Tax impact of Ind AS on M&A

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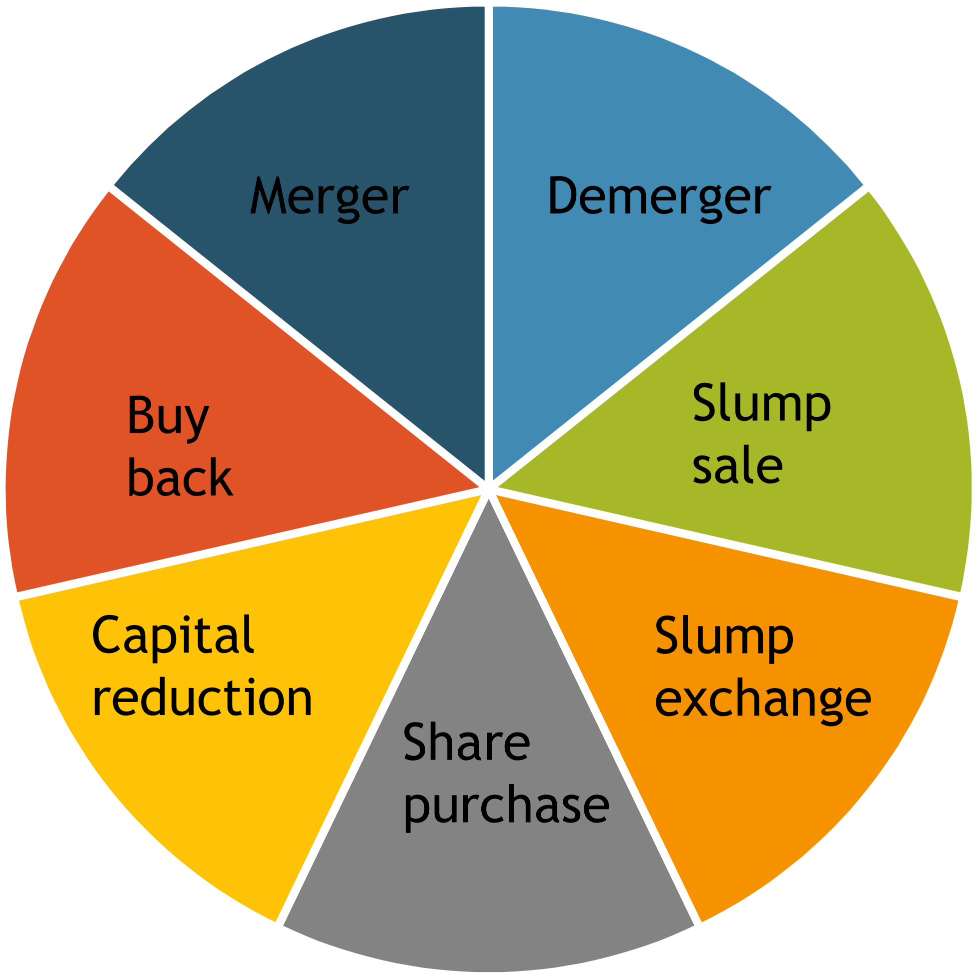
Chartered Accountants

Where Passion Delivers Value

Background



- AS-14 deals with accounting for amalgamations, but very limited guidance with respect to complex restructuring arrangements. Diverse practices prevails
- SEBI has mandated compliance with accounting standards for any amalgamation/ mergers/ reorganisation scheme filed by listed companies
- Companies Act, 2013 proposes compliance with accounting standards by all companies (section 230 notified on 15 Dec 2016)
- Statutory Auditor certificate mandatory for compliance of accounting treatment with Accounting Standards to be filed with NCLT

Key areas of change

- Goodwill generally amortised over period of 5 years in IGAAP vis-à-vis Ind AS where goodwill is tested for impairment and not amortised
- Acquisition related cost to be charged to P&L account
- Contingent consideration (earn outs) to be fair valued at acquisition date and considered as part of consideration for determination of goodwill. Any change in estimate to be recorded in P&L account
- Deferred consideration to be recorded at fair value and imputed interest charged to P&L account
- Common control transaction needs to be recorded at carrying value
- Transferee to record transaction in its books from acquisition date – acquisition date to mean date from which acquire obtains control

