

CASE STUDY ON INTERPLAY OF
SECTION 10(38) WITH MAT
COMPUTATION UNDER SECTION
115JB

FACTS:

- IPL Ltd is an Indian company.
- IPL Ltd held shares in BCCI Ltd as investments.
- The shares of BCCI Ltd are listed on a recognised stock exchange in India.
- IPL Ltd had acquired shares of BCCI Ltd in FY 2014-15 after paying securities transaction tax (STT).
- Cost of acquisition of BCCI Ltd shares was Rs 3,00,000.
- IPL Ltd transferred shares of BCCI Ltd during FY 2018-19 after paying STT.

FACTS:

- Transfer of shares of BCCI Ltd was made at quoted price of Rs 10,00,000.
- The fair market value / highest quoted price of shares of BCCI Ltd as on 31.01.2018 was Rs 7,00,000.

Issues for discussion:

- Capital gain implications
- MAT implications

Relevant provisions:

- Section 10(38)
 - First proviso
 - Fourth proviso
- Section 48
 - Third proviso
- Section 55(2)(ac)
- Section 112A
- Explanation 1 to section 115JB
 - Clause (ii) of downward adjustments / exclusions.

Implication under normal provisions:

- Transaction – transfer of listed shares held as investment – capital gains under section 45(1)
- Long term capital gain as shares were held for more than 12 months.
- No exemption under section 10(38)
 - The exemption under section 10(38) not applicable to IPL Ltd as the date of transfer of shares is after 01.04.2018 – *Fourth proviso to section 10(38) – Finance Act 2018*
 - ***4th proviso - “Provided also that nothing contained in this clause shall apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, made on or after the 1st day of April, 2018.”***
- Quantum of long term capital gain – Chapter IV-D.
 - Indexation not available – Third proviso to section 48.

Taxation under normal provisions:

- Capital gains – full value of consideration minus cost of acquisition determined under section 55(2)(ac).
- Cost of acquisition under section 55(2)(ac)
 - Step 1 – Determine actual cost of acquisition of shares – Rs 3,00,000
 - Step 2 – Determine the FMV of shares – Highest quoted price on 31.01.2018 – Rs 7,00,000

Taxation under normal provisions:

- Step 3 – Chose the lower of FMV of shares determined under step 2 or full value of consideration received by IPL Ltd – Rs 7,00,000
- Step 4 – Chose the higher of amount determined under step 1 and step 3 as cost of acquisition under section 55(2)(ac) – Rs 7,00,000
- Capital gains computed under section 48 – Rs 3,00,000 [Rs 10,00,000 minus Rs 7,00,000]
- Rate of tax under section 112A – 10%

MAT TAXATION

- ‘Book profits’ computation in terms of explanation 1 to section 115JB.
- Process begins with ‘net profit’ reported in the statement of profit and loss account.
- Process of inclusion / upward and exclusion / downward adjustments of certain sums to the ‘net profit’.
- Clause (ii) of explanation 1 is relevant.

“the amount of income to which any of the provisions of section 10 (other than the provisions contained in clause (38) thereof) or section 11 or section 12 apply, if any such amount is credited to the statement of profit and loss”

MAT TAXATION

- Clause (ii) of explanation 1 exclude incomes exempt under section 10, 11 and 12 [**except income to which provisions of section 10 (38) apply**] from the net profit **if such incomes are credited to the statement of profit and loss.**
- Which 'income' is envisaged in clause (ii) of explanation 1 to section 115JB? Whether it refers to the '**amount of gain actually credited (accounting gain)**' in the profit and loss account or '**long term capital gain**' **computed under Chapter IV-D of the Act?**
- Issue is not new – debated in courts – but rulings are inconsistent – two views – Finance Act 2018 has given a new angle/third view.

MAT TAXATION

VIEW 1 - Actual amount credited in the profit and loss account on sale of shares is to be included in the book profits.

- Reasons:
 - (i) Language employed in clause (ii) of explanation 1.
 - (ii) Indications from other clauses of explanation 1.
 - (iii) Objective with which MAT was introduced.
 - (iv) Indication from section 115J
 - (v) Decisions.

