Whether minimum alternate tax (MAT) is applicable to the share of a company in the income of a joint venture business

192 CTR (Art.) p.119 (Part IV)

- By S.K. Tyagi

1. Introduction

Of late, we have been witnessing a new and different trend in relation to the real estate development. Earlier, a builder would go for outright purchase of a piece of land from the landlord and develop the same at his own cost and risk. The scenario in this regard is undergoing a change. Now the landlord also desires to have a share in the profit of the project being undertaken by the builder and developer. On his part the builder and developer desire(s) to share his risk in the development of the project. This change in the trend in relation to real estate development is giving rise to a new concept of joint venture between the landlord and the builder / developer for the purpose of development of immovable properties.

It is often the case, that the builder / developer is either a limited company or a partnership firm, whereas the landowner is either an individual, a Hindu undivided family or a partnership firm.

The aforesaid joint venture business is assessed as an association of persons (AOP,for short) for the purposes of taxation under the Income-Tax Act, 1961(the Act).

It may also be stated here that an incentive deduction like deduction under Section (S.,for short) 80-IA(4)(iii) or S.80-IB(10), etc. of the Act, will also be available to such an AOP, if all the other relevant conditions are fulfilled.

In this context, I have been receiving a query for my opinion, from a number of tax-payers, as to whether the share of a company in the income of a joint venture, assessable as an AOP, is to be included in the profit and loss account of the company for the purpose of computation of *'book profit'* under the provisions of S.115JB of the Act or in other words for the purpose of computation of minimum alternate tax (MAT).

In order to answer the aforesaid query, it would be necessary to examine the provisions of S.115JB and other relevant provisions of the Act and also the provisions of Parts II and III of Schedule VI to the Companies Act, 1956. In this context, it would also be relevant to examine whether share of a member in the income of a joint venture business, taxed in the status of an AOP, will again be liable to tax in his hands. Besides, it would also be necessary to refer to the relevant case-law. The same are examined / discussed as follows-

2. Whether share of a member in the income of a joint venture business, taxed in the status of an AOP, will again be liable to tax in his hands

In order to answer this query, a number of the provisions of the Income-tax Act, falling under different chapters thereof, will have to be examined. These provisions may be listed as follows:

(i) S.66, with the heading "*total income*", falling under Chapter VI.

(ii) S.67A, with the heading "*Method of computing a member's share in the income of an AOP or body of individuals (BOI)",* falling under Chapter VI.

(iii) S.86, with the heading "*Share of member of an association of persons or body of individuals in the income of the association or body",* falling under Chapter VII.

(iv) S.110, with the heading, *"Determination of tax where total income includes income on which no tax is payable",* falling under Chapter XII.

(v) S.167B, with the heading, *"Charge of tax where shares of members in association of persons or body of individuals unknown, etc.",* falling under Chapter XV.

It may be seen from the heading of S.67A that it deals with the computation of a member's share in the income of the association of persons or body of individuals.

First Proviso (a) to S.86

The heading of S.86 is – *"share of member of an association of persons or body of individuals in the income of the association or body."* As the heading of S.86 suggests, it deals with the charge of income-tax on the share of a member of an association of persons / body of individuals, in the income of such association of persons / body of individuals. For our purpose, proviso (a) to S.86 is relevant. As per the aforesaid proviso (a), where the association of persons / body of individuals is chargeable to tax on its total income at the maximum marginal rate or any higher rate under any of the provisions of the Act, the share of a member computed as aforesaid, shall not be included in its total income.

Second proviso to S.86

In this context, the second proviso to S.86 is also very relevant. As per the aforesaid proviso where no income-tax is chargeable on the total income of an association of persons / body of individuals, the share of a member computed as aforesaid shall be chargeable to tax as part of his total income. In this context, the

meaning of the expression *"where no income-tax is chargeable on the total income of the association of persons / body of individuals",* is relevant. The aforesaid expression means, incomes which do not form part of the total income. In this connection, it may be stated that a deduction or relief under S.80-IA, S.80-IB, S.80-I and S.80J, cannot be said to be income, profits and gains, not includible in the total income. In support of this proposition, reliance may be placed on the judgement in the case of *Second ITO Vs. Stumpp, Schuele and Somappa P. Ltd. [1977] 106 ITR 399 (Karn.).*