Acquisition cost

Acquisition cost

Accounting	Tax

Accounting

IGAAP

- No specific guidance
- Divergent practice followed

Ind AS

- Acquisition related cost to be expensed out in P&L

Tax

Amalgamation/demerger

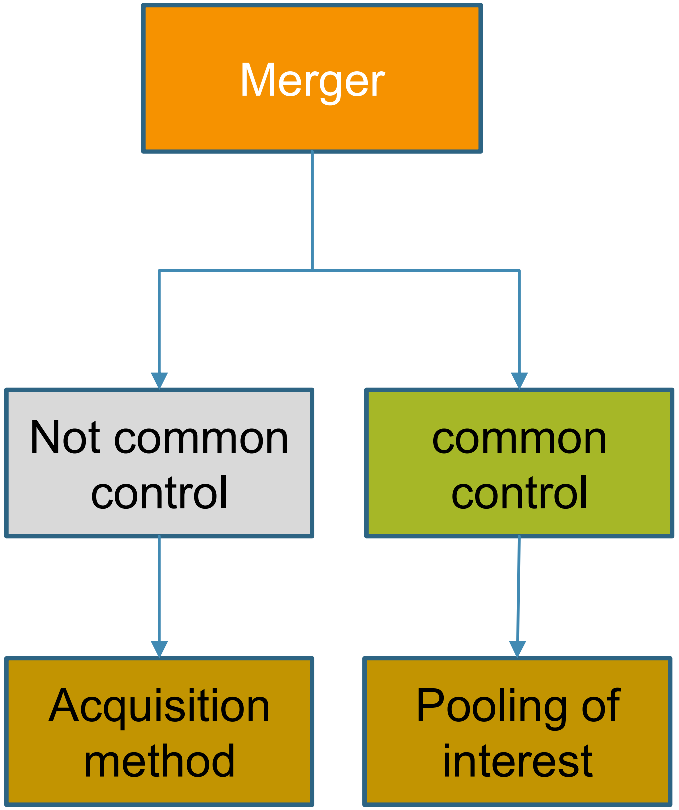
- Section 35DD permits deduction over 5 years period

Slump sale/slump exchange

- Limited guidance – generally capitalised by buyer and expensed out by seller

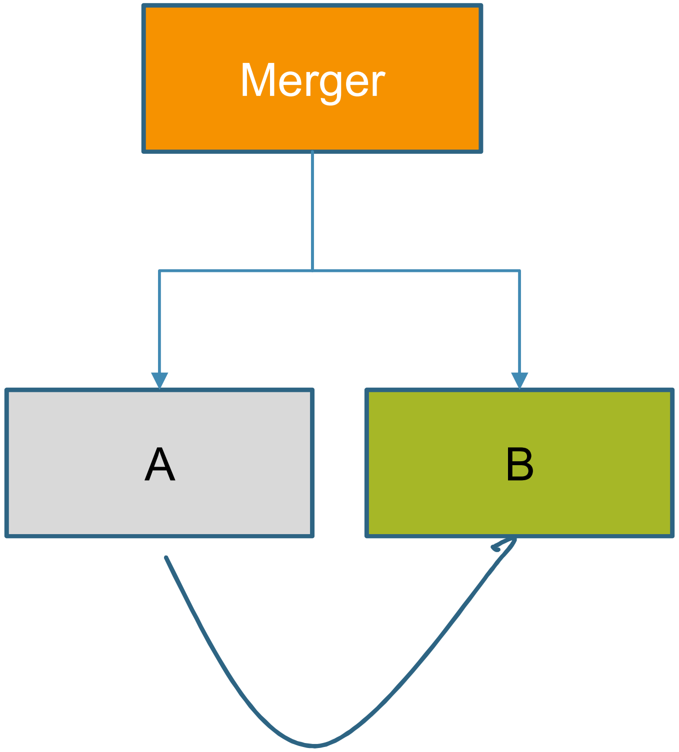
Merger

Accounting overview



- Under AS-14, Mergers fall into two broad categories:
  - Amalgamation in nature of merger
  - Amalgamation in nature of purchase
- Ind-AS 103, acquisition accounting applies to mergers and acquisition which are not common control
- For common control transactions Ind AS 103 provides for pooling of interest method
- Intangible asset to be recognised separate from goodwill
- Contingent liabilities to be accounted if it is a present obligation that arises from past events and its fair value can be measured reliably

