Impact Analysis

IND AS & ICDS

Accounting Policies, Changes in Accounting Estimates, Errors, Events after Reporting Period, Inventories, Financial Instruments

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Accounting Policies & Changes to them

Pre Ind AS	Ind AS
Significant accounting policies to be disclosed	Similar Explicit, unreserved statement of compliance in all material aspects of applicable Ind AS. Deviation permitted in extremely rare circumstances Extensive information of Entity
Changes to be made prospectively unless there is a transition impact. Exception - depreciation To be made if required by statute, accounting standard or for more appropriate presentation Impact to be given, including statement that there could be a material impact in future	Changes to be made retrospectively Opening balance of each component of equity to be adjusted for the earliest period presented and each period thereafter. Implies that all amounts presented are on same bases

Accounting Policies & Changes to them

- **Change from AS to Ind AS**
  - SDB Cisco (India) Ltd. v. ACIT (18 taxmann.com 1) (Mad.)

- **Change in method of accounting permissible only if it is *bonafide* and consistently followed**
  - CIT v. Bank of Rajasthan (2010) (326 ITR 526) (Bom.)
  - CIT v. Annamalai Finance Ltd. (2009) (319 ITR 196) (Mad.)
  - PCIT v. A2Z Maintenance & Engineering Services Ltd (2017) (79 taxmann.com 7) (Del HC)
  - CIT v. Andhra Pradesh Industrial Infrastructure Corpn (1999) (236 ITR 648) (Andhra Pradesh)
  - CIT v. Elgi Equipment Ltd. (2003) (128 Taxman 785) (Mad.)
  - Bajaj Auto Ltd. v. CIT (2016) (389 ITR 259) (Bom.)

Accounting Policies & Changes to them

- **Change to be retrospective - Impact on MAT**
  - Jodhpur Vidyut Vitran Nigam Ltd. (2010) (186 Taxman 32) (AAR)
  - Sansera Engg. (P.) Ltd (2017) (80 taxmann.com 248) (Kar)
  - ACIT v. Uflex Ltd (2012) (24 taxmann.com 228) (Delhi Trib.)

- **Change to be retrospective – Impact on normal tax**
  - CIT v. Nagri Mills Co. Ltd. (1958) (33 ITR 681) (Bom.)

- **Strategy for tax returns**
  - Revise Return for the earlier years; and/or
  - Offer/claim in the current year

Accounting Policies & Changes to them

- **Deviation from Ind AS is permitted in extremely rare circumstances – Para 19 of Ind AS 1 – "Presentation of Financial Statements"**

  "In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure."

- **Objectives of Financial Statements – Framework for the Preparation and Presentation of Financial Statements in accordance with Ind AS ("Framework")**
  - To provide information about financial position, performance and cash flows
  - To provide information that users may need to make economic decisions

Accounting Policies & Changes to them

Ind AS	ICDS
Selection of the Accounting Policies	
• Para 29 of Ind AS 1 recognises the concept of materiality as a general feature for presenting financial statements • Concept of prudence is not discussed in Ind AS, however, the Framework discusses the same under the head "Reliability" – Qualitative Characteristics of Financial Statements	The concept of prudence and materiality are not recognised in ICDS. ICDS provides that "marked to market loss" or an "expected loss" shall not be recognised unless the recognition of such loss is in accordance with the provisions of any other ICDS
Fundamental Accounting Assumptions	
• Ind AS 1 recognises concepts of going concern and accrual as general features of financial statements • Paras 22 and 23 of the Framework recognises accrual and going concern as the underlying assumptions	Going concern, consistency and accrual

Accounting Policies & Changes to them

- **"Accrual basis" - Para 22 of the Framework**

  "In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate….."

- **"Accrual" – As interpreted by Supreme Court for tax matters**
  - E.D. Sassoon & Co. Ltd. v. CIT (26 ITR 27) (SC)

    "….If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later on its being ascertained. The basic conception is that he must have acquired a right to receive the income. There must be a debt owed to him by somebody. There must be as is otherwise expressed debitum in praesenti, solvendum in futuro. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him."