The aforesaid judgement of the Karnataka High Court was affirmed by the Apex Court in the case of *Second ITO Vs. Stumpp Schuele and Somappa P. Ltd. [1991] 187 ITR 108.*

Thus, the deductions available under Ss.80-IA and 80-IB do not pose any problem in this respect. Otherwise also, if the total income of an association of persons is entitled to deduction under S.80-IA or S.80-IB, then the question of any tax liability on the share of a member in the income of the association of persons, will not arise, as the income of the association of persons or body of individuals would be nil.

Tax implications of the provisions of S.167B – "charge of tax where shares of members in AOP or BOI are known, etc."

From the provisions of S.167B, it may be seen that S.167B (1) deals with charge of tax, where the individual shares of the members of an association of persons / body of individuals, in the whole or any part of income of such association of persons / body of individuals, are indeterminate or unknown. In such a case, income-tax is charged on the total income of the association of persons / body of individuals at the maximum marginal rate.

S.167B (2), however, deals with cases, which do not fall under aforesaid S.167B (1). In other words, S.167B (2) deals with cases where the shares of the members of the association of persons / body of individuals are determinate or known. As per S.167B (2)(i), where the total income of any member of an association of persons / body of individuals, for the previous year, excluding the share from such association of persons / body of individuals, exceeds the maximum amount which is not chargeable to tax, in the case of that member, tax shall be charged on the total income of the association of persons / body of individuals, at the maximum marginal rate.

The term *"maximum marginal rate"* is defined under S.2 (29C) of the Act, and it means the rate of income-tax (including surcharge on income-tax if any) applicable in relation to the highest slab of income in the case of an individual, association of persons or body of individuals, as specified in the Finance Act of the relevant year. It may be clarified here that when the maximum marginal rate is charged on an income, no basic

exemption is allowed in respect of the income and the benefit of lower rate of taxation on the lower slabs of income, is also not available in such a case.

It may be reiterated here that where the association of persons / body of individuals, is chargeable to tax on its total income at the maximum marginal rate or any higher rate under any of the provisions of the Act, then as per clause (a) of the first proviso to S.86, the share of a member of such association of persons / body of individuals, shall not be included in its / his total income.

In the light of the aforesaid reasons, the share of income of a member (company) will not be liable to tax again in the hands of such member.

3. Whether share of a member (company) in the income of an AOP, is required to be disclosed in the profit and loss account of such company

As per the provisions of S.115JB of the Act, every assessee, being a company, shall prepare his profit and loss account for the relevant previous year, in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act, 1956.

From the aforesaid provisions of S.115JB (2) of the Act, it is evident that we will be required to deal with the relevant provisions of the Companies Act in order to find out whether share of a company in the income of an AOP, is required to be disclosed in the profit and loss account of such company. In this context, we will be required to deal with Parts II and III of Schedule VI of the Companies Act, 1956.

The heading of the aforesaid Part II of Schedule VI to the Companies Act, 1956, is "**Requirements as to profit and loss account".** On the other hand, the heading of Part III of Schedule VI of the Companies Act, 1956, is **'Interpretation'**. Thus, it is the aforesaid Part II of Schedule VI to the Companies Act, 1956, which is relevant to our purpose. The various paragraphs (paras) of Part II of Schedule VI to the Companies Act, are discussed as follows-

A. Para 1 of Part II

As per Para 1 of Part II, the provisions of this part shall apply to the income and expenditure account referred to in S.210 (2) of the Companies Act, in the like manner as they apply to a profit and loss account, but subject to the modification of references as specified thereunder.

When we examine the aforesaid S.210 (2), it refers to '*profit and loss account*', '*profit' and 'loss*'. In this context, we may also refer to the provisions of S.211 of the Companies Act, the heading of which is **'Form and contents of balance sheet and profit and loss account'.**

As per S.211(1), every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of the financial year and shall, subject to the provisions of this section be in the form set-out in Part I of Schedule VI. Further, as per S.11(2), every profit & loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year and shall comply with the requirements of Part II of Schedule VI to the Companies Act. In this context, it would also be necessary to refer to the provisions of S.211(6) of the Companies Act, 1956. As per aforesaid S.211(6), for the purposes of S.211, any reference to a balance sheet or profit & loss account shall include any Notes thereon or documents annexed thereto, giving information required by this Act and allowed by this Act, to be given in the form of such Notes or documents.