Merger



Merger

- A Ltd merges with B Ltd. Following are relevant date:

Appointed date	1 April 2018
Court order	30 September 2018
ROC filing	30 October 2018

- A Ltd has significant brand value which is not accounted in books of A Ltd pre merger

Appointed date v/s effective date

IGAAP	Ind AS
➢ Date as defined in Court scheme ➢ Accounts redrawn to give effect to scheme once approved by Court	➢ Date on which acquirer obtains control of the acquire ➢ Generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree - the closing date ➢ Acquisition date may precede the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date

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- In cases where the auditor is of the view that as per the proposed accounting treatment, the date from which the amalgamation is effected in the books of accounts of the amalgamated company is different from the acquisition date as per the Standard i.e. the date on which control has been actually transferred, then the auditor shall state the same in the certificate as required to be issued as per the proviso to Section 232 (3) of the Companies Act, 2013
- If the NCLT approves the scheme with a different appointed date as compared to the acquisition date as per Ind AS 103, the appointed date as approved by the NCLT under the scheme will be the acquisition date

Appointed date for the purpose of merger/demerger ?

Acquisition method accounting

Particulars	Pre Merger	Post
Inventory	200	200
Fixed Tangible assets	100	100
Intangible asset	0	500
Total Assets	300	620
Loans	100	100
Current liabilities	50	50
Contingent liabilities	0	50
Total liabilities	150	200
Net asset	150	420
Consideration	600	600
Goodwill	450	180

Key tax issues

Normal tax

- Implication on ratio of Marshall Sons [1997] 223 ITR 809
- Depreciation on goodwill
- Depreciation on intangible arising out of merger
- Deductibility of contingent consideration

MAT

- Goodwill cannot be amortised but tested on year on year basis

SC in Marshall Sons [1997] 223 ITR 809

- It is open to the Court to modify the said date and prescribe such date of amalgamation as it thinks appropriate in the facts and circumstances of the case.
- In the instant case, the scheme expressly provided that with effect from the transfer date, the transferor-company (subsidiary company) shall be deemed to have carried on the business for and on behalf of the transferee-company (holding company) with all attendant consequences
- The order of the Court sanctioning the scheme, the filing of the certified copies of the orders of the Court before the Registrar of Companies, the allotment of shares, etc., may have all taken place subsequent to the date of amalgamation, yet the date of amalgamation in the circumstances of the instant case would be 1-1-1982 (appointed date)

SC in Smifs Securities Ltd [2012] 348 ITR 302

Question of law before SC

- Whether goodwill is an asset within the meaning of Section 32 of the Income Tax Act, 1961, and whether depreciation on 'goodwill' is allowable under the said Section

Source of Goodwill

- In accordance with Scheme of Amalgamation of YSN Shares & Securities (P) Ltd with Smifs Securities Ltd (duly sanctioned by Hon'ble High Courts of Bombay and Calcutta) with retrospective effect from 1st April, 1998, assets and liabilities of YSN Shares & Securities (P) Ltd were transferred to and vest in the company. In the process goodwill has arisen in the books of the company
- It was further explained that excess consideration paid by the assessee over the value of net assets acquired of ….[Amalgamating Company] should be considered as goodwill arising on amalgamation. It was claimed that the extra consideration was paid towards the reputation which the Amalgamating Company was enjoying in order to retain its existing clientele

