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EY Tax Alert

Supreme Court rules on basis of export profits for MAT purpose



Executive summary

This Tax Alert summarizes a recent ruling of the Supreme Court (SC) in the case of Bhari Information Technology Systems (P) Ltd. (Taxpayer) (Civil Appeal No. 33750 of 2009)^[1] on the issue of deductibility of export profits from the net profit while computing 'book profit' for determining minimum alternate tax (MAT) liability under the Indian Tax Laws (ITL).

The SC ruled that while making downward adjustment to 'book profit' in respect of export profits, the basis of adjustment should be the net profit as per Profit and Loss Account (book profit base) and not the taxable income computed as per normal provisions of the ITL. Accordingly, even if the taxable income is Nil under normal provisions, the taxpayer will still be eligible for deduction of export profits computed on book profit base for MAT purposes.

Background

- ▶ MAT provisions, inserted by Finance Act, 2000, substituting the erstwhile comparable provision, apply to a company and provide for taxation based on 'book profit'. Taxation under MAT provisions is triggered when tax liability, computed at specified percentage^[2] of 'book profit', is higher than that under the normal computation.

[1] Source: www.itatonline.org

[2] Currently 18%

- ▶ 'Book profit' is computed by adopting the net profit as per Profit and Loss Account (P&L a/c) prepared in compliance with the relevant provisions of the Indian Company Laws (ICL) and further adjusted for upward and downward adjustments as specified under MAT provisions.
- ▶ One of the downward adjustments is in respect of reducing the amount of profits eligible for deduction under Section 80HHC, 80HHE etc., (export-linked incentive provision), admissible under the normal provisions of the ITL.
- ▶ On appeal by the Taxpayer, Chennai Income Tax Appellate Tribunal (Tribunal) ruled in favor of the Taxpayer by relying upon the Special Bench's decision of the Mumbai Tribunal in the case of DCIT v. Syncome Formulations (I) Ltd.^[3] (Syncome ruling).
- ▶ On appeal by the Tax Authority, the Madras High Court confirmed the Tribunal's decision. Being aggrieved, the Tax Authority appealed further to the SC.

Facts

- ▶ The Taxpayer was eligible for deduction under section 80HHE.
- ▶ However, for the relevant tax year, the income under normal computation was Nil due to set off of past losses.
- ▶ The Taxpayer, however, had profits as per its P&L a/c prepared under the ICL and, was accordingly, liable to tax under MAT provisions for tax year 1999-00. While computing 'book profit' for MAT purposes, it reduced the amount of export profits computed with respect to book profit base.
- ▶ The Tax Authority held that since the Taxpayer did not have positive income under the normal computation due to set off of past tax losses, it is not eligible for downward adjustment in respect of the export profits for the purposes of arriving at book profit.

Issue before the SC

Whether for determining 'book profit' for the purpose of MAT levy, the net profit, as shown in the P&L a/c, is to be reduced by the export profits, eligible for deduction under export incentive provision, computed on book profit base or by the export profits computed under the normal computation?

SC ruling

The SC ruled in favor of the Taxpayer. It agreed with and confirmed the correctness of Syncome ruling which had adopted the following reasoning:

- ▶ There is a distinction between taxable income as per normal computation and 'book profit' under MAT computation.

[3] [(106 ITD 193)(Mum)(SB)]

- ▶ For MAT purposes, 'book profit' forms the basis which is amenable to further adjustments as provided in MAT provisions.
- ▶ Accordingly, the deduction for export incentive in MAT computations also needs to be worked out on the basis of 'book profit' and not as per the normal computation.

Comments

The SC ruling settles the controversy over the basis of export incentive deduction for MAT purposes in favor of taxpayers and effectively overrules some High Court rulings^[4] which had taken a contrary view.

The Finance Act 2011 carried out a retrospective amendment with effect from tax year 2004-05 withdrawing the deductions available for export profits under MAT provisions. Thus, the impact of the present decision will be restricted to pending matters upto tax year 2003-04.

[4] Packworth Udyog Ltd. [198 Taxman 10(Ker)]; Al Kabeer Exports Ltd. [193 Taxman 56(Bom)]

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