Concept of 'true & fair view'

As could be seen from the provisions of S.211 of the Companies Act, the emphasis in the preparation of accounts is on *'true and fair view'*. The Companies Act, does not provide a definition of the expression *'true and fair view',* nor does it explain as to what is meant by it. Accordingly, all that could be inferred is that the annual financial statements should not only be made out correctly, but they should carry an overall fair view and should not give any misleading impression. All the relevant information should be disclosed in the balance sheet and the profit & loss account in such a manner that the financial position and the **working results** are shown as they are. There should be neither an over statement, nor an understatement.

As indicated earlier, it is an established and un-controverted position under the Companies Act, 1956, that Schedules / Annexures attached to the profit & loss account and balance sheet are integral part of the said profit & loss account and balance sheet. The basic objective sought by S.211 is that the profit & loss account and the balance sheet should give a '*true and fair view'* of the state of affairs and the profit or loss of the company for the financial year. Thus, Notes to the accounts would also become a part of the accounts, prepared as per the requirements of Parts II and III of Schedule VI to the Companies Act. The profit & loss account, balance sheet and the Notes have to be read together. Besides, S.211(6) amply clarifies that the Schedules / Annexures / Notes, giving required information are integral parts of the profit & loss account and balance sheet and the same are to be read along with these Notes.

B. Para 2 of Part II

Para 2 (a) lays down that the profit and loss account shall be so made out as to disclose the results of the **working of the company** during the period covered by the account. Para 2(b) lays down that profit and loss account shall disclose every material feature including credits or receipts and debits or expenses in respect of non-recurring **transactions** and **transactions** of an exceptional nature.

From the aforesaid provisions of Para 2, it may be seen that Para 2 is very crucial regarding the disclosure of various items of income and expenditures, in the profit and loss account. The crucial words used in aforesaid Para 2(a) and Para 2(b), are '*working*' and '*transaction*', respectively. The word '*working*' or '*work*' is not defined under the Companies Act or even under the Income-Tax Act. Similarly, the word, '*transaction*' used in the aforesaid Para 2(b) has also not been defined either under the Companies Act or the Income-Tax Act.

For this purpose we may look at the provisions of the General Clauses Act, 1897. This Act is the foundation of the interpretation of law and is, of course, the legislative dictionary. This Act lays down some important rules regarding the interpretation of the statutes. In the preamble of this Act, regarding '*words not defined*', it has been stated that where the definition of the word has not been given, it must be construed in its popular sense, if it is a word of everyday use. '*Popular sense'* means that sense which people, conversant with the subject-matter, with which the statute is dealing, would attribute to it. The phrase '*meaning of a word in popular sense',* is synonymous with the phrase '*meaning of a word in common parlance'*.

In this respect, we may also look at the judgement of the Apex Court in the case of *State of Orissa Vs. Titaghur Paper Mills Co. Ltd., AIR 1985 S.C. 1293*. In this case, while dealing with '*meanings of words in common parlance',* the Apex court has laid down that an effort should be made to take aid of dictionaries to ascertain the meaning of a word in common parlance, but nevertheless, to bear in mind to select a particular meaning, which is relevant to the context in which the Court has to interpret the word.

In this context, we may also refer to the judgement of the Apex Court in the case of *Aspinwall & Co. Ltd. Vs. CIT [2001] 251 ITR 323 (S.C.).* It was held in this case that in the absence of a definition of a word in the Act, such a word has to be given a meaning as understood in common parlance. Similarly, there are judgements of a number of High Courts, which have laid down that in the absence of a definition of a word in the Act, its popular or common sense meaning should be preferred. Similarly, in other judgements, it has been laid down that in such a situation the literal and dictionary meaning of the word should be adopted. These judgements are as follows-

(i) K.L. Swami Vs. CIT [1999] 239 ITR 386 (Karn.)
(ii) Abdul Gaffar A. Nadiadwala Vs. ACIT [2004] 267 ITR 488 (Bom.)
(iii)CIT Vs. U.P. Paschimi Kshetriya Vikas Nigam Ltd. [2003] 264 ITR 273 (All.)