SC in Smifs Securities Ltd [2012] 348 ITR 302

Held

- A reading the words 'any other business or commercial rights of similar nature' in clause (b) of Explanation 3 indicates that goodwill would fall under the expression 'any other business or commercial right of a similar nature'. The principle of ejusdem generis would strictly apply while interpreting the said expression which finds place in Explanation 3(b)

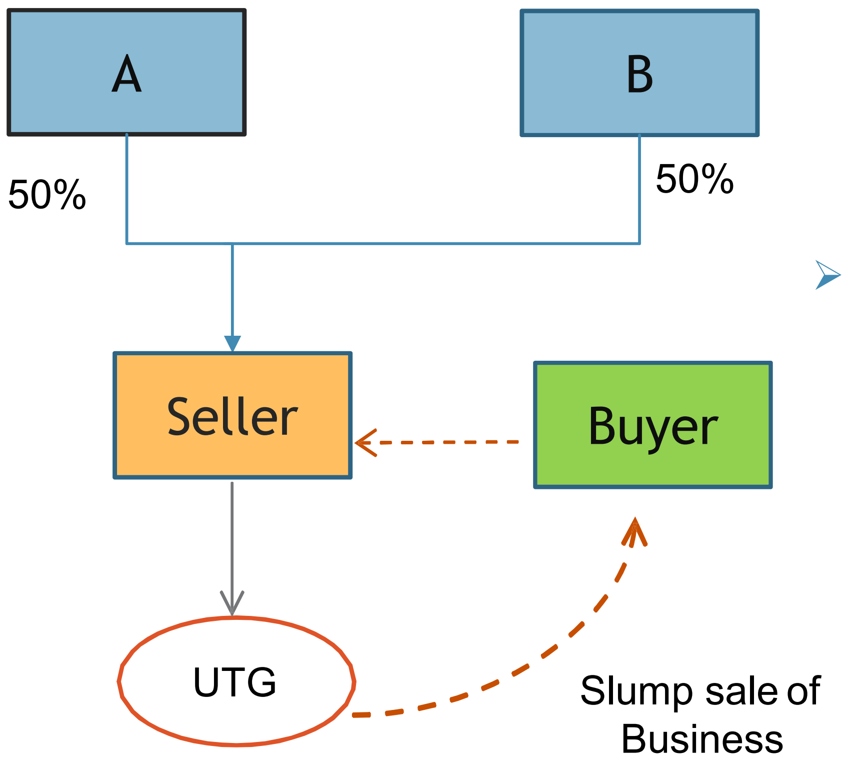
SC in Smifs Securities Ltd [2012] 348 ITR 302

Factual affirmation

- In the present case, the Assessing Officer, as a matter of fact, came to the conclusion that no amount was actually paid on account of goodwill
- The Commissioner of Income Tax (Appeals) ['CIT(A)', for short] has come to the conclusion that the authorised representatives had filed copies of the Orders of the High Court ordering amalgamation of the above two Companies; that the assets and liabilities of M/s. YSN Shares and Securities Private Limited were transferred to the assessee for a consideration; that the difference between the cost of an asset and the amount paid constituted goodwill and that the assessee-Company in the process of amalgamation had acquired a capital right in the form of goodwill because of which the market worth of the assessee-Company stood increased. This finding has also been upheld by Income Tax Appellate Tribunal ['ITAT', for short]

Slump sale

Fact pattern



- Seller Co sold its UTG to Buyer Co on following terms:
  - Sale of UTG effective from 1 April 2018
  - Sale subject to approval of CCI which was received on 1 July 2018
- Consideration:
  - Rs 100 crs on closing date
  - Rs 20 crs at end of Year 3
  - Rs 20 crs if EBITDA of UTG increases by 50% at end of Year 3
  - Mr B is key employee of UTG who joins Seller Co as MD
  - Right to receive 20crs forfeited if Mr B leaves Seller Co within 3 years

Contingent consideration

Buyer	Seller
Initial Recognition	**Initial Recognition**
➢ Recognised at fair value at acquisition date	➢ Recognised at fair value at acquisition date
➢ Goodwill debited with estimated fair value on acquisition date	➢ Estimated consideration accounted in year of transfer
➢ Classified as liability in accordance with Ind AS 32	➢ Classified as financial asset in accordance with Ind AS 32
Subsequent measurement	**Subsequent measurement**
➢ Debit/credit to profit/loss account	➢ Debit/credit to profit/loss account