Changes in Accounting Estimates

Pre Ind AS	Ind AS
No requirements as in Ind AS	Disclosures of key sources of estimation uncertainty at end of the period that have a significant risk of material adjustments in next financial year Nature of uncertainty and carrying amount of such assets and liabilities

Errors

Pre Ind AS	Ind AS
• Presented as a prior period item and included in determination of profit or loss • Separate disclosure required so that impact on current year profit or loss can be seen	• Material prior period errors are rectified retrospectively • Comparative amounts to be restated • If error was from a period prior to earliest period presented, opening financial position & component of equity to be restated

Events after Reporting Period

Pre Ind AS	Ind AS
• Until last year liability towards dividend needed to be recognised	• Dividend liability not to be recognised • Disclosure to be made

Statement of Other Comprehensive Income

Pre Ind AS	Post Ind AS

• No such component of financial statements	• New component of financial statements
	
	SOCI includes:-
	• <u>Items that will not be reclassified to profit or loss</u>
	    • Actuarial gains and losses of defined benefit plans for employees
	    • Revaluation of PPE
	
	• <u>Items that will be reclassified to profit or loss</u>
	    • Exchange differences on translation of foreign operations
	    • Net gains / losses of hedges of net investments in foreign operations
	    • FV Gains / Losses on Cash Flow Hedges
	    • FV Gains / Losses on FVOCI financial instruments

MAT Implications…

On transition-
Sub-section (2C)

Book profit to be increased/decreased every year for 5 five years by 1/5th of the transition amount

Transition amount = Aggregate of adjustments made in Other Equity excluding capital reserve/securities premium on the convergence date

6 exclusions for determining the transition amount – Explanation to section 115JB(2C)(iii)

Subsequent years-
Sub-sections (2A) and (2B)

Addition to profits	Deduction from profits
Amounts credited to OCI for items not to be re-classified to profit or loss	Amounts debited to OCI for items not to be re-classified to profit or loss
Amounts debited to P/L on distribution of non-cash assets to SH on demerger	Amounts credited to P/L on distribution of non-cash assets to SH on demerger

2 exclusions from 'items not to be re-classified to profit or loss' for addition/deduction from book profits – First proviso to section 115JB(2A)

…MAT Implications…

- **Exclusions from transition amount adjusted on transition date** - **<u>On transition</u>**
  - Amount adjusted in OCI and subsequently re-classified to profit or loss
  - Revaluation surplus for assets
  - Gains/losses from investments in equity instruments designated at fair value through OCI
  - Adjustments relating to PPE and intangible assets recorded at fair value as deemed cost
  - Adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost
  - Adjustments relating to cumulative translation differences of a foreign operation

…MAT Implications

- **Exclusions from “Items not to be re-classified to profit or loss” for addition/deduction from book profits – Post transition**
  - Revaluation surplus for assets in accordance with Ind AS 16 and Ind AS 38; and
  - Gains/losses from investments in equity instruments designated at FVOCI as per Ind AS 109

- The above amounts to be adjusted in book profits when the related asset/investment/foreign operation is sold/disposed/otherwise transferred

Financial Instruments…

Pre Ind AS	Ind AS
No specific AS	Family of standards – Ind AS 32, 107 and 109
Legal form drives the presentation – compound financial instruments	Substance over form requires splitting a compound financial instrument into debt and equity
Initial recognition at cost	Initial recognition at FV – requires recognition of another element of asset or liability. Classic example often quoted is below market rate loans to employees

…Financial Instruments…

Pre Ind AS	Ind AS
Other than for banks and insurance companies, no requirement of classification of investments – HTM / AFS / HFT etc	Subsequent measurement is based on classification – Amortised Cost, FVOCI and FVTPL
Income recognised on contractual terms	Income recognised on contractual terms or on EIR basis, basis the classification applied for subsequent measurement
Gains & losses recognised in PL	Gains & losses recognition based on classification (PL or OCI) Further rules on recycling from OCI to PL

