Tax impact of Ind AS

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September 2018

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Where Passion Delivers Value

Roadmap to Ind AS

For companies other than banks, insurance companies, NBFC	
2015-16 Voluntary Phase	▪ Early Adoption
2016-17 Mandatory Phase I	▪ Companies with net worth of Rs.500 crore or more
2017-18 Mandatory Phase II	▪ All Listed Companies not covered in Phase I ▪ All Unlisted Companies with net worth of Rs. 250 crore or more

For banks, insurance companies, NBFC	
2018-19 Phase I	▪ Scheduled commercial banks ▪ Term lending refinancing institutions ▪ Insurer/insurance companies ▪ NBFC with net worth of Rs. 500 crore or more
2019-20 Phase II	▪ All Listed NBFC (or in the process of listing) & not covered in Phase I ▪ All unlisted NBFC with net worth of Rs.250 crore or more, but less than Rs. 500 crore

- Also applies to holding, subsidiaries, joint ventures & associate companies of the above companies
- Applies to both standalone & consolidated financial statements.
- Financial statements to be presented with an opening balance & comparative period.

Roadmap to Ind AS

- Significant difference between existing GAAP and Ind AS
  - Financial instruments
  - Business consolidation and combination
  - Revenue recognition and leases
  - Share based payment
  - Presentation and disclosure

Convergence to Ind AS has all pervasive impact on reporting, IT, finance, budgeting, tax as it hits what matters the most – profits of company !!

Role of AS in computing tax

- J.K. Industries Ltd [2008] 297 ITR 176 (SC):

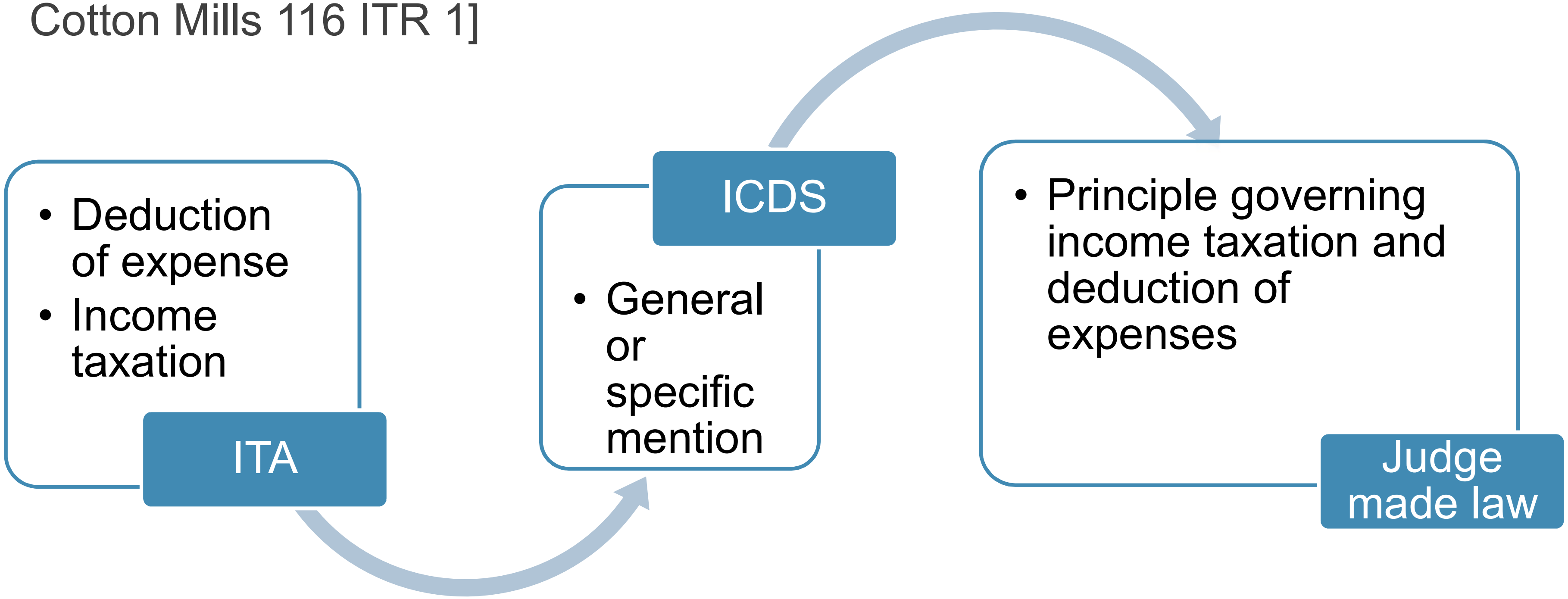
  "The main object sought to be achieved by Accounting Standards which is now made mandatory is to see that accounting income is adopted as taxable income and not merely as the basis from which taxable income is to be computed. Thus, if the rules by which inventories are to be valued are laid down in the Accounting Standards and are followed in the determination of accounting income, then tax laws do not need to lay down the rules and the tax authorities do not need to examine the computation of the value of inventories and its effect on computation of income. Similarly, if there is an accounting standard on depreciation which requires estimation of the useful life and prescribes the appropriate method for apportionment of cost of fixed assets over their useful life, it is unnecessary for tax laws to apply an artificial rule to decide the extent of allowance for depreciation"

