

All Registered Housing Finance Companies

Dear Sir/Madam

**Creation of Deferred Tax Liability on Special Reserve maintained by Housing Finance Companies under Section 36(1) (viii) of the Income Tax Act, 1961**

As per the provisions under Section 36(1)(viii) of Income Tax Act, 1961, the specified entity like housing finance company (HFC) is allowed the deduction in respect of any Special Reserve created and maintained by it, i.e. an amount not exceeding twenty per cent of the profits derived from eligible business computed under the head "Profits and gains of business or profession" (before making any deduction under this clause). This would not be applicable if the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid-up share capital and of the general reserves of the entity. Further, in terms of the Section 41(4A), where a deduction has been allowed in respect of any special reserve created and maintained under Section 36(1)(viii), any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income-tax as the income of the previous year in which such amount is withdrawn.

2. The Accounting Standard 22: 'Accounting for taxes on Income' (AS 22) required recognition of deferred tax for all the timing differences i.e. the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. This is based on the principle that the financial statements for a period should recognize the tax effect, whether current or deferred.

3. In this context, specified entity like HFC is required to create Deferred Tax Liability (DTL) on the Special Reserve created and maintained under Section 36(1)(viii) of the Income Tax Act, 1961. However, it is observed that some HFCs are not creating DTL on Special Reserve, as required by the AS-22 on the grounds that they do not intend to withdraw from such reserve in the future. It is also observed that many HFCs have also formalised the intent through resolution passed by their Board.

4. The matter regarding creation of DTL on Special Reserve has been examined and HFCs are advised that, as a matter of prudence, DTL should be created on the

Special Reserve created and maintained by them, under Section 36(1)(viii) of the Income Tax Act, 1961. For this purpose, HFCs may take the following course of action:

- a) If the expenditure due to the creation of DTL on Special Reserve as at March 31, 2014 has not been fully charged to the Statement of Profit and Loss, HFCs may adjust the same directly from the Reserves over a period of 3 years starting with the current financial year, in a phased manner in the ratio of 25:25:50, in case if it prefers so, based on prudence. The details of the amount adjusted and to be adjusted, if any, may be appropriately disclosed in the Notes to Accounts of the financial statements of the respective years.
  - b) DTL for amounts transferred to Special Reserve from the year ending March 31, 2015 onwards should be charged to the Statement of Profit and Loss of that year.
5. In view of the requirement to create DTL on Special reserve, HFCs may reckon the entire Special Reserve for the purpose of computing Tier-I Capital.
6. This Circular is issued in supersession of our earlier Circular No. NHB(ND)/DRS/Pol.No.62/2014 dated May 27, 2014, on the subject.
7. Kindly ensure compliance.

Yours faithfully



(Arnab Roy)  
Executive Director