MAT TAXATION

VIEW 1

(i) Language employed in clause (ii) of explanation 1.

- Clause (ii) begins with the phrase ‘amount of income’
- The phrase ‘amount of income’ is controlled by the last limb viz., *‘if any such amount is credited to the statement of profit and loss’*
- Interpretation of the phrase ‘amount of income’ as ‘capital gain computed under Chapter IV-D’ would effectively render the last limb of clause (ii) redundant.
- *Settled principle - Ut res magis valeat quam pereat* - a statutory provision is to be interpreted to make it workable rather than redundant.

MAT TAXATION

VIEW 1

(ii) Indication from other clauses of explanation 1

- Clause (iig) of the Explanation 1 excludes '*the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF*'.
- Clause (iig) of explanation does not contain the requirement of credit of income in the statement of profit and loss.
- Thus, where ever the Legislature intended to adjust the book profits by an amount of income other than that credited to the statement of profit and loss, the condition of credit of income has not been incorporated in the relevant clauses of explanation 1.

MAT TAXATION

VIEW 1

(iii) Objective with which MAT was introduced

- Objective was to tax companies who were 'rich in books' and declaring handsome dividends but not paying income tax.
- Legislature accordingly introduced an alternative mechanism to tax such companies.
- Alternative mechanism based on 'distributable profits' reported in financials.

MAT TAXATION

VIEW 1

- Correlation/nexus between the 'distributable profits' and 'tax base' on which MAT is levied.
- 1st Report of the MAT-Ind AS Committee recognized this proposition:
*“The adjustments indicate that the provisions of section 115JB of the Act seek to compute the realised profit before tax which is available for appropriation/distribution. Hence, there appears to be an **implicit relation between the distributable profits which is available for payment of dividend under the Companies Act and the tax base for levying MAT under section 115JB of the Act.**”*
- Thus, income referred to in clause (ii) should also be understood as an amount which forms part of the distributable profits.

MAT TAXATION

VIEW 1

(iv) Indication from section 115J

- Clause (iii) of the exclusionary part of section 115J permitted exclusion of **profits eligible for deduction under section 80HHC/80HHD** [and not income credited to the profit and loss account]
- Language employed – *‘such amounts as computed in the manner specified in section 80HHC(3)/80HHD(3)’*. Amount to be excluded from the net profits is the amount which is computed under section 80HHC/80HHD.
- Similar language is absent in clause (ii) of explanation 1 to section 115JB.

MAT TAXATION

VIEW 1

(v) Decisions

- ***DCIT v Roxy Investments (P) Ltd 24 SOT 227 (Del)***
 - *Para 13 – “A careful perusal of clause (ii) of the Explanation to section 115JB(2) reveals that, though the said clause speaks about the amount of ‘income’, **yet it also speaks of ‘if, any such amount is credited in profit & loss account’.** Thus, while reading the said clause **as a whole**, it becomes **clear that the amount of income which can be reduced** by the Assessing Officer for computing the book profit under clause (ii) of the Explanation to section 115JB(2), **it would be the amount which is credited to the profit & loss account and not the amount of income which is claimed by the assessee or determined by the Assessing Officer while assessing the income under the regular provisions of the Income-tax Act.”***
 - Department itself argued that eligible profits as computed under section 10B should be excluded under clause (ii) of explanation 1 to section 115JB.

MAT TAXATION

VIEW 1

(v) Decisions

- ***Dharmayug Investments Ltd. V ACIT 69 SOT 433 (Mum)***
 - *Assessee-company claimed exemption under section 10(38).*
 - *In book profit computation, long term capital gains as computed after claiming indexed cost was sought to be included under bracketed portion of clause (ii) of explanation 1 to section 115JB.*
 - *Tribunal rejected the contention of the assessee-company. It held that it is amount credited to the profit and loss account that should be included under clause (ii) of explanation to section 115JB and not long term capital gains.*
- ***CIT v. Veekaylal Investments (P.) Ltd. 249 ITR 597 (Bom)***
- ***N.J. Jose and Co. (P.) Ltd. v. Asstt. CIT [2010] 321 ITR 132 (Ker)***

MAT TAXATION

VIEW 2 - Capital gains as computed under Chapter IV-D should be included in the book profits.

