Chapter 2 : Systemic issues including ambiguities/lacunae in the special provisions

2.1 The chapter deals with the systemic issues including ambiguities or lacunae in the special provisions of the Income Tax Act, relevant Income Tax Rules.

2.2 Nature of ambiguities/lacunae

While conducting performance audit, we identified 195 assessment cases where systemic issues including ambiguities/lacunae in provisions of section 115JB of the Act were noticed. A summary of these cases is given in the table below:

Table 2.1: Nature of ambiguities/lacunae

Para No.	Nature of ambiguity/lacuna	No. of assessment cases	Tax effect (₹ in crore)
2.4	Incomes not considered for computation of book profit due to lack of specific provisions regarding their treatment in accounts	41	112.59
2.5	Treatment of items having element of both "Reserve" and "Provision for ascertained liability"	8	331.14
2.6	Effect of change in method of depreciation treated differently for the purpose of book profit	14	5.16
2.7	Treatment of brought forward business loss/unabsorbed depreciation as per books in computation of book profit under special provisions	10	28.14
2.8.1	Absence of provision to reduce bad debts actually written off in computation of book profit	9	0
2.8.2	Additions made on account of bogus purchases/undisclosed income/unaccounted income for taxation under normal provision not considered for computation of book profit	19	41.34
2.8.3	Non consideration of transfer pricing adjustments on items having direct bearing on the profit and loss account under MAT	36	93.05
2.8.4	Statutory dues not paid within due date of filing of return of income not considered for disallowance under MAT	39	75.89
2.8.5	Expenditure on Corporate Social Responsibility (CSR) not considered for disallowance under MAT	12	15.49
2.8.6	Need for disallowance of MAT credit of the amalgamating company on discontinuance of their business by the amalgamated company after amalgamation.	1	0
2.9	Uniform stand not adopted by ITD in set off of MAT credit in summary cases	6	0
	Total	**195**	**702.8**

The audit observations on above issues are given in subsequent paragraphs.

2.3 Ambiguities in provisions of the Act

The Supreme Court has restricted the powers of assessing officer holding[8] that the assessing officer had no power to recast the book profit beyond the adjustments prescribed under the special provisions of section 115JA of the Act. Consequently assessees started treating certain items in such a way that they are not routed through profit and loss account and as such they escape their adjustment in computation of book profit under special provisions. In the earlier Performance Audit Report, it was recommended in audit[9] to incorporate a suitable provision in the Act enabling the assessing officer to rectify mistakes in computation of net profit for the purpose of special provision of section 115JB. However, no such enabling provision has been brought in the Act so far. As a result thereof, the disputes and litigations pertaining to special provisions of section 115JB are still going on due to manipulation of various accounting treatments by the assessees.

2.4 Incomes not considered for computation of book profit due to lack of specific provisions regarding their treatment in accounts

Interest on advances/Inter Corporate Deposit(ICD)/Fixed Deposit (FD) and excess interest written back, grants-in-aid received, post amalgamation profit of the amalgamating company, profit on the long terms investments, duty drawback refund pertaining to capital assets neither offered as income nor reduced from the cost of asset in the books, waiver of royalty, sales tax, electricity charges etc. already claimed in the accounts of earlier years, surplus income due to change in method of cash system of accounting to mercantile system of accounting are the incomes, which were not considered for tax under MAT due to lack of specific provisions regarding their treatment in accounts.

2.4.1 Incomes offered for tax under normal provision but not under MAT

We noticed in 22 assessment cases in nine states[10] that the ITD did not consider incomes aggregating ₹ 337.86 crore for tax under MAT though the same were considered for tax under normal provision. Omission resulted in tax effect of ₹ 74.10 crore **(Appendix 4).**

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8 CIT Vs Apollo Tyres Limited(SC) [2002] 255 ITR 273

9 Para 1.5.3 of C&AG Performance Audit Report No.13 of 2004

10 Andhra Pradesh and Telangana(2), Assam(3), Gujarat(1), Haryana(2), Karnataka(3), Madhya Pradesh(1), Maharashtra(7) and West Bengal(3)

Box 2.1 Illustrative cases on income offered for tax under normal provision but not under MAT

(a) Charge: Pr. CIT-Central, Bangalore
Assessee: M/s Rajesh Exports Ltd
Assessment Years: 2013-14 and 2014-15
PAN: AAACR8642N

The AO made additions of ₹ 43.72 crore and ₹ 45.02 crore on account of accrued interest on ICD[11] during two AYs respectively under normal provision, which was not considered during computation of book profit under MAT. Omission resulted in short computation of book profit of ₹ 88.74 crore involving tax effect of ₹ 18.16 crore. Reply from ITD was awaited.

(b) Charge: Pr. CIT-2 Hyderabad
Assessee: M/s Transmission Corporation of Andhra Pradesh Ltd.
Assessment Years: 2010-11 and 2011-12
PAN: AABCT0088P

The AO made additions of ₹ 46.31 crore and ₹ 38.66 crore on account of accrued interest on fixed deposit made out of advances received from Government of Andhra Pradesh towards lift irrigation scheme works and investment made out of contingency reserve during two years respectively under normal provision, which were not considered during computation of book profit under MAT. Omission resulted in short computation of book profit of ₹ 84.97 crore involving tax effect of ₹ 21.39 crore. ITD did not accept (November 2016) the observation stating that section 115JB did not provide for such adjustment. The reply was not tenable in view of a judicial decision[12] holding that where the books of accounts have not been prepared in accordance with Part II and Part III of Schedule VI of Companies Act read with mandatory accounting standards then the AO was competent to re-cast the profit and loss account and re-compute the book profit for the purpose of section 115JB of the Act.