Contingent consideration - buyer

Date	Particulars	Debit	Credit
Year 0	Goodwill	15	
	To contingent consideration (Accounted fair value of consideration as financial liability)		15
Year 1	P&L account	1.5	
	To contingent consideration (yearly interest charge as fair value assumption continues)		1.5
Year 2	Contingent consideration	6.5	
	To P&L (Revised fair value of consideration based is Rs 10 crs)		6.5

Deferred consideration - buyer

Date	Particulars	Debit	Credit
Year 0	Goodwill	15	
	To deferred consideration (Accounting for deferred consideration)		15
Year 1	P&L account	1.5	
	To contingent consideration (yearly interest charge)		1.5
Year 2	P&L account	1.6	
	To contingent consideration (yearly interest charge)		1.6
Year 3	P&L account	1.6	
	To contingent consideration (yearly interest charge)		1.6
Year 3	Deferred consideration	20	
	To Bank		20

Tax issues

Buyer	Seller
➢ Depreciation on goodwill – acquisition method ➢ Depreciation on goodwill – common control transaction ➢ Value at which depreciation should be claimed ➢ Deductibility of interest cost of year 2 in MAT and normal provision ➢ Taxability of income in Year 2 under MAT and normal provision	➢ Year of taxability of contingent consideration ➢ Quantum of taxability of deferred consideration ➢ Taxability of income in year 2 and year 3

Tax issues - buyer

Provisions of law

- Section 43(6): WDV means

  a) in the case of assets acquired in the previous year, the actual cost to the assessee

- ICDS V - Valuation of Tangible Fixed Assets in Special Cases

  "Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis"

Tax issues - seller

Section 5 – scope of total income

2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(*a*) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(*b*) accrues or arises or is deemed to accrue or arise to him in India during such year

Section 45 – Charge to CG

45. (1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F , 54G and 54H, be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place

Judicial Precedents

Ajay Guliya vs ACIT (Del HC)

The tenor of the Tribunal's order is that the entire income by way of capital gains is chargeable to tax in the year in which the transfer took place. This is what is stated in Section 45(1). Merely because the agreement provides for payment of the balance of consideration upon the happening of certain events, it cannot be said that the income has not accrued in the year of transfer.

Mrs. Hemal Raju Shete (Bom HC)

In fact the application of formula in the agreement dated 25th January, 2006 itself makes the amount which is receivable as deferred consideration contingent upon the profits of M/s.Unisol and not an ascertained amount. Thus in the subject assessment year no right to claim any particular amount gets vested in the hands of the respondent-assessee. Therefore, entire amount of Rs.20 crores which is sought to be taxed by the Assessing Officer is not the amount which has accrued to the respondent-assessee. The test of accrual is whether there is a right to receive the amount though later and such right is legally enforceable.

Contingent consideration linked to remuneration

Ind AS

- Treated as remuneration if contract provides for automatic forfeiture of payment if employment is terminated
- Payment to be accounted as remuneration and not debited to goodwill

