

# Minimum Alternate Tax under section 115JB not payable on receipts that do not form part of Total Income

September 8, 2015

## In brief

In a recent decision, the Mumbai bench of the Income-tax Appellate Tribunal (the Tribunal) held that capital gains arising on transfer of capital assets from holding companies to their wholly owned subsidiaries, which was not liable to tax under section 45 of the Income-tax Act, 1961 (the Act) read with section 47(iv) of the Act, should be excluded from computation of book profits for levying Minimum Alternate Tax (MAT) under section 115JB of the Act.

## In detail

### Facts

- The taxpayer<sup>1</sup>, an Indian company, was engaged in the business of building and developing properties.
- The taxpayer had a wholly owned Indian subsidiary, SVRL.
- The taxpayer held a land parcel and development rights attached to it.
- During financial year 2008-09, the taxpayer transferred a part of the development rights to SVRL.
- The taxpayer disclosed the long-term gains on such transfer as an “extra ordinary income” in the profit and loss accounts for the year. The taxpayer

included the following note in the Notes to Accounts:

*“During the year the company has derived a surplus over cost of acquisition of assets held by it as CWIP amounting to INR 3.0024 billion. In view of the fact that it was a capital receipt, and the transaction was not regarded as a transfer under the Act, the company interprets that since it was not being in the nature of income, it did not come within purview of section 115JB.*

*The company interpretation on the matter of applicability to MAT on such book profits was also supported by opinion of the experts which were taken on the issue.”*

- Section 47(iv) of the Act provides that the transfer of capital assets from companies to their wholly owned subsidiaries should not be regarded as a transfer under section 45 of the Act. Consequently, the taxpayer considered that it was not liable to tax on the capital gains arising on such transfer under section 45 of the Act.
- The taxpayer did not consider the profits on transfer of development rights to be part of ‘book profits’ for computing MAT under section 115JB of the Act.

The Tax Officer (TO) and Commissioner of Income-tax (Appeals) (CIT(A)) did not agree with the taxpayer’s position, and included such gains as part of ‘net profit’ for the purpose of computing the

<sup>1</sup> I.T.A. No. 2008/Mum/2012

'book profit' under section 115JB of the Act. The taxpayer appealed to the Tribunal against the CIT(A)'s order.

### Issues before the Tribunal

The following issue was raised before the Tribunal:

- Should profit arising on transfer of development rights to a wholly owned subsidiary be included in the book profit under section 115JB of the Act?

### Key contentions of taxpayer

- The expression "net profit as shown in the profit and loss account" used in section 115JB of the Act should mean net profit, after giving effect to the notes to accounts having effect over the net profit.
- Capital gains on transfer to a wholly owned Indian subsidiary company was not "income" as per definition under section 2(24) of the Act and was not liable to tax under the normal provisions of the Act and hence, the same should not be liable to MAT under section 115JB of the Act either.
- In the case of Rain Commodities Limited<sup>2</sup> the Special Bench of Tribunal held:

*".....In the notes on accounts, it was nowhere mentioned and clarified that though the long term capital gain was included in the profit and loss account but it was not to be includible in the net profit in terms of provisions of Part II and Part III of Schedule VI to the Companies Act...."*

In this case, the taxpayer had explained about the non-

inclusion of capital gains in the Notes to Accounts and therefore the decision in case of Rain Commodities Limited<sup>2</sup> was not applicable.

### Key contentions of the Revenue

- Section 115JB was a self-contained code, and only the items prescribed under that section could be added or excluded from the Net Profit disclosed in the Profit and Loss Account.
- The taxpayer had prepared the Profit and Loss Account in accordance with Part II and Part III of Schedule VI to the Companies Act and credited the capital gain on transfer to subsidiary therein.
- Section 115JB did not provide for exclusion of gains arising on transfer of assets to its subsidiary. Considering facts, the decision of the Special bench in case of Rain Commodities Limited<sup>2</sup> was squarely applicable.

### Tribunal's Ruling

The Tribunal set aside the CIT(A)'s order and directed the TO to exclude the above-mentioned profit from the computation of 'Book Profits' on the following grounds:

- a) Notes to Accounts had to be considered as part of the Profit and Loss Account and adjusted in net profit for the purpose of computing the book profit:
  - Section 115JB(2) required that the Profit and Loss Account had to be prepared in accordance with Part II of Schedule VI to the Companies Act, 1956, and therefore the interpretation given to provisions of Companies Act would be relevant.

- The Delhi High Court had confirmed this view in Sain Processing Mills (P) Ltd.<sup>3</sup>.

- Therefore, profits arising on transfer of capital asset by a holding company to its wholly-owned subsidiary company, as specified in the Notes to Accounts, had to be excluded for computing book profit under section 115JB.

- For making this adjustment, a specified inclusion of such adjustment in 'increase' or 'reduction' given in Explanation 1 to section 115JB was not required, as the "net profit" itself was adjusted at the source level.

- b) Profits from a transaction, which were not income as per definition under section 2(24) of the Act, should not be included in computation of 'book profit' under section 115JB:

- Section 10 of the Act provided exemptions to certain receipts from being included in total income, which would otherwise be considered as income under section 2(24) of Act.
- The legislature has provided similar exemptions, except for certain exclusions, from 'book profit' under section 115JB. The legislature maintained parity between "total income" and "book profit" in respect of exempted income. Extending the same logic, an item of receipt

<sup>2</sup> Rain Commodities Ltd. v. DCIT [2010] 40 SOT 265 (Hyderabad) (SB)

<sup>3</sup> CIT v. Sain Processing & Weaving Mills (P) Ltd. [2010] 325 ITR 565 (Delhi)

not covered under the definition of 'income' not included in total income could not be included in book profit under section 115JB of the Act.

- Section 47(iv) of the Act provided that any transfer of capital asset by a company to its wholly owned subsidiary company was not regarded as 'transfer' and therefore, gains on such transfers were not chargeable to tax under section 45 of the Act. Hence, such gains would not be covered as 'income' under section 2(24) and did not enter the computation provisions of the Act.
- c) The decision of the Special Bench in Rain Commodities Limited<sup>2</sup> was distinguishable and therefore not applicable.

### ***The takeaways***

- The Tribunal has allowed the appeal on three grounds:
  - Profit as per Profit and Loss Account is to be adjusted for what is stated in Notes to Accounts.
  - All exempt income, even though not covered under section 10, which is allowed to be excluded under normal provisions of the Act, should also be allowed to be excluded from computation of 'book profit' under section 115JB.
  - Special Bench decision is distinguishable on facts.
- In view of the Supreme Court decision in case of Apollo Tyres Limited.<sup>4</sup>, which held that once the accounts were

in accordance with Part II of Schedule VI to the Companies Act, further adjustment was allowed only for matters provided under section 115JB, this decision requires further consideration.

### ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact:

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<sup>4</sup> Appollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC)

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