(c) Charge: CIT-2, Mumbai
Assessee: M/s Tata Realty and Infrastructure Ltd.
Assessment Year: 2012-13 & 2013-14
PAN: AACCT6242L

AO accepted the computation of income as returned by the assessee. The assessee offered ₹ 12.80 crore and ₹ 12.73 crore for two years respectively being interest on advance given to International Amusement Ltd, which was

[11] Inter Corporate Deposit
[12] M/s Veekaylal Investment Co. (Pvt) Ltd Vs CIT (249 ITR 597 Bombay HC-2001), M/s Vishwanath Fin Cap Vs CIT (2007-TIOL-241-ITAT-Delhi)

neither accounted for in the books of account nor considered for computation of book profit under MAT by the AO. Omission resulted in short computation of book profit of ₹ 25.53 crore involving tax effect of ₹ 4.53 crore. Reply from ITD was awaited.

Incomes such as interest accrued on ICD and fixed deposit made out of advances received from Government etc. as discussed in above cases were considered for taxation under normal provisions but not considered for computation of book profit by the AO.

2.4.2 Extraordinary/exceptional items not offered for tax under MAT

The Companies Act, 1956 provides for routing of all extra-ordinary/exceptional items[13] through profit and loss account, which are treated in books of accounts in following manner:

(i) Most of the companies route it through profit and loss account and consider the same during computation of book profit under MAT. However, some companies adopt the 'net profit as per profit and loss account before the extraordinary items' for the computation of book profit under MAT and hence exclude such items from the levy of tax under MAT.

(ii) Some companies take the items of extraordinary/exceptional items directly to balance sheet without routing the same through profit and loss account escaping the levy of MAT.

We noticed in 16 assessment cases in eight states[14] that AO did not consider the extraordinary/exceptional items for computation of book profit. Omission resulted in underassessment of income aggregating ₹ 126.57 crore involving tax effect of ₹ 23.13 crore **(Appendix 5)**. However, in four other assessment cases[15] in Maharashtra, the extraordinary/exceptional items were included in the computation of book profit**.**

[13] Extraordinary items included receipts/payments which are not derived through normal course of business of the companies. They are accounted under a separate head to show the companies earnings before and after such items.

[14] Andhra Pradesh and Telangana(5), Chhattisgarh(1), Gujarat(3), Kerala(1), Maharashtra(2), Tamil Nadu(3) and Uttar Pradesh(1)

[15] M/s Tata Sons Ltd (AY 2011-12), M/s HPCL (AY 2012-13 and 2013-14) and M/s Godrej & Boyce Mfg. Co. Ltd. (AY 2012-13)

Box 2.2 : Illustrative cases on extraordinary/exceptional item not offered for MAT

(a) Charge: Pr. CIT-3, Baroda
Assessee: M/s Narmada Clean Tech Ltd.
Assessment Year: 2013-14
PAN: AABCB4070D

AO allowed the assessee to take ₹ 18.12 crore received as grant in aid during the year directly to the balance sheet under the head 'Reserves and Surplus'. The receipt constitutes an extraordinary item; the same should have been routed through the profit and loss account, which was not done. Omission resulted in underassessment of book profit of ₹ 17.65 crore involving tax effect of ₹ 3.53 crore. Reply from ITD was awaited.

(b) Charge: CIT-I, Coimbatore
Assessee: M/s Sima Textile Processing Centre Ltd.
Assessment Year: 2013-14
PAN: AAJCS5062N

AO allowed the assessee to take ₹ 12 crore received as grant in aid during the year under the Scheme Integrated Textile Parks, directly to the balance sheet under the head 'Reserves and Surplus'. The receipt constitutes an extraordinary item; the same should have been routed through the profit and loss account, which was not done. Omission resulted in short computation of book profit of ₹ 12 crore involving tax effect of ₹ 3.22 crore. Reply from ITD was awaited.

In the absence of specific provisions regarding treatment of the income such as grant in aid etc. in books of accounts, these were directly taken to balance sheet and not routed through profit and loss account, thus escaping their adjustment in computation of book profit.

2.4.3 Treatment of profit/loss on sale of long term investment of amalgamating company

Profit/loss on sale of assets (investments in amalgamating company) on amalgamation is adjusted under the head, "General Reserve" in Balance sheet as per the scheme of amalgamation approved by the respective High Court. AS 14[16] also confirms this stand whereas as per AS 13[17] such profit/loss should have been routed through profit and loss account in normal course.

[16] Direction given for the treatment to be given to profit/loss on sale of investment relating to amalgamating companies on amalgamation in the scheme of amalgamation has to be followed.

[17] On disposal of an investment, the difference between the carrying amount and the net disposal proceeds should be charged or credited to profit and loss account

Suitable disclosure regarding the violation of accounting treatment as per AS 13 is given in the notes to annual account. Assessing Officers find it difficult to arrive at a decision regarding the treatment of such income/loss in computation of book profit under MAT in absence of any specific provision in the Act.

We noticed in three assessment cases in three states[18] that though the profit/loss was adjusted against the General Reserve as per the directions prescribed in the approved scheme of amalgamation, their treatment for the purpose of MAT varied according to the convenience of the assessee. While computing book profit, the assessees did not consider the income/ profit, whereas they considered the loss from such transactions though the same was not debited to the profit and loss account. Omission resulted in short computation of book profit of ₹ 99.39 crore involving tax effect of ₹ 15.36 crore **(Appendix 6).**

Box 2.3: Illustrative cases on treatment of profit/loss on sale of long term investment of amalgamating company

Charge: Pr. CIT-3, Mumbai
Assessee: M/s Daljita Financial & Technical Services Pvt. Ltd.
Assessment Year: 2013-14
PAN: AABCD1297L