…Financial Instruments…

Pre Ind AS	Ind AS
Derecognition applied based on legal form Concept of "true sale" applied in banks	Derecognition criteria based on assessments of retention or relinquishment of risk, rewards and control
Derivatives – permitted to follow the GN else recognise losses on prudence	Derivatives – permitted to apply hedge accounting rules, based on risk management strategies of the entity If not, all derivatives are classified as FVTPL
Disclosures are limited Regulated entities have disclosures specified	Extensive disclosures on how the FIs are measured, managed and the attendant risk involved in holding them and the bench marking against risk management policies of the entity

Issues – Interest free deposits…

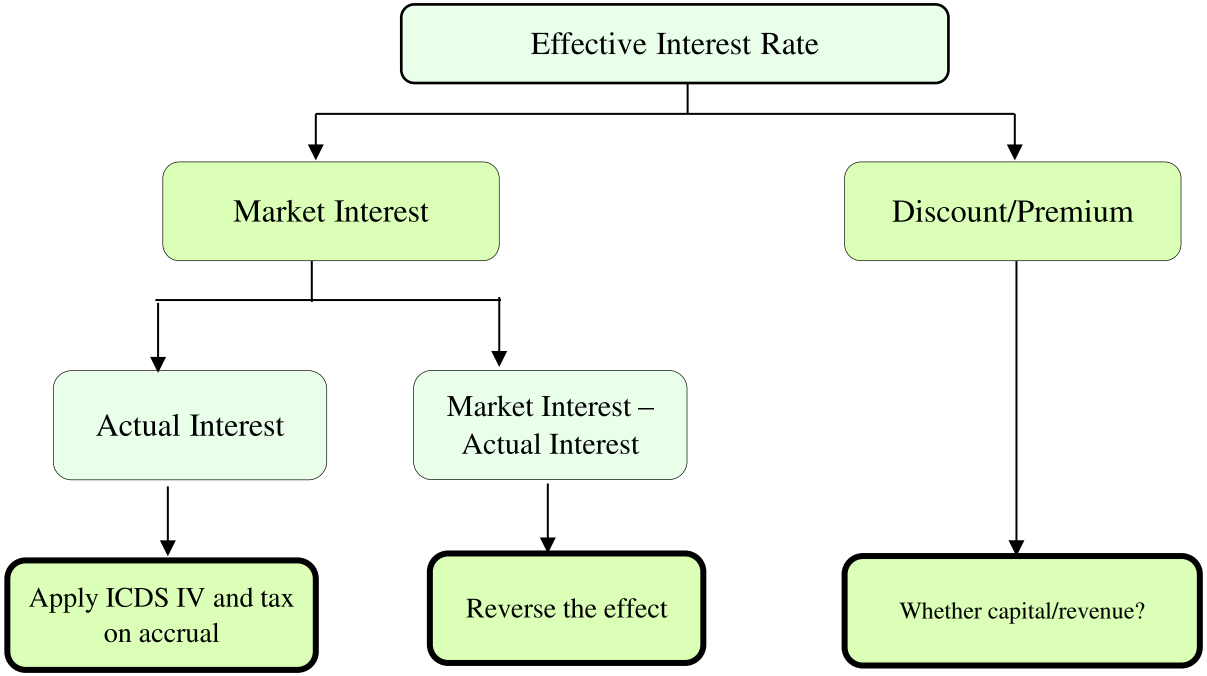
- **Ind AS**
  - Valuing interest free deposits at amortised cost (i.e., present value) and corresponding debit to opening balance of retained earnings/ profit and loss
  - Every year, notional interest income would be credited to profit and loss account

- **ICDS**
  - Interest shall accrue on the time basis determined by the amount outstanding and the rate applicable
  - Is the notional interest recognised in profit and loss account under Ind AS = "Interest" u/s. 2(28A)?