Cannon of taxation

- Income can be taxed only if assessee has a right to receive the income. There must be a debt owed to him by somebody [E.D. Sassoon 26 ITR 27]
- Income tax can be levied on real income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise [Shoorji Vallabhdas 46 ITR 144]
- Whether the assessee is entitled to a particular deduction or not will depend on the provision of law & not on existence or absence of entries in the books of account be decisive or conclusive [Kedarnath Jute 82 ITR 363]
- Income-tax law does not march step by step in the divergent footprints of the accountancy profession [B.S.C. Footwear 83 ITR 269 (HL)]

Cannon of taxation

➢ The question whether a receipt of money is taxable or not or whether certain deductions from that receipt are permissible in law or not has to be decided according to the principles of law and not in accordance with accountancy practice; Accounting practice cannot override the provisions of the Act [Sutlej Cotton Mills 116 ITR 1]



Cannon of MAT taxation

- The Assessing Officer does not have the jurisdiction to go behind the net profits shown in the profit and loss account except to the extent provided in the Explanation [Apollo Tyres Ltd 255 ITR 273]
- However, ITA can rewrite P&L if:
  - P&L is not drawn up in accordance with Schedule VI
  - If accounting policites, accounting standards are not adopted for preparing such accounts or method, rate of deprecation have been incorrectly adopted for preparation of P&L laid before AGM

  [Rain Commodities Ltd 40 SOT 265 (Hyd SB)]
- Judicial uncertainty on whether sum not constituting income and be taxed under MAT [loan waiver, capital receipt, subsidy etc]

Section 115JB contains specific guidance to deal with Ind AS adjustment

Reliance of tax on accounts

- Forms basis of book profits for MAT taxation
- Disallowance under Rule 8D:
  - Direct expenditure plus
  - 1% of annual average of monthly average of opening and closing balances of value of investment whose income is or shall be exempt
- Section 50B – net worth which is deem to be cost of undertaking is determined basis book value [except specified assets]
- Section 2(19AA)(iii) requires property and liabilities to be transferred at values appearing in books of account
- Section 49(2C) and section 49(2D) requires determination of cost of shares of demerged and resulting company based on same proportion as net book value of assets transferred in demerger bears to net worth of demerged company before demerger

Reliance of tax on accounts

- Section 56(2)(x) read with Rule 11UA consider book value (except specified assets) as basis for determining gift tax
- Related party disclosures is generally taken as base to determine TP transaction
- Section 94B limits interest deduction to lower of following:
  - 30% of EBITDA
  - Actual interest paid or payable to AE
- Determination of accumulated profit – will other equity be considered AP
- TP – comparability, determination of ALP, characterisation of entity etc

- First Time Adoption (FTA) provides number of options available to transition from IGAAP to Ind AS
- Company need to consider wider ramification of option selected - just not from tax but from overall organisational point of view

Tax provision dealing with Ind AS

Tax provision dealing with Ind AS

- Legislative action:
  - Set up Lohia committee for providing framework for computing book profit u/s 115JB for Ind AS compliant company
  - Wide stakeholders consultation
- FA 2017 amended section 115JB to provide framework for computing book profit in the year of adoption of Ind AS and subsequent year
- CBDT issued clarification vide Circular 24/2017 to clarify issues arising out of Ind AS

> - No guidance available for computing profit under normal provision
> - Profit under normal provision needs to be computed n accordance with provisions of ITA, ICDS and general principle of taxation

MAT provision dealing with Ind AS

<ins>Step 1</ins>: Compute book profit in accordance with Explanation 1 to section 115JB(2)

<ins>Step 2</ins>: Book profit computed under step 1 be adjusted:

Add: Credits to OCI under head 'items that will not be reclassified to profit or loss'

Less: debits to OCI under head 'items that will not be reclassified to profit or loss'

Add: Less – demerger adjustment

<ins>Step 3</ins>: Increase/decrease by 1/5th of transition amount

Revaluation surplus on account of fair value of PPE or equity investment in shares, JV etc to be ignored. Tax to be paid in year of disposal/retirement

MAT provision dealing with Ind AS

Ind AS Statement of Profit and Loss	
Particulars	**Amount (₹)**
Revenue From Operations	XX
Other Income	XX
Total Income	**XX**
EXPENSES Cost of material consumed	XX
Purchase of Stock-in-Trade	XX
Employee Benefit Expenses	XX
Finance Cost	XX
Other expenses	XX
Total Expenses	**XX**
Profit / (loss) before tax	**XX**
Tax Expense: 1. Current Tax 2. Deferred Tax	XX
Profit / (Loss) for the period	**XX**
Other Comprehensive Income A. (i) Items that will not be classified to profit or loss (ii) Income tax relating to items that will not be classified to profit or loss B. (i) Items that will be reclassified to profit or loss (ii) Income tax relating to items that will be classified to profit or loss	XX
Total Comprehensive Income for the period (Comprising Profit (Loss) and other Comprehensive Income for the period)	**XX**

MAT starting point

MAT provision dealing with Ind AS

Ind AS Balance Sheet	
Particulars	Amount
Equity and Liabilities	
Equity share capital	
Other equity	
(a) Equity component of compound financial instrument	
(b) Reserves & Surplus	
(c) Other reserves	

