the provisions related to MAT have been revised more than once. The insertion of sub-section (1A) to section 115JAA, of the Income-tax Act, 1961 by the Finance Act, 2005 (granting credit in respect of MAT paid), raised certain issues regarding the treatment of such credit, like, in view of Accounting Standard 22, Accounting for Taxes on Income, whether the credit available is deferred tax or not. There were also many interpretations of when and how the credit should be recognised and represented in the financial statements. The Research Committee, recognising the need of a Guidance Note on these issues, formulated this Guidance Note to deal with the aspects of accounting and presentation of MAT paid and the credit available in this regard.

It may be noted that the Institute had in the year 1997 issued a Guidance Note on Accounting in Respect of Minimum Alternative Tax which dealt with the recognition of MAT credit in the context of the Guidance Note on Accounting for Taxes on Income. The said Guidance Note on Accounting in respect of MAT credit was withdrawn pursuant to AS 22, Accounting for Taxes on Income, becoming mandatory.

I would like to take this opportunity to place on record my appreciation of Dr. Avinash Chander, Technical Director, Ms. Anuradha Jain, Secretary, Research Committee and Shri Piyush Tewari, Executive Officer in the Technical Directorate for preparing the basic draft of the Guidance Note. I also wish to place on record my gratitude to Shri H.N. Motiwalla, Vice Chairman of the Research Committee and Shri S. C. Vasudeva, my esteemed colleague on the Research Committee and the Central Council, for their support and contribution in finalisation of the Guidance Note. I also express my sincere gratitude to Shri T.N. Manoharan, President, ICAI, and Shri Sunil Talati, Vice President, ICAI, for their guidance, support and encouragement in striving towards various activities of the Committee for the year 2006-07.

Pawan Kumar Sharma
Chairman
Research Committee

New Delhi
March 24, 2006

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Guidance Note on Accounting for Credit Available in respect of Minimum Alternative Tax under the Income-tax Act, 1961

(The following is the text of the Guidance Note on Accounting for Credit Available in Respect of Minimum Alternative Tax Under the Income-tax Act, 1961, issued by the Council of the Institute of Chartered Accountants of India.)

Introduction

1. The Finance Act, 1997, introduced section 115JAA in the Income-tax Act, 1961 (hereinafter referred to as the 'Act') providing for tax credit in respect of MAT paid under section 115JA (hereinafter referred to as 'MAT credit') which could be carried forward for set-off for five succeeding years in accordance with the provisions of the Act. Section 115JA was inserted by the Finance Act, 1996, w.e.f. 1.4.1997. The said section provided for payment of Minimum Alternative Tax (hereinafter referred to as 'MAT') by certain companies, where the total income, as computed under the Income-tax Act, 1961, in respect of any previous year relevant to the assessment year commencing on or after 1st day of April, 1997, but before the 1st day of April, 2001, was less than 30% of its book profit. In such a case, the total income of the company chargeable to tax for the relevant previous year was deemed to be an amount equal to thirty per cent of its book profit.

2. The Finance Act, 2000, w.e.f. 1.4.2001, introduced section 115JB according to which a company is liable to pay MAT under the provisions of the said section in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2001. The MAT under this section is payable where the normal income-tax payable by such company in the previous year is less than 7.5 per cent (10 per cent proposed by the Finance Bill, 2006) of its book profit which is deemed to be the total income of the company. Such

company is liable to pay income-tax at the rate of 7.5 per cent (10 per cent proposed by the Finance Bill, 2006) of its book profit. The Finance Act, 2005, inserted sub-section (1A) to section 115JAA, to grant tax credit in respect of MAT paid under section 115JB of the Act with effect from assessment year 2006-07.

3. The salient features of MAT credit under section 115JAA as applicable, in respect of tax paid under sections 115JA and 115JB, are as below:

(a) A company, which has paid MAT, would be allowed credit in respect thereof.

(b) The amount of MAT credit would be equal to the excess of MAT over normal income-tax for the assessment year for which MAT is paid.

(c) No interest is allowable on such credit.

(d) The MAT credit so determined can be carried forward for set-off for five succeeding assessment years from the year in which MAT credit becomes allowable. The Finance Bill, 2006, has proposed that credit in respect of MAT paid under section 115JB can be carried forward upto seven succeeding assessment years (hereinafter referred to as the 'specified period').

(e) The amount of MAT credit can be set-off only in the year in which the company is liable to pay tax as per the normal provisions of the Act and such tax is in excess of MAT for that year.

(f) The amount of set-off would be to the extent of excess of normal income-tax over the amount of MAT calculated as if section 115JB had been applied for that assessment year for which the set-off is being allowed.