In the light of the aforesaid discussion, we would like to look at the meanings of the words '*transaction'* and *'working'* or *'work'* in the dictionary on law lexicon. The same are discussed as follows-

(i) Definition of 'work'

As per Concise Oxford Dictionary, Ninth Edition, P.1613, 'work' means – *the application of mental or physical effort.*

As per Law Lexicon, Vol. 2, by T.P. Mukherjee, p.825, 'work' means – *to bestow labour.*

As per Law Lexicon by P.R. Aiyer, p.1988, 'work' means – *to bestow labour.*

From the aforesaid definitions of the word 'work' the phrase '*the result of the working of the company'* will refer to something which relates to main business of the company.

In view of the aforesaid reasons, it may be stated that the share of income of a company in the income of an AOP, cannot constitute main business of the company.

(ii) Definition of 'transaction'

As per Law Lexicon, Vol.2 by T.P. Mukherjee, p.730, its dictionary meaning as given by Webster is – *doing or performing; business*. Thus, transaction means – that part which. a person (the company) is doing or performing in the course of its main business.

As per Concise Oxford Dictionary, Ninth Edition, P.1480, the word 'transaction' means – *commercial business done, the management of business*.

As per Law Lexicon by P.R. Aiyer, p.1910, the word 'transaction' means – *can be applied to any particular act done in the carrying on of a business.*

From the aforesaid definitions of the word '*transaction',* it is quite clear that it refers to the performance of acts done in the course of main business of the company. It may also be stated here that share of accompany in the income of an AOP is not a part of the acts done in the course of carrying on the main business of the company.

From the aforesaid discussion, it is quite evident that share of a company in the income of an AOP does not form part of the result of the working of the company and further the same will also not constitute a transaction of the business of the company.

In other words, such receipt should constitute a revenue relating to the working of the company and besides, the same cannot be treated as a part of any business transactions of the company whatsoever, by

any stretch of imagination, as such a receipt cannot, at all, be construed as a business transaction of any kind.

Therefore, the share of a company in the income of an AOP will not be required to be disclosed in the profit and loss account of the company.

C. *Para 3 of Part II*

As per Para 3, the profit and loss account shall set out the various items relating to the income and expenditure of the company under the most convenient heads. Para 3 also lays down that the profit and loss account shall disclose information in respect of turn-over, commission, raw materials consumed, purchases made, opening and closing stocks and income derived from services, etc. Para 3 further makes provisions for the disclosure of information in respect of work-in progress, depreciation, interest on debentures, reserves, provisions, expenditure on various items, etc.

It may, thus, be seen that all the aforesaid items in Para 3 refer to the performance of the main business of the company.

In this context, Para 3 (xi), is noteworthy. The same is reproduced as follows-

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(xi) (a) The amount of income from investments, distinguishing between trade investments and other investments.

(b) Other income by way of interest, specifying the nature of the income.

(c) The amount of income-tax deducted if the gross income is stated under sub-paragraphs (a) and (b) above.

From the aforesaid items, it is evident that they relate to the investment made in the course of the main business of the company and the same cannot embrace share of the company in the income of an AOP.

In this context, it would also be relevant to refer to Para 3 (xii), which is reproduced as follows-

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(xii) (a) Profits or losses on investments showing distinctly the extent of the profits or losses earned or incurred on account of membership of a partnership firm to the extent not adjusted from any previous provision or reserve

Note: Information in respect of this item should also be given in the balance sheet under the relevant provision or reserve account.

(b) Profits or losses in respect of transactions of a kind, not usually undertaken by the company or undertaken in circumstances of an exceptional or non-recurring nature, if material in amount.

(c) Miscellaneous income.