Transition adjustment

MAT provision dealing with Ind AS

Transition adjustment means amount or aggregate of amount adjusted in other equity (excluding capital reserve and securities premium reserve)

Exclusion:

a) Amount adjusted in OCI which shall be subsequently reclassified to P&L

b) Revaluation reserve as per Ind AS 16 & Ind AS 38

c) Gains or loss on equity investment recorded FVTOCI

d)PPE recorded at fair value

e) Investment in shares, subsidiaries, JV recorded at fair value

d) Comparative translation diff in foreign operation

Convergence date: Last day of preceding FY e.g 31 March 2017 (FY 2017-18 Ind AS year)

Guide to Ind AS changes

- FTA option exercised by company
- Company is required to present comparative financial statement for year prior to Ind-AS convergence
- Accounting policy followed in notes to account
- Profit reconciliation as per IGAAP and Ind AS in year of convergence
- Company following calendar year needs to prepare proportionate account in year of transition for tax purpose
- Items falling part of other equity Ind AS

Ind AS 16 - PPE

Key areas of change

- FTA may adopt any of the options as deem cost at transition date:
  - Fair value
  - Revaluation model
  - Previous GAAP carrying value
- Cost of acquisition does not include finance cost, general admin overhead etc. Accordingly, such cost will have to be reversed at the time of FTA
- Asset acquired on deferred consideration needs to be adjusted for time value of money (TVM). Interest cost to be accounted periodically
- Site restoration and decommissioning obligation to be included as part of cost at TVM. Subsequent unwinding of interest cost on periodic basis
- Foreign exchange fluctuation on PPE to be expenses to P&L

FV as deem cost

- S Ltd is phase II Ind AS and has adopted FV as on transition date as deem cost

Particulars	Value (Rs in crs)
Book value of PPE	10
FV on 31 March 2016	50
Useful life	10 years
Yearly depreciation	1

- Entries

Date	Particulars	Debit	Credit
1 April 2016	PPE	40	
	To Reserves (Restatement to FV)		40

FV as deem cost

Date	Particulars	Debit	Credit
31 March 2017	Depreciation	4	
	To PPE (Incremental depreciation charge for comparative period)		4
Aforesaid required for comparative period even though tax computed for FY 2016-17 based on GAAP			
31 March 2018	Depreciation	5	
	To PPE (Depreciation charge for FY 2017-18)		5

No impact under normal provisions. Cost of Acquisition Rs 10 crs and revaluation to be ignored

MAT computation

Particulars	Value (Rs in crs)
Net profit before OCI (assumed)	100
Add: Depreciation as per books	5
Less : Depreciation (excluding revaluation)	1
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil
Add/less : Transition amount as per sec 115JB(2C)	Nil

Transition Amount:

- TA means amount credited to other equity
- However, TA excludes revaluation surplus adjusted on transition date
- Accordingly, Rs 46 (50 -4) even though credit to other equity does not form part of TA
- Income taxable in year of disposal/retirement/transfer of asset

Revaluation model as deem cost

- Impact on TA amount same as FV as deem cost
- PPE will be revalued on yearly basis and difference will be credit/debited to OCI under head “items that will not be classified to P&L’
- Section 115JB(2B) specifically carves out exception to revaluation pertaining to PPE
- Amount taxable in year of disposal/retirement/transfer of asset

- Need to maintain robust documentation for entitles following fair valuation model as MAT catch up will happen in year of disposal/retirement/transfer

Spare parts

- S Ltd is phase II Ind AS. Under GAAP spare parts were debited to P&L and was claimed deductible for tax purpose

Particulars	Value (Rs in crs)
Spare parts purchased on 1 April 2015	10
Useful life	5 years

- Under Ind AS spare parts are considered as PPE and needs to be depreciated
- Entries

Date	Particulars	Debit	Credit
1 April 2016	PPE	10	
	To Reserves (Reversal of capitalisation)		10

Spare parts

Date	Particulars	Debit	Credit
31 March 2016	Depreciation	2	
	To PPE (Depreciation for said period)		2
31 March 2017	Depreciation	2	
	To PPE (Depreciation for comparative period)		2
31 March 2018	Depreciation	2	
	To PPE (Depreciation for previous year)		2

Spare parts

Normal tax

- Book treatment not decisive of income tax deduction
- Additional argument available to tax authorities

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	
Add: Depreciation as per books	2	CY depreciation on spares
Less : Depreciation (excluding revaluation)	2	
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	1.2	See next slide

Spare parts

Transition Amount:

- TA means amount credited to other equity
- Amount credited to other equity Rs 6 crs (10-2-2). Similar amount added to cost of PPE on which depreciation will be allowed in subsequent year
- Section 115JB(2C) provides for taxation of TA equally over period of 5 consecutive tax year Rs 1.2 (6/5)

- Adjustment are tax neutral over period of time since taxation of 1/5th of TA is offset by incremental deduction of depreciation in subsequent year
- Mismatch arises if tax is payable under normal provision in subsequent year

Site restoration

- S Ltd is phase II Ind AS engaged in mining activities. On extraction of mines it is obligated to restore surface area and plant trees