Tax Issues

Buyer

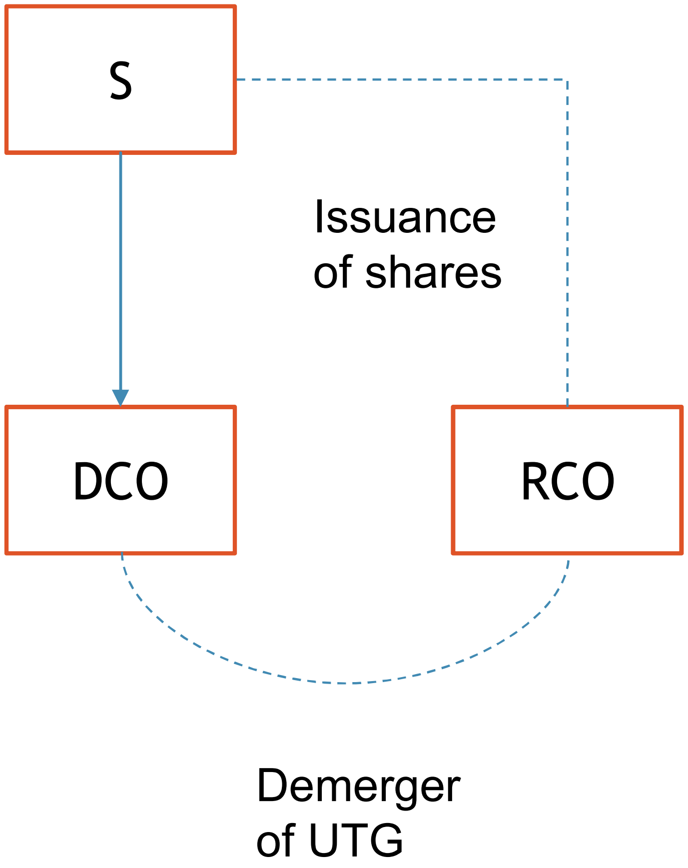
- Whether to be treated as salary requiring consequential TDS compliance
- Year of deduction of TDS

Employee

- Characterisation of contingent consideration

Demerger

Demerger

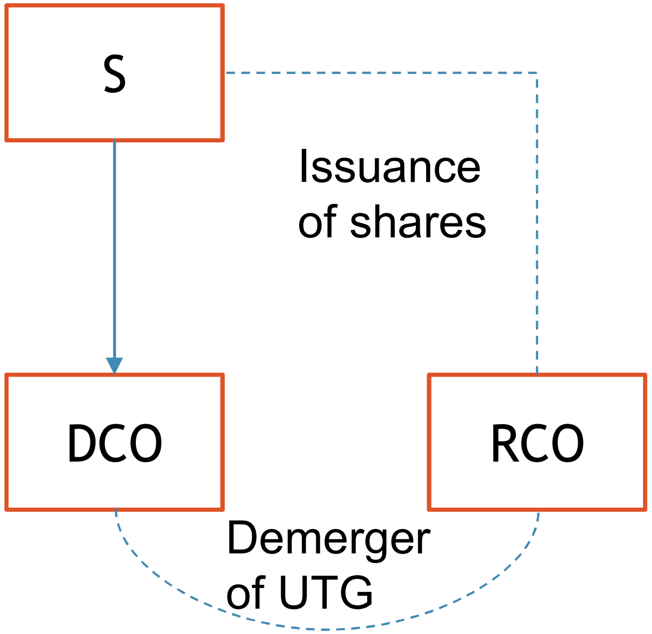


- DCO and RCO are unrelated parties
- DCO demerges its undertaking (UTG) to RCO. RCO issues shares to shareholder of DCO
- Valuation parameter

Particulars	Amount
Book value	100
Fair value	500

- DCO and RCO are Ind AS compliant company
- Court scheme provides for recording of transaction in accordance with Ind AS

Demerged company



- Per Ind AS 10 – distribution of non-cash asset to owner, UTG has to be fair valued
- Distribution is treated as non cash dividend to shareholder and hence dividend

P&L of DCO			
Expense	Amt	Income	Amt
Dividend	500	FV appreciation	400

Balance Sheet of DCO			
Liabilities	Amt	Asset	Amt
		UTG	100
		Add: FV appreciation	400
		Less: Dividend	500

Accounting entries in DCO

Particulars	Debit	Credit
Assets	400	
To P&L account (Fair value appreciation)		400
Other Equity	500	
To Proposed Dividend (Considered as distribution to shareholders as per Ind AS)		500
Proposed Dividend	500	
To Asset		500