AO accepted the computation of income as returned by the assessee. The assessee credited the profit on sale of long term investment of the amalgamating company to capital reserve, which was not considered for tax under MAT by the AO. Omission resulted in short computation of book profit of ₹ 31.73 crore involving tax effect of ₹ 5.21 crore. ITD did not accept the observation (January 2017) stating that (i) such transaction due to amalgamation was not a transfer as per section 47(vi) of the Act, and as such there arose no capital gains on such transactions, (ii). AO had no power to make any adjustment beyond prescribed adjustments in view of apex court decision in the case of M/s Apollo Tyres Ltd and (iii) AS 13 was not attracted in this case and transfer due to amalgamation was well covered by AS14. The reply was not tenable in view of a judicial decision[19] that a scheme sanctioned under sections 391 and 394 of Companies Act, 1956 did not have any over-riding effect or dispense with provisions of any other law including Companies Act. The effect of any accounting made on the basis of scheme of compromise/arrangement under Companies Act, 1956 will have to be independently judged in accordance with provisions of

[18] Andhra Pradesh and Telangana(1) and Maharashtra(2)
[19] M/s J K Lakshmi Cement Vs ACIT -ITAT Kolkata (ITA Nos. 1275,1417 and 1470 of 2009 dated 30.08.2011)

the Income Tax Act in assessment and subsequent proceedings. The primary duty of AO while computing book profit was to see whether the accounts have been maintained in accordance with the requirements of Companies Act, which he failed to perform despite the auditors' opinion. Non applicability of the decision of apex court in the case of M/s Apollo Tyres was also discussed within the judicial decision above.

Further, on the contrary, in another case of **M/s Gati Ltd. (AY 2013-14, PAN-AABCG3709Q) assessed at PCIT-2, Hyderabad charge, ITD allowed claim of the assessee towards** the loss of ₹ 64 crore on sale of shares relating to M/s Gati Ship Ltd. (amalgamating company) which was not debited to the profit and loss account, in computation of book profit under MAT relying on the decision of M/s. J. K. Lakshmi Cement Ltd Vs ACIT.

ITD took contradictory stand in the cases illustrated above. In the first case, the profit on sale of long term investment of the amalgamating company credited to capital reserve which was not routed through the profit and loss account, was not considered for MAT, whereas in the second case the loss on sale of shares of amalgamating company was also adjusted against "capital reserve, which although not debited to the profit and loss account, was claimed and also allowed the same in computation of book profit under MAT. Contradictory/ inconsistent but convenient implementation/ treatment of the provisions by the ITD resulted in undue advantage to the assessees and loss of revenue to the Government. Reply from ITD was awaited.

2.5 Treatment of items having element of both "Reserve" and "Provision for ascertained liability"

As per section 115JB(2)(b) of the Act, "any amount carried to reserve by whatever name called" has to be disallowed during computation of book profit whereas section 115JB(2)(c) provides for disallowance of the amounts or amounts set aside to provisions made for meeting unascertained liabilities.

Debenture Redemption Reserve (DRR) is one of such reserves[20] which is charged to profit and loss account. The Apex court and Bombay High Court held[21] that DRR is a 'provision for ascertained liability' and hence allowable under section 115JB(2)(c) of the Act. Delhi High court had different view[22] holding that DRR if charged to appropriation account shall be treated as

[20] Guidance Note on revised Schedule VI to Companies Act, 1956 issued by ICAI classifies 'reserves and surplus' as (a) capital reserve; (b) capital redemption reserve; (c) securities premium reserve; (d) debenture redemption reserve; (e) revaluation reserve or other reserve.

[21] CIT Vs National Rayon Corporation (SC)[1997] 227 ITR 764 and CIT Vs Raymond Ltd. (Bom HC) [2012] 21 Taxmann.com 60

[22] Addl CIT Vs SREI Infrastructure (Delhi HC) [2015] Civil Appeal No. 371 of 2012

reserve instead of treating it as provision for ascertained liability and the same will be disallowed under section 115JB(2)(b).

Provision for Debenture Redemption/Loan Redemption Reserve etc. debited to profit and loss account though ascertained liability has the element of capital as well as revenue portion of the loan (interest). The reserve is created for the redemption of both capital as well as interest. It will have no impact in computation of income under normal provisions as provision for ascertained as well as for unascertained liability is disallowed. Allowance of such reserve in the computation of book profit under MAT will tantamount to allowance of capital expenditure.

We noticed in eight assessment cases in two states[23] that AO allowed deduction of ₹ 2,163.47 crore charged as Debenture Redemption Reserve/Loan Redemption Reserve to the 'Appropriation Account' as claimed by assessee in computation of book profit under MAT involving tax effect of ₹ 331.14 crore **(Appendix 7)**. We further noticed in another three assessment cases[24] in Maharashtra that the assessee had charged the same to appropriation account but had offered the same for tax under MAT.

Box 2.4: Illustrative cases on treatment of items having element of both "Reserve" and "Provision for ascertained liability"

(a) **Charge: Pr. CIT(Central)-3, Mumbai**
Assessee: M/s Housing Development & Infrastructure Limited
Assessment Year: 2008-09 to 2010-11 and 2012-13
PAN: AAACH5443F

AO allowed deduction aggregating ₹ 1,917.12 crore towards DRR from AYs 2008-09 to 2010-11 and AY 2012-13 in the computation of book profit as claimed although the same was charged to appropriation account. The net profit for computation of book profit under MAT was taken as per profit and loss account before appropriation. This resulted in short computation of book profit of ₹ 1,917.12 crore involving tax effect of ₹ 285.63 crore. Reply from ITD was awaited.