Accounting Treatment

Whether MAT credit is a deferred tax asset

4. An issue has been raised whether the MAT credit can be considered as a deferred tax asset within the meaning of Accounting Standard (AS) 22, Accounting for Taxes on Income, issued by the Institute of Chartered Accountants of India. In this context, the following definitions given in AS 22 are noted:

***"Timing differences* are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods."**

***"Accounting income* (loss) is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving."**

***"Taxable income* (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined."**

5. From the above, it is noted that payment of MAT, does not by itself, result in any timing difference since it does not give rise to any difference between the accounting income and the taxable income which are arrived at before adjusting the tax expense, namely, MAT. In other words, under AS 22, deferred tax asset and deferred tax liability arise on account of differences in the items of income and expenses credited or charged in the profit and loss account as compared to the items of income that are taxed or items of expense that are allowed as deduction, for the purposes of the Act. Thus, deferred tax assets and deferred tax liabilities do not arise on account of the amount of the tax expense itself. In view of this, it is not appropriate to consider MAT credit as a deferred tax asset for the purposes of AS 22.

Whether MAT credit can be considered as an 'asset'

6. Although MAT credit is not a deferred tax asset under AS 22 as discussed above, yet it gives rise to expected future economic benefit in the form of adjustment of future income tax liability arising within the specified period. A question, therefore, arises whether the MAT credit can be considered as an 'asset' and in case it can be considered as an asset whether it should be so recognised in the financial statements.

7. The Framework for the Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India, defines the term 'asset' as follows:

> "An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise."

8. MAT paid in a year in respect of which the credit is allowed during the specified period under the Act is a resource controlled by the company as a result of past event, namely, the payment of MAT. MAT credit has expected future economic benefits in the form of its adjustment against the discharge of the normal tax liability if the same arises during the specified period. Accordingly, MAT credit is an 'asset'.

9. According to the Framework, once an item meets the definition of the term 'asset', it has to meet the criteria for recognition of an asset so that it may be recognised as such in the financial statements. Paragraph 88 of the Framework provides the following criteria for recognition of an asset:

> "88. An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably."

10. In order to decide when it is 'probable' that the future economic benefits associated with the asset will flow to the enterprise, paragraph 84 of the Framework, *inter alia*, provides as below:

> "84. The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the enterprise. The concept is in keeping with the uncertainty that characterises the environment in which an enterprise operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared."

11. The concept of probability as contemplated in paragraph 84 of the Framework relates to both items of assets and liabilities and, therefore, the degree of uncertainty for recognition of assets and liabilities may vary keeping in view the consideration of 'prudence'. Accordingly, while for recognition of a liability the degree of uncertainty to be considered 'probable' can be 'more likely than not' (as in paragraph 22 of Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets') for recognition of an asset, in appropriate conditions, the degree may have to be higher than that. Thus, for the purpose of consideration of the probability of expected future economic benefits in respect of MAT credit, the fact that a company is paying MAT and not the normal income tax, provides a *prima facie* evidence that normal income tax liability may not arise within the specified period to avail MAT credit. In view

of this, MAT credit should be recognised as an asset only when and to the extent there is convincing evidence that the company will pay normal income tax during the specified period. Such evidence may exist, for example, where a company has, in the current year, a deferred tax liability because its depreciation for the income-tax purposes is higher than the depreciation for accounting purposes, but from the next year onwards, the depreciation for accounting purposes would be higher than the depreciation for income-tax purposes, thereby resulting in the reversal of the deferred tax liability to an extent that the company becomes liable to pay normal income tax.

12. Where MAT credit is recognised as an asset in accordance with paragraph 11 above, the same should be reviewed at each balance sheet date. A company should write down the carrying amount of the MAT credit asset to the extent there is no longer a convincing evidence to the effect that the company will pay normal income tax during the specified period.

Presentation of MAT credit in the financial statements

Balance Sheet

13. Where a company recognises MAT credit as an asset on the basis of the considerations specified in paragraph 11 above, the same should be presented under the head 'Loans and Advances' since, there being a convincing evidence of realisation of the asset, it is of the nature of a pre-paid tax which would be adjusted against the normal income tax during the specified period. The asset may be reflected as 'MAT credit entitlement'.

14. In the year of set-off of credit, the amount of credit availed should be shown as a deduction from the 'Provision for Taxation' on the liabilities side of the balance sheet. The unavailed amount of MAT credit entitlement, if any, should continue to be presented under the head 'Loans and Advances' if it continues to meet the considerations stated in paragraph 11 above.

Profit and Loss Account

15. According to paragraph 6 of Accounting Standards Interpretation (ASI) 6, 'Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961', issued by the Institute of Chartered Accountants of India, MAT is the current tax. Accordingly, the tax expense arising on account of payment of MAT should be charged at the gross amount, in the normal way, to the profit

and loss account in the year of payment of MAT. In the year in which the MAT credit becomes eligible to be recognised as an asset in accordance with the recommendations contained in this Guidance Note, the said asset should be created by way of a credit to the profit and loss account and presented as a separate line item therein.