Demerged company

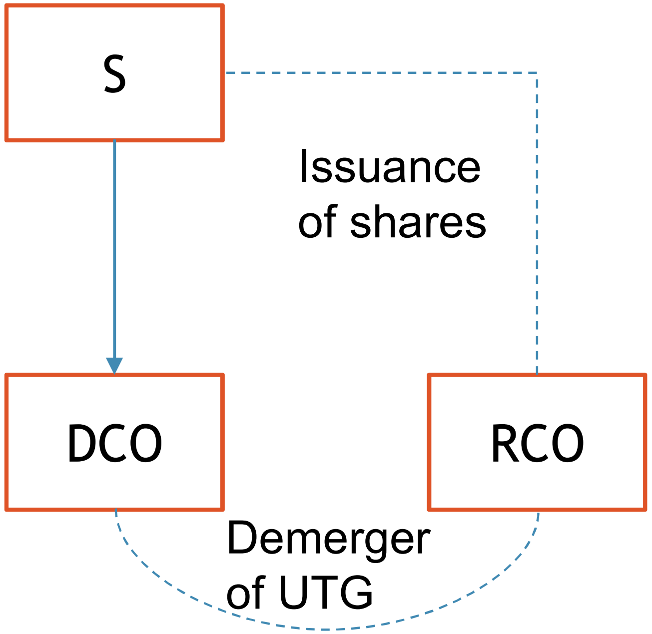
Normal tax

- Fair value appreciation not income of DCO
- DCO not taxable on transfer of UTG u/s 47(vib)
- Section 115-O arguably not applicable as no dividend is declared, distributed or paid by DCO to its shareholder
- Section 115BBDA not applicable in hands of shareholder as dividend for said section shall have same meaning assigned in section 2(22)
- Section 2(22) excludes distribution of shares pursuant to a demerger by resulting company from ambit of dividend

MAT

- Section 115JB(2A) provides to decrease book profit by credit to P&L on distribution of non cash asset to shareholder in demerger
- Explanation 1 to section 115JB provides for addition of ‘dividend paid or proposed’ – is it dividend paid or proposed?

Resulting company



Ind AS

- RCO to record asset and liabilities at fair value
- Difference between fair value of consideration and net asset to be recorded as goodwill/capital reserve
- Intangible asset to be separately recorded

Tax

- Section 2(19AA)(iv) reads:

  "property and liabilities of the undertaking …being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger"

- Whether demerger is tax compliant ?

Resulting company

Normal tax

- Can RCO claim depreciation on goodwill by extending ratio of Smifs Securities?

MAT

- Even though RCO records assets at fair value – for computing MAT depreciation increase in value needs to be ignored and depreciation to be claimed at carrying value [section 115JB(2B)]
- Section 115JB(2B)

  "In the case of a resulting company, where the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computation of book profit of the resulting company under this section"

Variation 1: Reference to Ind AS

Scheme of Tata Teleservices Maharashtra Limited with Bharti Airtel Ltd

Accounting treatment

Notwithstanding anything contained in any other clause in the Scheme, Transferor Company shall give effect to the demerger in its books of accounts as per the applicable accounting principles and as on the date as prescribed under Indian Accounting Standards (Ind-AS) prescribed under Section 133 of the Companies Act, 2013, as notified under the Companies (Indian Accounting Standards) Rules, 2015, as may be amended from time to time. In case of the Transferee Company, the accounting treatment shall also take into account the provisions of Clause 7.2 below

Variation 1: Reference to Ind AS

Scheme of Tata Teleservices Maharashtra Limited with Bharti Airtel Ltd

In books of Resulting Company

On this Scheme becoming effective, with effect from the Appointed Date, the Transferee Company shall account for the transfer and vesting of Demerged Undertaking in its books in accordance with the requirements of Ind AS 103 'Business Combinations' as notified under Section 133 of the Companies Act, 2013:

i. The Transferee Company shall, on this Scheme becoming effective, record all assets (tangible and intangible) and liabilities of the Demerged Undertaking;

ii. For the liabilities of the Demerged Undertaking recognised in (i) above against which indemnification has been provided, corresponding indemnification asset, to the extent allowed under Ind AS, would be accounted;

iii. The Transferee Company shall record the consideration transferred (shares of Transferee Company issued to equity holders of Transferor Company pursuant to this Scheme);

iv. The difference, if any, being excess / deficit arising pursuant to this Scheme shall be accounted as capital reserve / goodwill; and

v. To the extent there are inter-corporate balances between the Transferee Company and the Demerged Undertaking, the obligations in respect thereof shall stand cancelled.