Particulars	Value (Rs in crs)
Site restoration cost	1000
Discount rate	10%
Net prevent value	385.84
Period	10 years

- Under GAAP, it created provision for site restoration on scientific basis and claimed it as expenditure. Prov for FY 2016-17 – Rs 30
- Rs 385.54 is included as cost to PPE
- Yearly charge as created to P&L with corresponding provision in Balance Sheet

Site restoration

- Yearly interest

Year	Opening	Interest @ 10%	Closing Balance
1	385.54	38.55	424.09
2	424.09	42.40	466.49
10	909.09	90.91	1000

- Entries

Date	Particulars	Debit	Credit
1 April 2016	Prov for site restoration	30	
	To Reserves (Reversal of provision in FY 2016-17)		30

Site restoration

Date	Particulars	Debit	Credit
1 April 2016	PPE	385.54	
	To Prov for site restoration (Capitalisation to PPE)		385.54
31 March 2017	P&L a/c	38.55	
	To Prov for site restoration (Prov for comparative period)		38.55
31 March 2018	P&L a/c	42.40	
	To Prov for site restoration (Current year charge)		42.40

Site restoration

Normal tax

- Unlikely to qualify as ‘actual cost’ of asset for the purpose of section 43
- Whether provision meets test of ICDS X
- If not, whether said expenditure is deductible in year of incurrence u/s 37(1)

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• Interest cost eligible for deduction
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	-9.75	See next slide

Site restoration

Transition Amount:

- TA means amount credited to other equity
- Amount credited to other equity Rs -48.75 (30 – 37.5 – 41.25).
- Section 115JB(2C) provides for taxation of TA equally over period of 5 consecutive tax year Rs 9.75 (48.75/5)

- Resulted in back ending of deduction under normal tax
- Largely MAT neutral

Ind AS 27 – Separate financial statement

Key areas of change

- Scope: Measurement of
  - Subsidiaries
  - Associates
  - Joint ventures
- FTA may adopt any of the options as deem cost at transition date:
  - Fair value
  - Revaluation model
  - Previous GAAP carrying value
- Equity instrument which does not fulfil above needs to be fair valued through P&L or OCI
- Transaction likely to be tax neutral
- Ongoing controversy on applicability of section 14A to strategic investment

Key areas of change

- Section 14A read with Rule 8D
  - Direct expenditure
  - 1% of annual average of the monthly average of the opening and closing balances of the value of investment
- Likely to impact section 14A disallowance if investment valued at fair value

Tax impact similar to that discussed for PPE

Ind AS 102 – Share based payment

Key areas of change

- Wider in scope - SBP covers payments to employees and non employees as also transactions involving receipt of goods and services
- ICAI GN provided for measurement of SBP at intrinsic value or fair value. In practice, most companies accounted SBP at intrinsic value i.e. if the exercise price for the employee stock option is not less than the market price of the underlying shares on the date of the grant, no compensation cost is recorded
- SEBI mandates recording of difference between exercise price and market price as expense on straight line basis
- Measurement:
  - Equity settled SBP at fair value
  - Others – fair value of goods or services obtained
- FTA companies may not record SBV value for option already vested on transition date
- SBP requires accounting of group company ESOP plans. Under IGAAP such cost was recognised only in case of cross charge
- In case of graded option – cost to be recognised over grant period as against straight lining option under IGAAP

Deductibility of ESOP expense

Expense held deductible*

Deductibility

- ESOP discount represents consideration/compensation for services rendered by employees
- It is ascertained liability since employer incurs obligation to compensate employees over vesting period

Year of deduction

- Deduction to be granted over period of vesting

Quantum

- Exact quantum of discount is determined on the date of exercise of options i.e. difference between market value on date of exercise and exercise price
- Deduction to be provisionally allowed in earlier period based on vesting of option and should be adjusted upwards or downwards based on market value as on date of exercise

*Biocon Ltd 144 ITD 21

Graded option

- S Ltd is phase II Ind AS. It granted 400 option to employees on 1 April 2014. 100 option vested in each financial year over period of next 4 years

Vesting date	No of option vesting	Fair value	Cost
31 March 2015	100	2.5	250
31 March 2016	100	3	300
31 March 2017	100	4	400
31 March 2018	100	5	500
			1450

- Compensation recording

Particular	FY 15-16	FY 16-17	FY 17-18	FY 18-19	
IGAAP	290	290	290	290	1450
Ind AS	658	408.33	258.33	125	1450
Difference	(368)	(118.33)			

Graded option

Normal tax

- Deductible relying on judicial precedents
- Reduction in quantum of deduction basis book entry in transition year
- True up/ true down as per Biocon ratio

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	1000	• ESOP cost deductible • No ascertained liability
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	-97.26	1/5 of TA - 486.33 (368 + 118.33)

Group ESOP

- H Ltd grants ESOP to employees of its unlisted WOS - S Ltd
- There is no cross charge between S Ltd and H Ltd
- Amortised charge under Ind AS:

Particular	FY 15-16	FY 16-17	FY 17-18	FY 18-19	
Ind AS	100	100	100	100	400

- Entries in books of H Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Investment in S Ltd	200	
	To Retained earning (Reversal of provision in FY 2015-16 & 2016-17)		200
31 March 2018	Investment in S Ltd	100	
	To Stock reserve		100