(b) **Charge: Pr. CIT-2, Kolkata**
Assessee: M/s Keshoram Industries Ltd
Assessment Year: 2010-11
PAN: AABCK2417P

While computing book profit under MAT, AO did not add back ₹ 101.25 crore debited to profit and loss account as transfer to debenture redemption reserve. Debenture redemption reserve was created[25] out of

23 Maharashtra(6) and West Bengal(2)
24 Reliance Industries Ltd, Tata Sons Ltd. and Tata Power Ltd.
25 Note 19.3 to Schedule 17 of profit and loss account

the profit of the company. Thus, it being an appropriation of profits was required to be treated as reserve and not provision for ascertained liability. Omission resulted in short computation of book profit of ₹ 101.25 crore involving tax effect of ₹ 17.21 crore. Reply from ITD was awaited.

The Debenture Redemption Reserve/Loan Redemption Reserve, a "reserve" created for meeting an "ascertained liability" made its treatment more complex for the purpose of book profit computation as section 115JB(2)(c) provided for addition of any reserve created irrespective of its nomenclature, whereas as per section 115JB(2)(b) any provision for an 'unascertained liability' shall be added in computation of book profit. Lack of clarity on the issue may lead to litigations.

In the exit conference, Audit pointed out that on the issue of DRR/LRR, there are two conflicting High Court decisions for which the CBDT agreed to examine and take suitable action.

2.6 Effect of change in method of depreciation treated differently for the purpose of book profit

In the event of a change in the method of depreciation[26], a company shall calculate depreciation from the year of inception of asset under new method adopted and the shortfall/excess shall be debited/ credited to the profit and loss account and given effect in computation of book profit accordingly[27].

We noticed that in eight assessment cases[28] in Karnataka and Maharashtra out of 14 assessment cases in five states[29], excess depreciation of ₹ 38.50 crore pertaining to earlier years due to change in method of depreciation was credited to the profit and loss account and reduced in computation of book profit. In remaining six assessment cases[30], shortfall in depreciation of ₹ 124.31 crore due to change in method was charged to profit and loss account but not added in computation of book profit which was allowed by the ITD. Reduction of excess allowance of depreciation from computation of book profit, credited to profit and loss account due to change in method of depreciation involved tax effect of ₹ 5.16 crore **(Appendix 8).**

[26] From straight line method to written down value method and vice-versa as per Para 21 of AS 6 issued by Institute of Chartered Accountant of India

[27] Para 15 of AS 6

[28] Fair Export India Pvt. Ltd. AY 2011-12, Ridham Synthetics P.Ltd. AY 2013-14, Zenith Industrial Rubber Products P.Ltd. AY 2013-14, Mind Tree Wireless P.Ltd. AY 2010-11,Cognizant Global Services P.Ltd. AY 2008-09, 2009-10, Mukhtar Minerals P. Ltd. AY 2012-13 and Citrix R&D India P.Ltd. AY 2011-12,

[29] Karnataka (5), Kerala(1), Maharashtra(5), Madhya Pradesh (2) and Tamil Nadu (1)

[30] Laxmi Mills Co.Ltd. AY 2013-14, Petronet CCK Ltd. AY 2013-14, AVI Agri Business P. Ltd. AY 2011-12, HD Wires P. Ltd. AY 2011-12, Saurashtra Containers Pvt. Ltd. AY2012-13 and The West Coast Paper Mills Ltd. AY 2010-11

Box 2.5: Illustrative cases on effect of change in method of depreciation treated differently for the purpose of book profit

(a) Charge: Pr. CIT-14, Mumbai
Assessee: M/s Fair Export India Pvt. Ltd.
Assessment Year: 2011-12
PAN: AAACF3799A

AO allowed the assessee to credit ₹ 8.86 crore towards excess depreciation pertaining to earlier years due to change in method of depreciation to the profit and loss account under the head, "extra ordinary and prior period items" below the net profit but did not consider it for inclusion in the book profit under special provisions. Omission resulted in short computation of book profit of ₹ 8.82 crore involving tax effect of ₹ 1.76 crore. Reply from ITD was awaited.

(b) Charge: Pr. CIT-1, Mumbai
Assessee: M/s Zenith Industrial Rubber Products Pvt Ltd.
Assessment Year: 2013-14
PAN: AAACA3874D

AO allowed the assessee to credit ₹ 7.20 crore to profit and loss account towards excess depreciation pertaining to earlier years due to change in the method of depreciation which was reduced in computation of book profit under MAT. Omission resulted in short computation of book profit of ₹ 7.20 crore involving tax effect of ₹ 1.11 crore. Reply from ITD was awaited.

(c) Charge: Pr. CIT-1, Kochi
Assessee: M/s Petronet CCK Ltd.
Assessment Year: 2013-14
PAN: AABCP9197R

AO allowed the assessee to debit ₹ 61.40 crore to profit and loss account towards shortfall in depreciation pertaining to earlier years due to change in the method of depreciation but did not add back the same in computation of book profit under MAT. Reply from ITD was awaited.

Thus, different treatment has been given to excess depreciation and shortfall in depreciation caused due to change in method of depreciation to the benefit of the assessee in computation of book profit under MAT resulting either in short or excess allowance of depreciation.