Variation 2: Reference to Ind AS and 2(19AA)

Scheme of Century Textiles and Industries Ltd and Ultratech Cement Ltd

In books of Demerged Company

Pursuant to the Scheme coming into effect, with effect from the Effective Date, the Demerged Company shall account for the demerger, in its books of account in accordance with the accounting standards prescribed under section 133 of the Act in the following manner:

i. The Demerged Company shall transfer all assets and liabilities pertaining to the Demerged Undertaking as on the Effective Date at the values appearing in its books of account immediately before the Effective Date and correspondingly reduce from its books of account, the book values appearing on such date in accordance with the provisions of section 2(19AA) of the Income Tax Act

ii. For the sake of compliance with Indian Accounting Standard **("Ind AS")** 10, the Demerged Company shall debit the fair value of the Demerged Undertaking to the general reserve/ retained earnings and create a corresponding liability

Variation 2: Reference to Ind AS and 2(19AA)

Scheme of Century Textiles and Industries Ltd and Ultratech Cement Ltd

In books of Demerged Company

i. The book value of net assets derecognised at 10.1.1 above will ***be*** adjusted against the liability recognised at paragraph 10.1.2 above. The difference, if any, shall be recognised in the statement of profit and loss for the period in accordance with Annexure A to Ind AS 10

Variation 2: Reference to Ind AS and 2(19AA)

Scheme of Century Textiles and Industries Ltd and Ultratech Cement Ltd

In books of Resulting Company

<u>Recording the transfer of assets and liabilities on demerger:</u>

Pursuant to the Scheme coming into effect, with effect from the Effective Date, the Resulting Company shall account for the demerger, in its books of accounts such that:

i. The Resulting Company shall initially record the assets and liabilities of the Demerged Undertaking, transferred to and vested in it pursuant to this Scheme, at their respective book values as appearing in the books of account of the Demerged Company immediately before the demerger in accordance with the provisions of section 2(19AA) of the Income Tax Act;

ii. The Resulting Company shall credit its share capital account with the face value of New Equity Shares issued in accordance with Clause 9.1.

iii. The surplus / deficit between the value of Net Assets ("Net Assets" means excess of value of assets over the value of liabilities as per Clause 10.2.1) pertaining to the Demerged Undertaking and the amount of New Equity Shares issued under Clause 9.1 above shall be credited to capital reserve / debited to goodwill as the case may be.

Variation 2: Reference to Ind AS and 2(19AA)

iv. Having recorded the transfer of the assets and the liabilities as aforesaid, the Resulting Company shall make necessary adjustments such that all the assets and liabilities acquired (including assets and liabilities not specifically recognized by the Demerged company in its financial statements), as well as shares issued and the resultant goodwill/ capital reserve arising on demerger are reflected at their acquisition date fair values as required for compliance with the mandatory Indian Accounting Standards, specifically, Ind AS 103 'Business Combinations', notified under Section 133 of the Act, read with the rules made there under and other Generally Accepted Accounting Principles. Further, acquisition related costs will also be accounted in accordance with the requirements of Ind AS 103 'Business Combinations'.

Variation 3: Common Control

Scheme of Datamatics Global Services Limited and LDR Retail Limited

In books of Resulting Company

The Resulting Company shall give effect to the accounting treatment in its books of account in accordance with the "Pooling of Interests Method" under Ind-AS 103 (Accounting for Business Combinations) and any other relevant Indian Accounting Standard prescribed under Section 133 of the Companies Act, 2013

Variation 4: Common Control

Scheme of Hypercity Retail India Limited and Future Retail Limited

In books of Resulting Company

Upon the coming into effect of this Scheme, HRIL and FRL shall account for the demerger in their books as per the applicable accounting principles prescribed under Indian Accounting Standard (Ind AS) or such other accounting principles as may be applicable or prescribed under the Act

Thank You

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