MAT provisions require book profit to be adjusted against lower of brought forward unabsorbed loss and unabsorbed depreciation and not merely restrict the amount set-off to the lower number

August 21, 2018

In brief

In a recent ruling[1] of the Ahmedabad bench of the Income-tax Appellate Tribunal (Tribunal), an issue relating to determining the quantum of brought forward unabsorbed loss and unabsorbed depreciation eligible for reduction from the profits in the tax computation under section 115JB of the Income-tax Act, 1961 (the Act) has come up.

The Tribunal, while examining the above issue, has observed that the taxpayer had no option to choose that profits of preceding years would first be adjusted against the brought forward business loss, and lastly, against the unabsorbed depreciation. The Tribunal held that if the lower of the two[2] happens to be unabsorbed depreciation, the profits should have been reduced from unabsorbed depreciation and not from unabsorbed loss.

In detail

Facts

- The taxpayer in the preceding years, while computing "book profits" under section 115JB of the Act, applied clause (iii) of Explanation 1 to section 115JB of the Act[3] (clause) and reduced the profits of the preceding years using the methodology prescribed in that clause.
- However, while determining the quantum eligible for set-off under the said clause for a succeeding year, the taxpayer had followed the first-in, first-out method and reduced the profits of preceding years against the brought forward unabsorbed loss. This methodology was followed by the taxpayer irrespective of the fact that unabsorbed depreciation was lower than brought forward business loss in the preceding year.
- The tax officer (TO) disputed the methodology adopted by the taxpayer. On appeal, the Commissioner of Income-tax (Appeals), upheld the TO's order.
- Aggrieved, the taxpayer preferred an appeal before the Tribunal.

Issue before the Tribunal

Whether the methodology adopted by the taxpayer for computing the eligible amount of set-off towards the lower of

[1] ITA No. 209/ Ahd/ 2018
[2] That is, brought forward unabsorbed loss and unabsorbed depreciation
[3] The clause states that "the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account" should be reduced from the profits of that year.

the brought forward unabsorbed losses and unabsorbed depreciation while computing book profits was in consonance with the provisions of section 115JB of the Act.

Tribunal's ruling

- The Tribunal has explained its position through the following illustration:
  - Brought forward unabsorbed loss: INR 75;
  - Brought forward unabsorbed depreciation: INR 25;
  - Profit as per profit and loss account in the current year: INR 35;
  - The taxpayer reduced INR 25 (being lower of unabsorbed loss and unabsorbed depreciation) in the tax computation under section 115JB of the Act;
  - However, for computing the eligible amount for the succeeding year, the taxpayer has adjusted INR 25 against unabsorbed business loss, and consequently, carried forward unabsorbed loss at INR 50 and unabsorbed depreciation at INR 25 to the succeeding year.
- The Tribunal observed that it is an established principle that in the event that either the brought forward business loss or unabsorbed depreciation is zero, the taxpayer would not be entitled to set-off against books profits.
- The Tribunal observed that the methodology adopted by the taxpayer would generally defeat a situation in which one of the two, i.e., unabsorbed loss or unabsorbed depreciation was NIL. The Tribunal held that the said clause should have been given effect as per letter and in spirit.
- Thus, the Tribunal to give effect to the object of clause, has held that "like should have been reduced from like, and not differently" and concluded that "if the lower of the two[2] happens to be unabsorbed depreciation, the reduction should have been from unabsorbed depreciation alone, and not from the brought forward business loss".

The takeaways

This decision reaffirms the principle that while determining the quantum eligible for set-off in the MAT computation, "the profits of preceding years have to be reduced from unabsorbed depreciation, when the same was lower of the two[2] in the preceding year". Similarly, "the profits of the preceding years have to be reduced from business loss, when the same was lower of the two[2] in the preceding year". The taxpayer had no option to choose a different approach other than the approach specified above.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

Our Offices

Ahmedabad
1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Bengaluru
6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Chennai
8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Hyderabad
Plot no. 77/A, 8-2-624/A/1, 4th Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Telangana
+91-40 44246000

Kolkata
56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata – 700 091,
West Bengal
+91-033 2357 9101/
4400 1111

Mumbai
PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

Gurgaon
Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Pune
7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

For more information
Contact us at
pwctrs.knowledgemanagement@in.pwc.com

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