From the aforesaid sub-clause (a) of Para 3(xii), it may be seen that it refers to the profits or losses on investments earned or incurred on account of the membership of a partnership firm. **It is noteworthy in this context that the aforesaid sub-clause (a) does not include share of a company in the income of an AOP.**

D. Para 4 of Part II

Para 4 makes disclosure mandatory in respect of payments made to directors, managing agents, secretaries, treasurers or manager of the company.

E. Paras 4A, 4B, 4C, 4D, 5 and 6 are not relevant for our purpose

In this context, a reference may be made to the case of *Needle Industries (I) Ltd. Vs. CIT [1990] 183 ITR 393 (Mad.).* In this case, the company had credited the insurance moneys received on loss by fire to the reserves. This was considered sufficient disclosure so as to exclude the jurisdiction for re-opening of assessment under S.147(b) of the Act. What is ordinarily required is the disclosure so that a disclosure in the balance sheet or in the Notes on accounts would satisfy the normal requirements in respect of the share of the company in the income of the AOP. A disclosure is not necessarily made only through a credit or debit in the profit & loss account. Where it refers to a balance sheet item or where the assessee considers that it need not form part of either the profit & loss account or the profit & loss appropriation account, the information may be disclosed in the balance sheet or in the Notes on account.

From the aforesaid discussion, it is absolutely clear that as per the provisions of Part II and Part III of Schedule VI to the Companies Act, share of a company in the income of an AOP is not required to be disclosed in its profit and loss account.

4. Liability of a receipt to income-tax is not relevant to the provisions of S.115JB

It has already been stated in the discussion in earlier para (1), that share of a company in the income of an AOP, is not liable to tax in its hands. It may, however, be stated in the present context that liability of a receipt to tax is not relevant for the purpose of computation of '*net profit*' under Explanation to S.115JB (2). The reason for the same is not far to seek, because it has been clearly laid down under the provisions of S.115JB (2) that the profit and loss account for the relevant previous year is to be prepared in accordance with the provisions of Parts II and III of Schedule VI of the Companies Act, 1956.

As already stated, the profit and loss account, as contemplated under S.115JB (2) is to be prepared as per the provisions of Parts II and III of Schedule VI to the Companies Act, 1956. Further, the same interpretation, meaning and scope is to be given to the words used thereunder, for income-tax purposes, as had been given under the Companies Act.

In other words, the '*book-profit'* is to be computed on the basis of the profit and loss account prepared according to the aforesaid provisions of the Companies Act and not the provisions of the I.T. Act. The aforesaid proposition is supported by the following judgements-

(a) Surana Steels Pvt. Ltd. Vs. Dy.C.I.T. [1999] 237 ITR 777 (S.C.)

In this case, it was held, *inter alia,* that the principle of legislation by incorporation must be applied to interpret the relevant provisions of S.115J of the I.T. Act, as if the corresponding provisions of the Companies Act had been incorporated therein and further by giving the same interpretation, meaning and scope to those words for income-tax purposes as had been given under the Companies Act.

(b) C.I.T. Vs. Echjay Forgings Pvt. Ltd. [2001] 251 ITR 15(Bom.)

It was held in this case that although, normally, under the provisions of the Income-tax Act, the increase in the liability for purchase price of plant and machinery due to fluctuations in the foreign exchange rates is taken as on capital account, the same is debited to the profit & loss account under the Companies Act. While applying S.115J, the AO had to go by the computation of book profits as permitted under the Companies Act. Book profits were the net profits as shown in the profit & loss account prepared in accordance with ScheduleVI to the Companies Act, subject to certain adjustments. Since the amount on account of foreign exchange fluctuations had been debited to profit & loss account in accordance with the Companies Act, the same could not be added back to the net profit of the company.

It was also held in this case that since clause (a) of the Explanation does not contemplate wealth-tax, the net profits could not be increased by the amount of wealth-tax paid by the company and debited to the profit & loss account.

(c) Kinetic Motors Co. Ltd. Vs. Dy.CIT [2003] 262 ITR 330 (Bom.)

In this case, the company debited depreciation allowance to the profit & loss account, which was calculated as per written down value method, though the assessee used to provide the depreciation allowance on the straight-line method in its corporate accounts in earlier years. The AO took the view that there was no justification for the assessee to change the basis of providing depreciation allowance.