2.7 Treatment of brought forward business loss/unabsorbed depreciation as per books in computation of book profit under special provisions

Amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account is reduced from the net profit in computation of book profit[31]. During this performance audit, we came across certain irregularities in computation of brought forward loss and unabsorbed depreciation as discussed in the following sub paragraphs:

2.7.1 Apportioning the profit as per profit and loss account in the ratio of brought forward loss and unabsorbed depreciation

We noticed in three assessment cases in Maharashtra that for arriving at figure of brought forward loss or unabsorbed depreciation for the purpose of book profit, the AO allowed the assessee to bifurcate its profit as per profit and loss account in the ratio of its brought forward loss and unabsorbed depreciation and then adjusted the apportioned amount of profit against the brought forward losses respectively instead of adjusting the profit against the brought forward loss or unabsorbed depreciation whichever was less, for computation of book profit under the special provisions. Omission resulted in short computation of book profit of ₹ 101.33 crore involving tax effect of ₹ 8.15 crore **(Appendix 9).**

Box 2.6: Illustrative case of apportioning the profit as per profit and loss account in the ratio of brought forward loss and unabsorbed depreciation

Charge: Pr. CIT-8, Mumbai
Assessee: M/s Vodafone Ltd.
Assessment Year: 2004-05 and 2005-06
PAN: AAACH5332B

While giving effect to an appellate order[32] (February 2013), AO levied tax under MAT on the book profit of ₹ 185.88 crore and ₹ 348.54 crore for the two AYs respectively which was worked out by the assessee after reducing ₹ 59.66 crore and ₹ 39.20 crore towards business loss/unabsorbed depreciation pertaining to AYs 1996-97 to 2000-01. The assessee had bifurcated its profit as per profit and loss account in the ratio of its brought forward loss and unabsorbed depreciation and then adjusted the apportioned amount of profit against the brought forward losses/depreciation respectively instead of adjusting the profit against the

[31] Explanation (I)(iii) to section 115JB(2) of the Act
[32] Passed by Punjab and Haryana High Court under section 260A

brought forward loss or unabsorbed depreciation whichever was less, in computation of book profit under the special provisions.. The incorrect approach allowed by the AO resulted in excess set off unabsorbed business loss/depreciation of ₹ 59.66 crore and ₹ 39.23 crore[33] involving tax effect of ₹ 4.59 crore and ₹ 3.08 crore respectively. Reply from ITD was awaited.

2.7.2 Previous year's brought forward loss/unabsorbed depreciation considered for reduction instead of their cumulative position as on date

We noticed in five assessment cases in two states[34] that while computing book profit, the AO allowed the assessee to reduce the lesser of brought forward loss or unabsorbed depreciation pertaining to the immediately preceding year instead of considering lesser of the updated figures of brought forward loss or unabsorbed depreciation as on date. Omission resulted in irregular set off of unabsorbed loss/depreciation of ₹ 22.25 crore involving tax effect of ₹ 4.43 crore **(Appendix 10)**.

Box 2.7: Illustrative cases on previous year's brought forward loss/unabsorbed depreciation considered for reduction instead of their cumulative position as on date

(a) Charge: Pr. CIT-10, Mumbai
Assessee: M/s Jeson Industries
Assessment Year: 2010-11
PAN: AAACJ7659P

AO accepted the reduction of ₹ 2.18 crore pertaining to AY 2009-10 as unabsorbed depreciation (being less), made by the assessee in computation of book profit for AY 2010-11, ignoring the accumulated profit of ₹ 17.36 crore of earlier years. As a matter of fact, no loss or depreciation was available for AY 2010-11. Irregular reduction of unabsorbed depreciation resulted in short computation of book profit of ₹ 2.18 crore involving tax effect of ₹ 37.06 lakh. Reply from ITD was awaited.

(b) Charge: Pr. CIT-2, Chennai
Assessee: M/s EIH Associates Hotels Ltd.
Assessment Year: 2012-13
PAN: AAACE2125M

While computing book profit, AO reduced unabsorbed depreciation of ₹ 18.29 crore pertaining to the amalgamating company as claimed. Further, assessee adjusted the loss of amalgamating company of ₹ 50.53

33 AO mistakenly reduced depreciation of ₹ 3.92 lakh again in computing book profit for AY 2005-06
34 Maharashtra (2) and Tamil Nadu (3)

crore against its profit of ₹ 69.87 crore available in the General Reserves and Surplus and as such no loss was available. Irregular allowance of unabsorbed depreciation of the amalgamating company by the AO resulted in short computation of book profit of ₹ 18.29 crore involving tax effect of ₹ 3.66 crore. ITD did not accept the audit observation (May 2015) stating that the accumulated General Reserve has no bearing on the actual losses as per books of account to be carried forward and set off. The reply was not tenable as the assessee itself had set off loss of the amalgamating company against its accumulated surplus. Further, the unabsorbed depreciation or loss, whichever was less, should have been reduced on accumulated basis up to the previous financial year.

2.7.3 Same amount of brought forward business loss/unabsorbed depreciation as per books was claimed in successive years including current year

We noticed in two assessment cases in Maharashtra that while arriving at the amount of brought forward loss/unabsorbed depreciation, whichever is less as per books, the same amount of deduction was claimed and allowed during computation of book profit for three consecutive assessment years by adjusting the profit from higher of the brought forward loss/unabsorbed depreciation instead of the lower of the two **(Appendix 11)**.

Box 2.8 : Illustrative cases on incorrect allowance of brought forward business loss/unabsorbed depreciation as per books of account

Charge: Pr. CIT-2, Mumbai
Assessee: M/s DCB Bank Ltd
Assessment Year: 2012-13 and 2013-14
PAN: AAACD1461F

While computing book profit at nil, AO reduced same amount of ₹ 50.99 crore towards unabsorbed depreciation in both the AYs restricting the same to the extent of profit of ₹ 45.93 crore and ₹ 40.86 crore, which the assessee was claiming for the last three years by adjusting the profit with the higher of the accumulated business loss keeping the amount of unabsorbed depreciation intact. Unabsorbed depreciation available for set off in AYs 2012-13 and 2013-14 was ₹ 9 crore and 'nil' respectively. Excess set off of unabsorbed depreciation resulted in short computation of book profit aggregating ₹ 77.79 crore involving tax effect of ₹ 15.56 crore for the two years.