Group ESOP

Normal tax

- Can ratio of Biocon and other ruling apply to cost of ESOP pertaining to subsidiary employees?
- Can ratio of SA Builder be applicable to content that ESOP expense is for the purpose of business of H Ltd?
- Will absence of debit to P&L as per Ind – AS be impediment in claiming deduction?
- Cost of S Ltd same as original investment – not impacted by book entry

Group ESOP

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• ESOP expense not routed through P&L and hence no question of deduction
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	40	• 1/5 of TA • TA = 300 (100 + 100)
Book profit	140	

Group ESOP

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Retained earning	200	
	To Other equity (Deem capital) (Expense for FY 2015-16 & 2016-17)		200
31 March 2018	Retained earning	100	
	To Other equity (Deem capital) (Expense for 2018-19)		100

Group ESOP

Normal tax

- Can ratio of Biocon and other ruling apply?
- Can deduction be granted merely because of book entry even though there is no obligation on S Ltd to pay?

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• ESOP expense deductible
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	- 40	• 1/5 of TA • TA = 200 (100 plus 100)
	140	

Ind AS 109 – Financial instrument

Key areas of change

- Financial instrument is defined as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity
- Financial asset (FA) and financial liabilities (FL) wide enough to include shares, debentures, deposit, loan, payable/receivable
- Financial instrument or its component parts should be classified by issuer upon initial recognition as a FL or equity instrument according to substance of contractual arrangement rather than legal form
- Ind AS requires FA/FL to be fair valued at inception. Difference to reflect substance of the transaction
- FA which do not fulfil contractual characteristics i.e. repayment of capital and interest needs to be fair valued through P&L (FVTPL)
  - Option to record equity instrument through OCI
- Compound instrument i.e. instrument which have debt and equity feature needs to be split and recorded separately (e.g. CCD)
- Redeemable preference shares to be treated as FL

Interest free loan

- H Ltd provides 1000 crs interest free loan to S Ltd repayable after 10 years at par on 1 April 2015
- Market rate of interest in parallel situation is 10%. NPV of loan discounted at 10% is 385.84
- Loan amortisation:

FY	Op Balance	Interest	Repayment	Closing Bal
2015-16	385.54	38.55		424.09
2016-17	424.09	42.40		466.49
2017-18	466.49	46.65		513.14
2024-25	909.09	90.91	1000	-

Interest free loan

- Entries in books of H Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Loan receivable	385.84	
	Investment in S Ltd	614.16	
	To Loan receivable (Recording FA as per Ind AS)		1000
1 Apr 2016	Loan receivable	38.55	
	To Retained earning (Recording of notional interest receivable for FY 2015-16)		38.55
31 March 2017	Loan receivable	42.40	
	To Retained earning (Recording of notional interest receivable for comparable period FY 2016-17)		42.40

Interest free loan

- Entries in books of H Ltd

Date	Particulars	Debit	Credit
31 March 2018	Loan receivable	46.65	
	To P&L account (Recording of notional interest receivable for FY 2017-18)		46.65

- Year 10 – repayment of loan

Date	Particulars	Debit	Credit
31 March 2018	Bank	1000	
	To Loan receivable		1000

Investment in S Ltd continues in Balance Sheet of H Ltd even after repayment of Loan

Interest free loan

Normal tax

- Notional income unlikely to be taxable in absence of enforceable debt
- Income has to be real income
- Ind AS balance sheet figures to be considered for sec 56(2)(x)/ net worth computation u/s 50B
- Cost of S Ltd same as original investment – not impacted by Ind AS

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• Interest income part of MAT
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	16.19	• 1/5 of TA • TA = 80.85 (38.55 + 42.40)
Book Profit	116.19	

Interest free loan

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Loan payable	1000	
	To Other equity (deem capital)		614.16
	To Loan repayable (Recording FL as per Ind AS)		385.84
1 Apr 2016	Retained earning	38.55	
	To Loan payable (Recording of notional interest payable for FY 2015-16)		38.55
31 March 2017	Retained earnings	42.40	
	To Loan payable (Recording of notional interest payable for comparable period FY 2016-17)		42.40

Interest free loan

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
31 March 2018	P&L account	46.65	
	To Loan payable (Recording of notional interest payable for FY 2017-18)		46.65

Interest free loan

Normal tax

- Notional interest not deductible in absence of obligation
- Included for EBITDA calculation for the purpose of section 94B

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• Interest deductible
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	106.64	• 1/5 of TA • TA = TA = 533.21 (614.16 - 38.55 - 42.40)
Book Profit	206.64	

- Similar treatment for lease deposit, concessional loan to subsidiary/employee
- In case of concessional loan, differential rate needs to be accounted as suggested above

CBDT Circular 24/2017

Question 9: How do we account for items such as equity component, if any, of financial instruments like Non-Convertible debentures (NCDs), Interest free loan etc. included in other equity as per Ind AS for the computation of transition amount under MAT?

Answer: Items such as equity component of financial instruments like NCD's, Interest free loan etc. would be included in the Transition Amount.

- Results in larger MAT tax outflow in case of borrower company
- Conflict with TP: In case of loan to overseas subsidiary it is judicially settled that LIBOR is accepted rate of interest
- Will charge of notional interest reignite debate?