- **MAT**
  - Since credit is to profit or loss, it is liable to MAT

…Issues – Long-term Bonds…

- Under Ind AS, assume long-term bonds (investments) are recognised at amortised cost using effective interest rate
  - Now, effective interest rate is arrived at after considering actual interest and discount/premium
  - Accordingly, for ICDS, following adjustments to be made:



…Issues – Equity Investments (OCI)…

- **Ind AS**
  - Record investments at fair value and recognise changes in OCI (not to be reclassified to profit or loss)

- **Normal Tax**
  - U/s. 45, capital gains to arise only at the time of transfer
  - Reverse any adjustment in the Statement of Profit and Loss on account of fair valuation

- **MAT**
  - Exception provided u/s. 115JB – MAT will arise only at the time of sale / transfer of such instruments

…Issues – Forward Contracts on Firm Commitments…

- **Ind AS**
  - Entity may adopt fair value hedge (adjustments in profit or loss) or cash flow hedge (adjustments in OCI to be reclassified to profit or loss)
  - Recognise all gains and losses
- **ICDS**
  - ICDS VI not to apply; hence, ICDS 1 will apply
  - Notional gains and losses not to be offered to tax or deducted
- **MAT**
  - Fair value hedge – No adjustment in book profits - Liable to MAT
  - Cash flow hedge – No adjustment in book profits – Liable to MAT as and when amount is reclassified from OCI to profit or loss

…Issues – Guarantee Commission…

- Assume Hold Co. has given guarantee to the bank on behalf of Sub Co. with respect to loan availed by it without charging any guarantee commission for 5 years (Assume fair value of similar guarantee commission is Rs. 15 crore)

- Ind AS – Entries to be passed as under:

In the books of Hold Co.		**In the books of Sub Co.**	
Initial Recognition			
Investment in Sub Co.	15	Prepaid expense	15
To Financial Guarantee Liability	15	To Equity	15
Subsequent recognition (assumed straight-line basis)			
Financial Guarantee Liability	3	Guarantee Expense	3
To Guarantee Income	3	To Prepaid expense	3

Can Para 19 of Ind AS 1 be invoked?

…Issues – Guarantee Commission…

- **Normal tax / ICDS**
  - ED Sassoon & Co. (1954) (26 ITR 27) (SC) – *Income accrues when a right vests to receive it and accrues to a person who has the right on the date when income arises*
    - In guarantee commission, neither does Hold Co. has a right to claim guarantee commission nor the Sub Co. has an obligation to pay it - No accrual, hence, there is no income chargeable to tax
  - Indian Molasses Co. (P.) Ltd (1959) (37 ITR 66) (SC) – *Expenditure" is thus what is "paid out or away" and is something which is gone irretrievably*
    - Sub Co. does not incur any expenditure and hence, amount of guarantee commission debited to be added back while computing tax
  - CIT v. A. Raman & Co. (1968) 67 ITR 11 (SC) - *The law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him*

…Issues – Guarantee Commission

- **MAT**
  - Tax on ‘book profits’ as per profit or loss
  - Apollo Tyres Ltd. (255 ITR 273) (SC) - No adjustment may be made to book profits
    - Hence, MAT is liable to be paid on such guarantee commission

…Issues – Optionally Convertible Preference Shares…

- Assume Co. A issued optionally convertible preference shares of face value Rs. 1000. On maturity, the holder has an option either to receive cash payment of Rs. 100 or 1000 equity shares
- Under AS, Rs. 100 was shown as part of share capital
- Under Ind AS, depending on the terms, the instrument is classified as compound financial instrument whereby Rs. 80 pertains to financial liability component
- Accordingly, on the date of transition, Co. A to pass following entries

Share Capital	100	
To Other Equity (Deemed Capital Contribution)		20
To Financial Liability		80

…Issues – Optionally Convertible Preference Shares…

- On subsequent measurement, Co. A to measure financial liability at amortised cost by using effective interest rate method whereby Co. A would pass the following journal entries:

Interest expense (at EIR)	9	
To Financial Liability		9
Financial Liability	5	
To Cash		5