> ITD did not accept the observation (October 2015) for AY 2012-13 stating that the business loss and unabsorbed depreciation as per book has to be bifurcated for each assessment year and the claim has to be allowed accordingly even if the lower of the two is already allowed in the previous year. The reply was not tenable on the ground that only the lower of the carried forward business loss and unabsorbed depreciation has to be reduced in computation of book profit. Hence if the same amount of unabsorbed depreciation treating it as lower of the two is claimed fully in any year, it cannot be claimed as lower of the two in subsequent year. Ruling by Authority of Advance Rulings in the case of M/s Rashtriya Ispat Nigam Ltd. Vs CIT (AAR No. 652 of 2004) is relevant here. If the ITD's view is upheld then there will be a situation where the assessee will never have a "nil" amount of lower of business loss/unabsorbed depreciation as per books.

There was lack of clarity in the provision of the Act to deal with the manner of treatment of brought forward loss/unabsorbed depreciation in computation of book profit as discussed in para 2.7.1 to 2.7.3 above.

2.8 Lacunae in the provisions of the Act

We came across cases where AOs have made additions for certain items under normal provisions which had bearing on the net profit. However, these items could not be considered for the computation of book profit for want of enabling prescribed adjustments under special provisions. Such additions are discussed in succeeding paragraphs.

2.8.1 Absence of provision to reduce bad debts actually written off in computation of book profit

The bad debts actually written off but not separately charged to profit and loss account can be allowed under normal provision as per section 36(1)(vii), which in the case of Scheduled/Non-Scheduled Banks, Public/State Financial Institutions and State Industrial Investment Corporation will not apply[35] unless the assessee has debited such debt or part of the debt to the provisions for bad and doubtful debt account for the purpose of deduction under section 36(1)(viia) at the prescribed *per cent*[36]. However, there is no such corresponding provision under section 115JB to allow such bad debts written off and if not separately charged to profit and loss account, as a result

[35] Section 36(2)(v) of the Act

[36] (a) 7.5 *per cent* of total income before allowing deduction under section 36(1)(viia) and chapter VIA; and (b) 10 *per cent* of the aggregate average advances made by the rural branches of such bank.

of which its treatment by different AOs was not uniform in computation of book profit.

We test checked nine assessment cases in four states[37] where bad debts actually written off were allowed as deduction in normal computation of income as per provisions of section 36(1)(vii). However, while computing book profit under section 115JB, bad debts actually written off was reduced from book profit in three assessment cases but was not considered at all in six assessment cases (**Appendix12).**

Box 2.9 : Illustrative case on absence of provision to allow bad debts actually written off in computation of book profit

(a) Charge: Pr. CIT-2, Mumbai

Assessee: M/s Bank of India
Assessment Year: 2007-08 and 2014-15
PAN: AAACB0472C

AO, inter alia, allowed ₹ 5,23.53 crore and ₹ 3,836.25 crore towards bad debts actually written off under normal provisions as claimed which were not considered at all in computation of book profit as there was no provision therefor under special provision. Reply from ITD was awaited.

(b) Charge: CIT-7, New Delhi
Assessee: M/s Oriental Bank of Commerce
Assessment Year: 2013-14 and 2014-15
PAN: AAACO0191M

AO, inter alia, allowed ₹ 1393.20 crore and ₹ 1231.56 crore towards bad debts actually written off under normal provisions as claimed which were not considered at all in computation of book profit as there was no provision therefor under special provision. Reply from ITD was awaited.

(c) Charge: Pr. CIT-2, Mumbai
Assessee: M/s DCB Bank Ltd
Assessment Year: 2012-13 and 2013-14
PAN: AAACD1461F

AO, inter alia, allowed bad debts of ₹ 36.29 crore and ₹ 85.26 crore actually written off under normal provisions as claimed, which was also reduced in computation of book profit though there was no such provision therefor under special provision. Reply from ITD was awaited.

There being no adjustment prescribed under special provisions to reduce the bad debts actually written off from the book profit, its treatment in computation of book profit is not uniform by different AOs.

[37] Andhra Pradesh and Telangana(2), Delhi (3), Maharashtra (4)

2.8.2 Additions made on account of bogus purchases/undisclosed income/unaccounted income for taxation under normal provision not considered for computation of book profit

We test checked 19 assessment cases in six states[38] and found that in 18 assessment cases, disallowances were made on account of bogus purchases/undisclosed income/unaccounted income under normal provisions only and not under special provisions of MAT, there being no provision for addition of such items under special provisions. However, in one case, ITD itself disallowed the same for computation of book profit. The tax effect worked out to ₹ 41.34 crore **(Appendix 13).**

Box 2.10: Illustrative case on additions made on account of bogus purchases/undisclosed income/unaccounted income for taxation under normal provision not considered for computation of book profit

(a) Charge: Pr. CIT-LTU, Mumbai
Assessee: M/s Lupin Ltd
Assessment Year: 2009-10 to 2012-13
PAN: AAACL1069K

AO made additions aggregating ₹ 77.89 crore towards bogus commission expenses debited to profit and loss account but the same were not considered for computation of book profit under MAT provisions in the absence of any specific provision thereof under prescribed adjustment, which might have increased the book profit to the extent of additions made involving tax effect of ₹ 13.66 crore. Reply from ITD was awaited.

(b) Charge: Pr. CIT-3 Hyderabad
Assessee: M/s Soma Enterprises Ltd.
Assessment Years: 2011-12 and 2012-13
PAN: AACCS8242F

AO made additions of ₹ 51.28 crore and ₹ 46.96 crore during the two AYs respectively towards bogus payments made to sub contractors and vendors debited to profit and loss account but the same were not considered for computation of book profit under special provisions in the absence of any specific provision therefor under prescribed adjustment, which might have increased the book profit to the extent of additions made involving tax effect of ₹ 20.05 crore. ITD did not accept the audit observation

[38] Andhra Pradesh and Telangana (2), Bihar (6), Gujarat (1), Maharashtra(9) and Tamil Nadu (1)

(October 2016) in view of Apex court decision in the case of M/s Apollo Tyres Ltd stating that there is no such adjustment prescribed under section 115JB. The reply is not tenable as non applicability of the decision of apex court in the case of M/s. Apollo Tyres has already been considered in another decision[39] delivered, based on which in another case of M/s. Gati Ltd[40] ITD allowed claim of the assessee towards the loss on sale of shares, not debited to the profit and loss account although not covered under prescribed adjustments under MAT, in computation of book profit. Similarly, in the instant case, the expenses related to the alleged payments to sub-contractors, already booked in the profit and loss account, and added back in computation of income under normal provisions although not covered under prescribed adjustments under MAT, should have been added in computation of book profit.