CIT v Virtual Soft System Ltd*

Facts:

- Issue pertains to tax year AY 1996-97 to AY 2000-2001 when GN was in force. Subsequently AS 19 was issued in 2001 which replaced GN

Issue:

- Whether lease equalisation debit in case of finance lease as per ICAI GN is admissible for tax purpose

Ruling:

- Method of accounting in GN captures 'real income' by separating capital recovery and finance income
- Bifurcation is not artificial calculation. It ensures that real income from lease transaction in form of revenue is only captured
- Method prescribed by GN show fair and real income liable to tax

* (2018) 404 ITR 409

Debenture redeemable at premium

- S Ltd invested in debenture of 1000 crs on 1 April 2015
- Debenture redeemable at premium such that IRR is 10%
- No interest was recorded under IGAAP
- Ind AS requires recording of interest on annual basis
- Yearly interest income:

FY	Op Balance	Interest	Repayment	Closing Bal
2015-16	1,000	100	-	1,100
2016-17	1,100	110	-	1,210
2017-18	1,210	121	-	1,331
2024-25	2,358	236	-	2,594

- Impact of fair value of Debenture not considered in this case study

Debenture redeemable at premium

- Entries in books of H Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Interest receivable	100	
	To Retained earning (Recording of notional interest receivable for FY 2015-16)		100
31 March 2017	Interest receivable	110	
	To Retained earning (Recording of notional interest receivable for comparable period)		1110
31 March 2018	Interest receivable	121	
	To Retained earning (Recording of notional interest receivable for FY 2017-18)		121

Debenture redeemable at premium

In hands of H Ltd

Normal tax

- Whether Circular 2/2002 dealing with deep discount bond can be applied?
- Can interest be taxed on notional basis?
- Possibility of double taxation – assume MAT payable from year 1 to year 9 and S Ltd falls under normal taxation in year 10.

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• Interest included in income
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	42	• 1/5 of TA • TA = 210 (100 + 110)

Mutual fund

- S Ltd invested surplus cash of Rs 100 crs in mutual fund
- Purpose is to get capital appreciation and have liquidly float in case of business exigency
- Under IGAAP, investment were recorded at lower of cost or market value. Ind AS requires to measure investment at FVTPL
- MF are not equity as there is obligation on issuer to redeem the same. Hence option of fair valuing through OCI is not available
- Market value

FY	Market Value
2015-16	110
2016-17	95
2017-18	120

Mutual fund

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Investment in MF	10	
	To Retained earning (Recording FA as per Ind AS)		10
31 March 2017	Retained earning	15	
	To Investment in MF (Recording of decrease in FMV for FY 2016-17)		15
31 March 2018	Investment in MF	25	
	To Retained earning (Recording of increase in FMV for FY 2016-17)		25

Mutual fund

Normal tax

- MF taxable in year of sale
- Increase/decrease in MV irrelevant

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• Increase in market value of Rs 25 crs to be included in MAT
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	- 1	• 1/5 of TA • TA = - 5 (10 – 15)
Book profit	- 99	

- Since fair value is routed through P&L exception u/s 115JB(2A) not applicable
- Since gain does not pertain to equity instrument exception carved out u/s 115JB(2C) not applicable

CBDT Circular 24/2017

Question 1: The profit for the period may include Marked to market (MTM) gains/losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (*i*) of *Explanation 1* to section 115JB (2) of the Act. Whether the losses on such instruments require any adjustment for computing book profits for the purposes of MAT?

Answer: Since MTM gains recognised through profit or loss on FVTPL classified financial instruments are included in book profits for MAT computation, it is clarified that MTM losses on such instruments recognised through profit or loss shall not require any adjustments as provided under clause (*i*) of *Explanation 1* to section 115JB(2) of the Act. However, in case of provision for diminution/impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (*i*) of *Explanation 1* to section 115JB(2) of the Act shall apply.

- Favourable interpretation in circular to allay fears whether downward MTM can be considered as 'amount set aside as provision for diminution in value of any asset'

Redeemable preference share

- H Ltd invested surplus cash of Rs 1000 crs in 0% redeemable preference share of S Ltd. Shares are redeemable at par at the end of 10 year.
- Under IGAAP, S Ltd recorded preference shares as part of equity capital
- Ind AS provides that said instrument needs to be bifurcated as equity and financial liability

Particulars	Value (Rs in crs)
Investment cost	1000
Discount rate	10%
Net prevent value	385.84
Period	10 years

Redeemable preference share

- Yearly interest:

Year	Opening	Interest @ 10%	Closing Balance
1	385.54	38.55	424.09
2	424.09	42.40	466.49
10	909.09	90.91	1000

Redeemable preference share

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
1 Apr 2016	Preference share capital	1000	
	To Other equity (deem capital)		614.16
	To RPS (recorded as financial liability)		385.84
31 March 2017	Finance cost (Retained earning)	38.584	
	To RPS (recorded as financial liability) (Liability for FY 2016-17)		38.584
31 March 2018	Finance cost (Retained earning)	42.40	
	To RPS (recorded as financial liability) (Liability for FY 2017-18)		42.40

Redeemable preference share

Normal tax

- Interest on RPS not tax deductible
- Whether preference share booked under liabilities be reduced to compute Rule 11UA value as also net worth for slump sale ?