- Reasons:
 - (i) Legislative history of clause (ii) of explanation 1 to section 115JB and section 10(38).
 - (ii) Import of the phrase '*provisions contained in section 10(38)*' in clause (ii) of explanation 1.
 - (iii) Section 115JB(5)
 - (iv) Clause (ii) of explanation 1 - a deeming provision.
 - (v) Decisions

MAT TAXATION

VIEW 2

(i) Legislative history of clause (ii) of explanation 1 and section 10(38).

- Section 115JB originally enacted as 115J vide the Finance Act 1987.
- Clause (ii) of explanation 1 therein excluded all exempt incomes if such amount is credited to the profit and loss account.
- Section 115J was substituted with section 115JA vide the Finance (No 2) Act 1996.

MAT TAXATION

VIEW 2

- Clause (ii) of explanation 1 to 115JA also excluded all exempt incomes if any such amount is credited to the profit and loss account.
- Language employed in clause (ii) of section 115J / 115JA were identical - *“the amount of income to which any of the provisions of Chapter III applies, if any such amount is credited to the profit and loss account;”*
- Scope of clause (ii) – Board Circular No 762 dated 18.02.1998 – *“Income arising from Free Trade Zone (FTZ), Export Oriented Undertakings (EOU’s), Charitable activities, investment by a venture capital company and other exempted incomes (section 10) are excluded from the purview of the alternate tax.”*

MAT TAXATION

VIEW 2

- Section 115JA was substituted with section 115JB with effect from AY 2001-02.
- Language in clause (ii) of explanation 1 changed. Reference to Chapter III deleted.
- Clause (ii) of explanation 1 to section 115JB – *“incomes to which the provisions of section 10, 10A, 10B, 11 and 12 apply if such incomes are credited to the profit and loss account”*.
- Exclusion of incomes from MAT confined to specific sections.

MAT TAXATION

VIEW 2

- Finance (No 2) Act 2004 - Clause (ii) of explanation 1 to section 115JB was amended to incorporate a bracket – giving reference to section 10(23G)
- Clause (ii) of explanation 1 to section 115JB in its amended form read as *“the amount of income to which any of the provisions of section 10 (**other than the provisions contained in clause (23G) thereof**) or section 10A or section 10B or section 11 or section 12 apply, if any such amount is credited to the statement of profit and loss”*
- Clause (ii) was amended consequent to insertion of the proviso to section 10(23G) – Memorandum to Finance Bill (No 2) 2004
- The proviso stipulated that income, by way of dividends other than dividends referred to in section 115-O, interest, long-term capital gains of an infrastructure capital company shall be taken into account in computing the book profit.

MAT TAXATION

VIEW 2

- Board in Circular No 5 of 2005 clarified that amendments were made to rationalize the provisions of section 10(23G) by levying MAT on infrastructure capital company.
- Board also acknowledged that the amendment in section 115JB is **consequential** to introduction of the proviso to section 10(23G).

MAT TAXATION

VIEW 2

- Finance Act 2006 omitted section 10(23G) and reference to section 10(23G) from the bracketed portion of clause (ii) of explanation 1 to section 115JB.
- Memorandum to Finance Bill 2006 and CBDT in Circular 14 of 2006 again stated that the omission to reference to section 10(23G) is **consequential** to omission of section 10(23G).
- Both the times - Finance (No 2) Act, 2004 and Finance Act 2006 – the legislature has clarified that the first proviso to section 10(23G) is the enabling provision and reference to section 10(23G) is consequential provision.

MAT TAXATION

VIEW 2

- Another amendment in Finance Act 2006 –reference to section 10(38) in the bracketed portion of clause (ii) of explanation 1 to section 115JB was incorporated.
- Simultaneously, first proviso to section 10(38) was also incorporated.
- First proviso to section 10(38) - *“Provided that the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB”*
- Which is the enabling provision - Memorandum and Circular 14 of 2006 silent.

MAT TAXATION

VIEW 2

- Going by the history of section 10(23G) – One could argue that the 1st proviso to section 10(38) is the enabling provision and clause (ii) of explanation to section 115JB is consequential provision.
- The decision of Punjab & Haryana HC in ***Stock Home India case 369 ITR 250*** supports the view that the first proviso is the enabling provision for levying MAT on long term capital gain.