There being no adjustment prescribed under special provisions with respect to treatment of bogus purchases/ undisclosed income/ unaccounted income in computation of book profits, its treatment was not uniform by the AOs leading to short computation of book profit.

2.8.3 Non consideration of transfer pricing adjustments on items having direct bearing on the profit and loss account under MAT

As per section 92CA of the Act, transfer pricing adjustments are made to the income under normal provision on items of receipts and expenditure credited/debited to profit and loss account which has been entered by the assessee with its associated enterprise. This exercise is done to bring the transaction amount to the arms length price[41] so that the excess expense/under reporting of receipts related to the transactions with associated enterprise can be curbed and the revenue loss/profit shifting under the garb of various accounting practices is protected.

We noticed in 36 assessment cases in six states[42] that transfer pricing adjustments were made during computation of income under normal provisions with respect to items which had direct bearing on the profit as per profit and loss account, but were not considered for computation of book profit under MAT. There being no provision in the Act to consider the same for computation of book profit under MAT, led the assessee effectively escaping the liability of tax of ₹ 93.05 crore on such disallowances **(Appendix 14)**.

[39] M/s J K Lakshmi Cement Vs ACIT -ITAT Kolkata (ITA Nos. 1275,1417 and 1470 of 2009 dated 30.08.2011)
[40] (AY 2013-14, PAN-AABCG3709Q) assessed at PCIT-2, Hyderabad charge
[41] Price at which transaction is entered with unrelated party
[42] Andhra Pradesh and Telangana(2), Karnataka (10), Kerala(1), Maharashtra (12) and West Bengal (11)

2.8.4 Statutory dues not paid within due date of filing of return of income not considered for addition under MAT

Any tax, duty, cess or fee (among other things) are disallowed[43] during computation of income under normal provisions if such amount is not paid within the due date of filing of return of income. This provision has been brought into effect to promote timely payment of statutory dues. If the assessee was liable to pay tax under MAT during any year, it could intentionally delay the payment as there was no corresponding provision/adjustment prescribed for disallowance of the same in the computation of book profit.

We noticed in 39 assessment cases in 11 states[44] that the statutory dues in the form of taxes were disallowed during computation of income under normal provisions but were not considered under MAT. Had such disallowances been considered under MAT also, there would have been a revenue impact of ₹ 75.89 crore **(Appendix 15).**

2.8.5 Expenditure on Corporate Social Responsibility (CSR) not considered for disallowance under MAT

Every company, based on certain parameters, shall set apart at least two *per cent* of the average profits of immediately preceding three financial years for the purpose of CSR in the books of accounts[45]. Such provision has been brought to share the burden of the Government in providing social services[46] and hence such expense shall not be allowed as benefit under Income Tax Act. The provision for disallowance of expenditure on CSR under normal provision has been introduced[47] from 1 April 2015. However, no corresponding provision for disallowance of such expenses for computation of book profit is prescribed under special provisions.

We noticed in 12 assessment cases in eight states[48] that CSR expenses were debited to the profit and loss account but not considered for disallowance under MAT. Had such disallowances been considered for MAT also, there would have been a revenue impact of ₹ 15.49 crore **(Appendix 16).**

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[43] As per section 43B (a) of the Act,
[44] Andhra Pradesh and Telangana (2), Assam (1), Gujarat (7),Haryana (2), Karnataka (2), Maharashtra (19), Punjab (3), Rajasthan (1), Uttar Pradesh (1) and West Bengal (1)
[45] Section 135 of New Companies (Amendment) Act, 2013
[46] Circular 1 of 2015 issued by CBDT issued on 21 January 2015
[47] Finance Act 2014 w.e.f. AY 2015-16
[48] Andhra Pradesh and Telangana (1), Chhattisgarh (5), Delhi (1) Himachal Pradesh (1), Karnataka (1), Maharashtra (2) and Rajasthan (1)

Box 2.11: Illustrative case on expenditure on CSR not considered for disallowance under MAT

(a) Charge: Pr. CIT, Bilaspur
Assessee: M/s Jindal Power Ltd.
Assessment Year: 2010-11 to 2012-13
PAN: AABCJ4683J

AO disallowed CSR expense of ₹ 5.40 crore, ₹ 6.50 crore and ₹ 5.83 crore pertaining to three AYs respectively under normal provisions but did not consider the same for disallowance for computation of book profit under MAT. Had such disallowances been considered for MAT also, there would have been a revenue impact of ₹ 3.38 crore. ITD did not accept the audit observation stating that the AO has no jurisdiction to go behind the net profit shown in profit and loss account except to the extent provided in Explanation to section 115JB. Further this provision is applicable from FY 2014-15 (October 2016). The reply was not tenable as Finance Act 2014 has expressly brought an amendment to disallow such expenses during the computation of income under normal provision. Further vide Circular 1 of 2015 dated 21.01.2015, CBDT clarified that CSR expenses were in the nature of application of income with the objective to share burden of the Government in providing social services. If such expenses are allowed as tax deduction, this would result in subsidizing such expenses by the Government by way of tax expenditure. Hence, on the same logic such expenses should also be considered for disallowance during computation of book profit under MAT.