- Therefore, effectively, the financial liability increase by Rs. 4 such that at the end of the tenure, the liability would be reflected at Rs. 100

…Issues – Optionally Convertible Preference Shares…

- **If holder elects to receive shares**
  - Co. A to derecognize the liability (Rs. 100) and recognise increase in equity of same amount – No gain/loss

Financial Liability	100	
To Equity		100

- **If holder elects to receive cash**
  - Co. A to derecognize the liability Rs. 100 and recognizes a corresponding decrease in cash

Financial Liability	100	
To Cash		100

…Issues – Optionally Convertible Preference Shares

- **Normal tax / ICDS**
  - No impact on date of transition
  - Even on subsequent measurement, there will be no impact on account of effective interest rate
  - Actual interest on preference shares – Allowable under the Income-tax Act?

- **MAT**
  - Since Rs. 20 is adjusted in other equity on convergence date, it will be liable to MAT for 5 years
  - On subsequent measurement, adjustment made to financial liability on account of effective interest rate will be recognised in profit or loss and thereby, liable to MAT

…Issues – Optionally Convertible Preference Shares

- **MAT**
  - However, Tribunals have held that capital receipt should not be included while computing book profits since it is not an 'income' in the first place:
    - Sicpa India (P.) Ltd. v. DCIT (2017) (80 taxmann.com 87) (Kol)
    - M/s. JSW Steel Limited v. ACIT (ITA No. 923/Bang/2009)
    - Shivalik Venture (P.) Ltd. v. DCIT (2015) (60 taxmann.com 314) (Mum)
    - DCIT v. M/s. Binani Industries Ltd. (2016) (3) TMI 873 (Kol)

Inventories…

Pre Ind AS	Ind AS
No scope exemption for inventories held by commodity traders	Measurement requirements do not apply to inventories held by commodity traders and brokers who measure it a FV less cost to sell
No specific guidance on reversal of write downs. AS 5 may permit such reversals with appropriate disclosure	Reversals of write down permitted if circumstances that caused / required the write down no longer exist or there is an increase in NRV Reversal not to exceed original write down

...Inventories...

Ind AS	ICDS
Opening Inventory	
Does not specifically mention about valuation of opening inventory	The value of the inventory of a business as on the beginning of a previous year shall be the same as the value of inventory at the end of the immediately preceding previous year. If the business has commenced during the previous year, it shall be cost of inventory available on the day of commencement of business
Change in Method of Valuation	
Ind AS 2 read with Ind AS 8 provides that method of valuation of inventories may be changed only if it is required by Ind AS or results in financial statements providing reliable and more relevant information	The method of valuation of inventory once adopted by a person in any previous year shall not be changed without a reasonable cause

...Inventories...

Ind AS	ICDS
Valuation of Inventory in case of certain dissolutions	
No specific mention of valuation of inventory in case of dissolution in AS	Provides that inventory on the date of dissolution of partnership firm or AOP or BOI shall be valued at the net realisable value
Exclusions	
Para 8 of Ind AS 16 - Spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10	Machinery spares which can be used only in connection with a tangible fixed asset and their use is expected to be irregular ICDS V – Para 4 – Standby equipment and servicing equipment are to be capitalised

…Inventories…

Ind AS	ICDS
Inventory of service provider	
• Measure inventories at costs of production • Cost consist primarily of labour and other costs of personnel directly engaged in providing service including supervisory personnel and attributable overheads	Cost of services ~~in the case of a service provider~~ to consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads
Inventory held by commodity stock broker	
Not to apply to measurement of such inventories, who measure their inventories at fair value less costs to sell	No specific guidance

...Inventories

Ind AS	ICDS
Reversal of write-down	
• Reversal of any write-down, arising from an increase in net realisable value – Recognise as reduction in the amount of inventories recognised as an expense in which reversal occurs	No specific guidance
Inventories purchased on deferred settlement basis	
If entity purchases inventories on deferred settlement terms, the difference between purchase price for normal credit terms and amount paid, is recognised as interest expense	No specific guidance

Thank you