Relevant Observation - “...prior to the insertion of the first proviso under Section 10(38) of the Act, the long term capital gains on shares was not required to be included while determining the book profits under Section 115JB of the Act”

MAT TAXATION

VIEW 2

Another reason forthcoming from Legislative history:

- Finance Minister statement while moving the Finance Bill 2006 - ***“I also propose to include long-term capital gains arising out of securities in calculating book profits”***
- Board Circular 14 of 2006 – ***“The provisions of sub-section (38) of section 10 have also been amended to provide that **income by way of long-term capital gains of a company shall be taken into account in computing the book profit under section 115JB** and for payment of Income-tax under that section.”***

MAT TAXATION

VIEW 2

- Finance Minister's speech and Circular No 14 of 2006 are clear that the first proviso to section 10(38) and reference to the provisions of section 10(38) in clause (ii) of explanation to section 115JB were incorporated to levy MAT on **long term capital gain** arising on transfer of securities.
- Finance Minister speech could be relied upon to construe a provision of law - *K.P. Varghese v. ITO 131 ITR 597 (SC)*, *Queen's Educational Society v CIT 372 ITR 699 (SC)*
- SC applied the principle of contemporanea exposition to held that FM speech and circular constitutes contemporary expositions and hence constitute aid in construction.

MAT TAXATION

VIEW 2

(ii) Import of the phrase '*provisions contained in section 10(38)*' in clause (ii) of explanation 1 to section 115JB.

- Phrase 'provisions contained in section 10(38)' indicates that the legislature intends to cover income dealt under section 10(38).
- As per the Memorandum to Finance Bill 2006 – the phrase 'provisions contained in section 10(38)' should be understood as 'income referred to in section 10(38)'.
- If intention was to tax accounting gain – legislature could have used the phrase such as 'other than the gains from the transfer of securities' in the bracketed portion of clause (ii).

MAT TAXATION

VIEW 2

(iii) Sub-section 5 of section 115JB

- Section 115JB is a code by itself.
- Section 115JB(5) is an exception to the above proposition.
- As per section 115JB(5) - except for what has been provided for in the section, all other provisions of the Act shall apply to the assessee.
- Board in Circular No 13 of 2001 – explains the mandate of section 115JB(5)
*“...except for substitution of tax payable under the provision and the manner of computation of book profits, **all the provisions of the Act including the provision relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of the provisions of this section.**”*

MAT TAXATION

VIEW 2

- Karnataka HC in ***Sankala Polymers (P) Ltd 338 ITR 617*** – section 115JB(5) permits the application of other provisions of the Act in computation of book profits.
- Madras HC in ***CIT vs. Metal & Chromium Plater (P.) Ltd. [2016] 76 taxmann.com 229 relying on section 115JB(5)*** held that long term capital gain as reduced by amount of exemption under section 54EC forms part of the book profits under section 115JB.

MAT TAXATION

VIEW 2

- Madras HC distinguished decisions in *Veekaylal Investments and N J Jose case*.
- Madras HC reasoned that section 115J did not contain provisions analogous to section 115JB(5).
- Accordingly, it was held that the income referred to in bracketed portion of clause (ii) of Explanation 1 to section 115JB should be understood to mean long term capital gain computed under Chapter IV-E of the Act.

MAT TAXATION

VIEW 2

(iv) MAT is a deeming provision

- A deeming provision should be construed strictly having regard to the object / purpose for which it has been enacted - ***CIT v. Amarchand N. Shroff (1963) 48 ITR 59 (SC)*** and ***CIT v. Mother India Refrigeration Industries (P) Ltd. (1985) 155 ITR (SC)***.
- Purpose of incorporating reference to section 10(38) in clause (ii) was to levy MAT on long term capital gain.
- Deeming fiction under section 115JB thus operate to include long term capital gain in book profits (and not accounting gain).