2.8.6 Need for disallowance of MAT credit of the amalgamating company on discontinuance of their business by the amalgamated company after amalgamation.

Certain conditions have to be fulfilled for availing the benefit of carry forward and set off of brought forward losses of amalgamating companies which *inter-alia* provide[49] that the amalgamated company should continue business of the amalgamating companies for a minimum period of five years from the date of amalgamation. This provision was introduced to discourage the unnecessary amalgamation of companies having huge losses with profit making companies for the sole purpose of reducing tax liability. However, there was no such provision u/s 115JAA to prohibit the claim of set off of MAT credit of amalgamating company in case of discontinuation of business of the amalgamating company by the amalgamated company after amalgamation.

[49] Section 72A(2) of the Income Tax Act

In one assessment case in Maharashtra, we noticed that MAT credit of amalgamating company was claimed in spite of discontinuing the business of amalgamating unit after amalgamation **(Appendix 17)**.

Box 2.12: Illustrative case on need for disallowance of MAT credit of the amalgamating company on discontinuance of their business by the amalgamated company after amalgamation.

Charge: Pr. CIT-10, Mumbai
Assessee: M/s Parle Agro Pvt. Ltd.
Assessment Year: 2010-11
PAN: AABCP8416G

AO allowed carry forward of MAT credit of ₹ 1.58 crore of the amalgamating company, M/s Parle Pet Pvt. Ltd., though the main business of the amalgamating company was discontinued within the first year post amalgamation, which did not appear to be in order. Like section 72A(2), there was no provision under section 115JAA to prohibit the claim of set off of MAT credit of amalgamating company by the assessee company as it did not continue the business of the amalgamating company for a minimum period of five years after amalgamation. The CBDT during exit conference admitted that it was a mistake on part of the assessing officer.

There was no provision under section 115JAA to prohibit the claim of set off of MAT credit of amalgamating company by the assessee company in case of discontinuance of the business of the amalgamating company before five years after amalgamation.

2.9 Uniform stand not adopted by ITD in set off of MAT credit in summary cases

From the AY 2012-13, ITR 6 has been modified to compute MAT credit set off inclusive of surcharge and education cess.

We noticed in six assessment cases in Andhra Pradesh and Telangana, pertaining to AYs 2010-11 and 2012-13 to 2015-16 processed in summary manner that ITD allowed set off of MAT credit without surcharge and education cess thereon in five assessment cases whereas in one case it was allowed inclusive of surcharge and education cess **(Appendix 18).**

2.10 Conclusion

There were no specific provisions for treatment of the income in computation of book profit in respect of following items:

(i) Interest accrued on ICD and fixed deposit made out of advances received from Government etc. which were considered for taxation under normal provisions

(ii) Grant in aid etc., directly taken to balance sheet and not routed through profit and loss account

(iii) Profit/loss on sale of long term investment of the amalgamating company

(iv) Debenture Redemption Reserve/Loan Redemption Reserve considering its complexity involving element of reserve as well as ascertained liability

(v) Excess/short depreciation due to change in method of depreciation

There was lack of clarity in the provision of the Act to deal with the manner of treatment of brought forward loss/unabsorbed depreciation in computation of book profit.

There being no adjustment prescribed under special provisions to reduce the bad debts actually written off from the book profit, its treatment in computation of book profit is not uniform by different AOs.

There being no adjustment prescribed under section 115JB in respect of the following items for additions in computation of book profit, though they were considered for addition under normal provision:

- (i) bogus purchases/undisclosed income/unaccounted income
- (ii) transfer pricing adjustments on items having direct bearing on the profit and loss account
- (iii) Statutory dues not paid within due date of filing of return of income
- (iv) Expenditure on Corporate Social Responsibility (CSR)

There is no provision under section 115JAA to prohibit the claim of set off of MAT credit of amalgamating company by the assessee company in case of discontinuance of the business of the amalgamating company before five years after amalgamation.

2.11 Recommendations

(a) CBDT may like to insert enabling provisions under Explanation (1) to sub section (2) of section 115JB clarifying the treatment of following items in computation of book profit:

(i) Interest accrued on ICD and fixed deposit made out of advances received from Government etc. which were considered for taxation under normal provisions

(ii) Grant in aid etc., directly taken to balance sheet and not routed through profit and loss account

(iii) Profit/loss on sale of long term investment of the amalgamating company

(iv) Debenture Redemption Reserve/Loan Redemption Reserve considering its complexity involving element of reserve as well as ascertained liability

(v) Excess/short depreciation due to change in method of depreciation

(Para 2.4.1 to 2.4.3, 2.5 and 2.6)

(b) CBDT may like to clarify the manner of setting off brought forward business loss/unabsorbed depreciation in computation of book profit.

(Para 2.7.1 to 2.7.3)

(c) CBDT may like to prescribe an adjustment for reduction of the bad debts actually written off in the books of accounts in computation of book profit, as the same is considered for reduction under normal provisions. **(Para 2.8.1)**

(d) CBDT may like to prescribe an adjustment for additions of the following items in computation of book profit, which were considered for addition under normal provision:

(i) Bogus purchases/undisclosed income/unaccounted income

(ii) Transfer pricing adjustments on items having direct bearing on the profit and loss account

(iii) Statutory dues not paid within due date of filing of return of income

(iv) Expenditure on Corporate Social Responsibility (CSR)

(Para 2.8.2. to 2.8.5)

(e) CBDT may like to introduce a provision in the Act for disallowance of MAT credit of the amalgamating company on discontinuance of their business by the amalgamated company after amalgamation.

(Para 2.8.6)

The CBDT during exit conference agreed to examine all the issues above and stated that feasibility of issuing a circular/clarification if required will be explored.