It was held that, it was not in dispute that under the Companies Act, both straight line method and written down value method are recognised. Therefore, once the amount of depreciation actually debited to the profit and loss account was certified by the auditors, it was not permissible for the AO to make book adjustments.

(d) C.I.T Vs. Fertilisers & Chemicals Travancore Ltd. [2002] 178 CTR 461 (Ker.)

In this case, the interest on income-tax was also debited to the profit & loss account. The AO added back income-tax as well as interest thereon to the book profits.

It was held that clause (a) of Explanation to S.115J mentions only the amount of income-tax paid or payable and not the interest. Therefore, interest on income-tax cannot be added back.

5. The AO has no power to scrutinise the profit and loss account and make adjustments therein, except as provided in the Explanation to S.115JB (2)

While looking into the accounts of the company for the purpose of computing the book profits, the AO has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, which obligate the company to maintain its accounts in a manner provided by that Act and the same to be scrutinised and certified by statutory auditors and approved by the company in general meeting and thereafter to be filed before the Registrar of Companies, who has a statutory obligation also to examine and be satisfied that the accounts of the company are maintained in accordance with the requirements of the Companies Act. S.115JB (2) doest not empower the AO to embark upon a fresh enquiry in regard to the entries made in the books of account of the company.

The aforesaid proposition is supported by the judgement of the Apex Court in the case of *Apollo Tyres Ltd. Vs. CIT [2002] 255 ITR 273 (S.C.).* The relevant parts of the aforesaid judgement on page 280 of the Report are reproduced as follows-

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Sub-section (1A) of section 115J does not empower the Assessing Officer to embark upon a fresh inquiry in regard to the entries made in the books of account of the company. The said sub-section, as a matter of fact, mandates the company to maintain its account in accordance with the requirements of the Companies Act which mandate, according to us, is bodily lifted from the Companies Act into the Income-tax Act for the limited purpose of making the said account so maintained as a basis for computing the company's income for levy of income-tax. Beyond that, we do not think that the said sub-section empowers the authority under the Income-tax Act to probe into the accounts accepted by the authorities

under the Companies Act. If the statute mandates that income prepared in accordance with the Companies Act shall be deemed income for the purpose of section 115J of the Act, then it should be that income which is acceptable to the authorities under the Companies Act. There cannot be two incomes one for the purpose of the Companies Act and another for the purpose of income-tax both maintained under the same Act.

Therefore, we are of the opinion, the Assessing Officer while computing the income under section 115J has only the power of examining whether the books of account are certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act. The Assessing Officer thereafter has the limited power of making increases and reductions as provided for in the Explanation to the said section. To put it differently, the Assessing Officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent provided in the Explanation to section 115J.

It may, thus, be seen that the AO has no power to scrutinize the profit and loss account and make adjustments therein, except as provided in the Explanation to S.115JB(2). The AO has to accept the authenticity of the profit and loss account as prepared according to the Companies Act and scrutinized and certified by the statutory auditors, except as aforesaid.

It may also be stated here that the aforesaid judgement of the Apex Court has impliedly reversed / disapproved the judgement of the Bombay High Court in the case of *CIT Vs. Veekay Lal Investment Company Pvt. Ltd. [2001] 249 ITR 597 (Bom.)*

6. Conclusion

In the light of the aforesaid discussion, it may be concluded that-

(i) Share of a company in the income of a joint venture, assessed as an AOP, is not required to be disclosed in the profit & loss account of the company, as per the provisions of Parts II and III of Schedule VI to the Companies Act, 1956.

It may be disclosed either in the profit & loss appropriation account or by way of a Note to the accounts.

(ii) The AO will have no power to make any adjustment except those provided under Explanation to S.115JB.

The Explanation to S.115JB does not make any reference to the share of a company in the income of a joint venture, assessable as an AOP, and

(iii) Once the accounts are audited and certified by the auditors, the AO has no power to make any enquiry or adjustment in respect thereof.

Thus, it may be finally concluded that S.115JB of the I.T. Act or MAT, is snot applicable to the share of a company in the income of a joint venture business..

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