MAT TAXATION

VIEW 2

(v) Decisions

- The Bangalore Tribunal in the following decisions held that the long term capital gains as computed under Chapter IV-E of the Act is to be included under MAT by virtue of the first proviso to section 10(38):
 - (i) M.S.R & Sons Investments Ltd. v. Dy. CIT [IT Appeal No.769 (Bang.) of 2000] – Karnataka HC subsequently upheld this decision.*
 - (ii) KIADB v. DCIT [2016] 76 taxmann.com 360 (Bang)*

MAT TAXATION

VIEW 3 - *No liability to pay MAT*

- 4th proviso to section 10(38) - *“Provided also that nothing contained in **this clause** shall apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, made on or after the 1st day of April, 2018”*
- Import of the words ‘this clause’.
- Literal connotation – the words ‘this clause’ would qualify the main body as well as first three provisos.
- Literal interpretation is supported by the principle that a proviso must be considered in relation to the main body to which it stands as a proviso [CIT v Indo Mercantile Bank Ltd 36 ITR 1 (SC)]. Extension of this principle - a proviso cannot operate if the main body is held to be non-operative.

MAT TAXATION

VIEW 3

- Another indication - Section 112A(3).
- Section 112A(3)

“The condition specified in clause (ii) of sub-section (1) shall not apply to a transfer undertaken on a recognized stock exchange located in any International Financial Services Centre and where the consideration for such transfer is received or receivable in foreign exchange.”

- Section 112A(3) similar to second proviso to section 10(38).
- *Second proviso to section 10(38)*

“Provided also that nothing contained in sub-clause (b) shall apply to a transaction undertaken on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency”

MAT TAXATION

VIEW 3

- If second proviso to section 10(38) continues to operate? - What was the need of incorporation of section 112A(3).
- Thus, section 112A(3) indicates that the fourth proviso to section 10(38) qualifies the main body as well as first three provisos.
- What is the fallout – first proviso not applicable qua transfer of securities on or after 01.04.2018 – enabling provision not applicable - hence MAT is not payable on long term capital gain arising on or after the said date.
- Bracketed portion in clause (ii) and first proviso to section 10(38) would only cover long term capital gains arising before 01.04.2018.

MAT TAXATION

Shortcomings in all three views.

- 1st view – based on last limb of clause (ii) – would not be giving effect to first limb of clause (ii) as well as the first proviso to section 10(38).
- 2nd view – based on the first limb of clause (ii) and the first proviso to section 10(38) – would not be giving effect to the second limb of clause (ii).
- 3rd view – (i) against the intention of the Legislature - Intention in enacting 4th proviso was to withdraw exemption under section 10(38) and (ii) 4th proviso does not qualify the first proviso to modify the MAT implications on LTCG.

MAT TAXATION

Shortcomings in all three views.

- First proviso to section 10(38) continues to apply on a standalone basis as it is in the nature of a substantive provision.
- A proviso which is substantive in nature can survive on its own leg – Commissioner of commercial taxes v Ramkishan Shrikishan Jhaver 1967 (8) TMI 37 (SC)

MAT TAXATION

BETTER APPROACH – HARMONIOUS CONSTRUCTION

- Harmonious construction of two limbs of clause (ii) of explanation 1 to section 115JB and first proviso to section 10(38).
- Under the rule of harmonious construction effect is given to both the inconsistent provisions [or inconsistent parts of the same provision] - ***Venkataramana Devaru v. State of Mysore, AIR 1958 SC 255.***
- Harmonious construction in the present case is possible if clause (ii) of explanation 1 to section 115JB is construed as a provision having dual mandate.

MAT TAXATION

- First mandate – 1st limb of clause (ii) of explanation 1 – this limb should be understood as a provision which creates a fiction that MAT is to be paid on the long term capital gains.
- Second mandate – second limb – this limb requires the company to determine whether gains on sale of shares or other specified securities forms part of the net profits reported in the financials.
- If net profits include gains on sale of shares/specified securities, first limb of clause (ii) of explanation to section 115JB **temporarily exclude the same from the net profits.**

MAT TAXATION

- Excluded amount [viz., accounting gain/surplus] is then **thrown back** to section 10(38) where the same is recomputed as long term capital gain.
- Long term capital gain computed under the Act **again travels back** to clause (ii) of Explanation to section 115JB to enter the book profits.

Thank you

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