MAT

Particulars	Amount	Remark
Net profit before OCI (assumed)	100	• Interest on RPS allowed as deduction
Add/ Less : Adjustment provided in sec 115JB(2A)	Nil	
Add/less : Transition amount as per sec 115JB(2C)	115.116	• 1/5 of TA • TA = 575.58 (614.16 – 38.58)
Book profit	215.116	

Redeemable preference share

- **Question 8: Under Ind AS, Investments in preference share is considered to be a liability and the corresponding dividend expense is debited to Profit and loss account as interest cost. Should such interest expenses on preference shares be deducted for the purpose of MAT computation?**
- Answer: For the purpose of computation of MAT, profit/Transition Amount shall be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

- In facts, RPS are issued at 0% yield. If there is dividend obligation same is classified as interest in booked. To be added in computing MAT
- Harsh consequences - equity component to be included in TA
- Can MAT be levied on share capital which is not income per se!!

Compulsorily convertible debenture

- H Ltd issues 2000 convertible bonds
- The bonds have a 3 year term, and are issued at par with a face value of INR1,000 per bond, giving total proceeds of INR 2,000,000
- Interest is payable annually in arrears at a nominal annual interest rate of 6% (i.e. INR120,000 per annum)
- Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9% per annum
- The entity incurs issue costs of INR100,000.

Bifurcation

Year	Particulars	Cash flow	Discount factor (@ 9%)	NPV of cash flow
1	Interest	120,000	1/1.09	110,092
2	Interest	120,000	1/1.092	101,001
3	Interest & principal	2,120,000	1/1.093	1,637,029
	Total liability component at PV			1,848,122
	Equity component (balance)			151,878
	Total proceeds			2,000,000

Bifurcation

Particulars	Liability component	Equity component	Total
Gross proceeds	1,848,122	151,878	2,000,000
Issue cost (pro-rata)	92,406	7,594	100,000
Net proceeds	1,755,716	144,284	1,900,000

Bifurcation

Year	Opening liability	Interest @ 10.98%	Cash paid	Closing liability
1	1,755,716	193,094	(120,000)	1828,810
2	1,828,810	201,134	(120,000)	1,909,944
3	1,909,944	210,056	(2,120,000)	-
	Total finance cost	604,284		

INR 144,284 (151,878 minus 7,594) credited to equity is not subsequently remeasured

Conversion

- On conversion of a compound instrument at maturity, the entity should de-recognize the liability component and recognize it as equity.
- Equity issued on conversion is measured at the carrying amount of the liability component at the date of conversion.
- There is no gain or loss on conversion at maturity.
- The equity component of the instrument recognised initially is transferred to share capital. Other components of equity (like share premium) are recognised depending on the legal requirements

Entries on recognition

- Entries in books of H Ltd

Date	Particulars	Debit	Credit
1 Apr 2018	Bank	2,000,000	
	To Other equity (equity component of CCD)		151,878
	To CCD (recorded as financial liability)		1,848,122
1 April 2018	CCD	92,406	
	Other equity	7,594	
	To Bank (Issue expenses)		1,00,000

Yearly interest cost

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
31 March 2019	Finance cost	193,094	
	To CCD (recorded as financial liability) (Interest expense booked in FY 2018-19)		193,094
31 March 2020	Finance cost	201,134	
	To CCD (recorded as financial liability) (Interest expense booked in FY 2019-20)		201,134
31 March 2021	Finance cost	210,056	
	To CCD (recorded as financial liability) (Interest expense booked in FY 2021-22)		210,056

Yearly interest cost

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
31 March 2021	CCD (recorded as financial liability)	2,00,000	
	To Equity shares/security premium		2,000,000
31 March 2021	Other Equity	144,284	
	To Equity		144,284

Tax implication

Normal tax

- Quantum of interest deduction – actual or as per books
- TDS responsibility – actual or as per books
- Section 94B/ section 14A – actual or as per books
- Can issue expense claim in totality ?

MAT

- Yearly interest provision deductible under MAT
- Not a provision for unascertained liability

Ind AS 103 – Business Combination

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

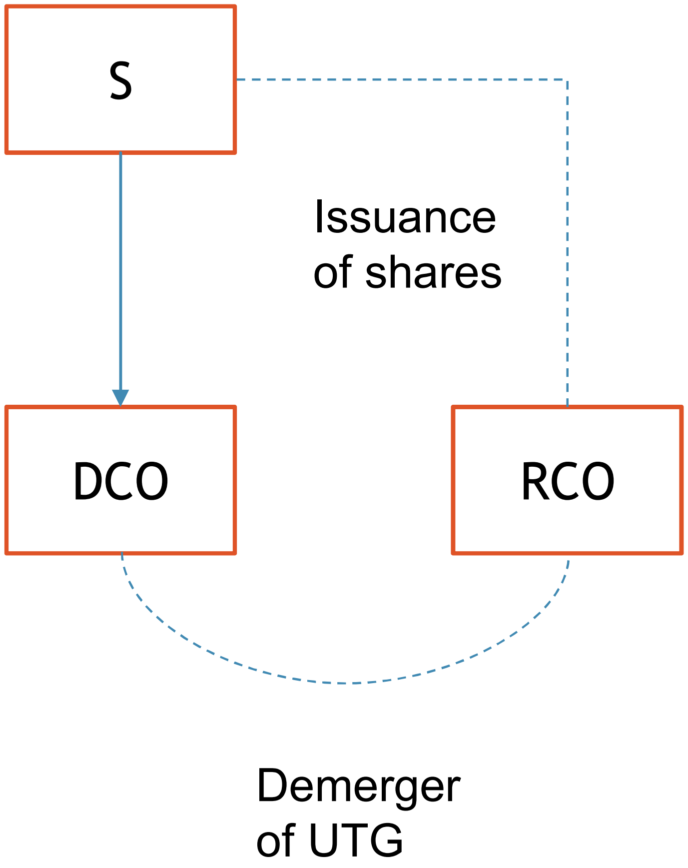
Acquisition date - amalgamation

Ind AS	Tax
➢ A Ltd mergers with B Ltd ➢ Appointed date : 1 April 2018 ➢ Court order : 20 August 2018 ➢ Registration with ROC : 30 September 2018 ➢ B Ltd will record transaction on 30 September 2018 i.e date on which it obtains control ➢ Goodwill to be calculated basis acquisition date	➢ Amalgamation to be effective from date mentioned in scheme i.e appointed date [Marshal Sons & Co (223 ITR 809)] ➢ Cos Act specifically auditors certificate for accounting of amalgamation which has to be in accordance with Ind AS ➢ Essential that scheme details tax aspect specifically to avoid litigation

Group company amalgamation

Ind AS	Tax
➢ A Ltd mergers with B Ltd. Both A Ltd and B Ltd are held by common shareholder ➢ Since transaction is amongst common group of shareholder B Ltd records value of asset and liability at carrying value ➢ No goodwill is recorded ➢ Difference in consideration and net asset is recorded as reserve	➢ Goodwill arising as a result of amalgamation is depreciable [Smifs Securities Ltd 348 ITR 302] ➢ In Smifs Securities goodwill was recorded on account of excess consideration over net asset ➢ B Ltd unable to claim depreciation in absence of recording of goodwill

Demerger

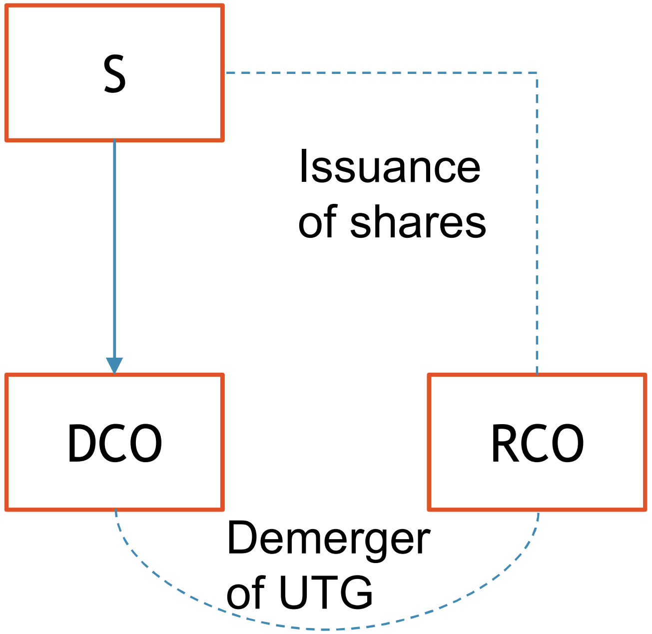


- DCO and RCO are unrelated parties
- DCO demerges its undertaking (UTG) to RCO. RCO issues shares to shareholder of DCO
- Valuation parameter

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

Demerged company

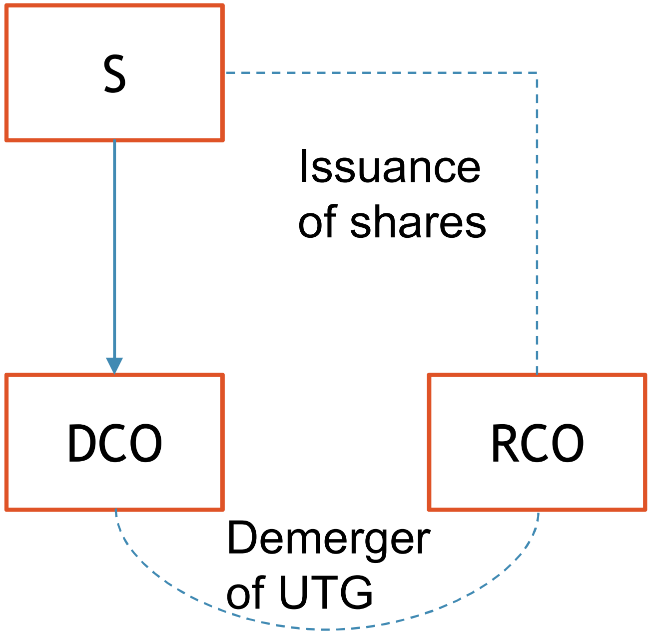
Normal tax

- 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

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)

Thank You

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