Ind AS – M&A tax perspectives

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Agenda

Ind AS 103 – Business Combination - Overview

Ind AS 103 – Case Studies

Ind AS 32, 107 and 109 – Financial instruments – Overview

Ind AS 32, 107 and 109 – Case Studies

Ind AS MAT Interplay

Ind AS 103 – Business Combination Overview

Ind AS 103 - Business Combination - Objective

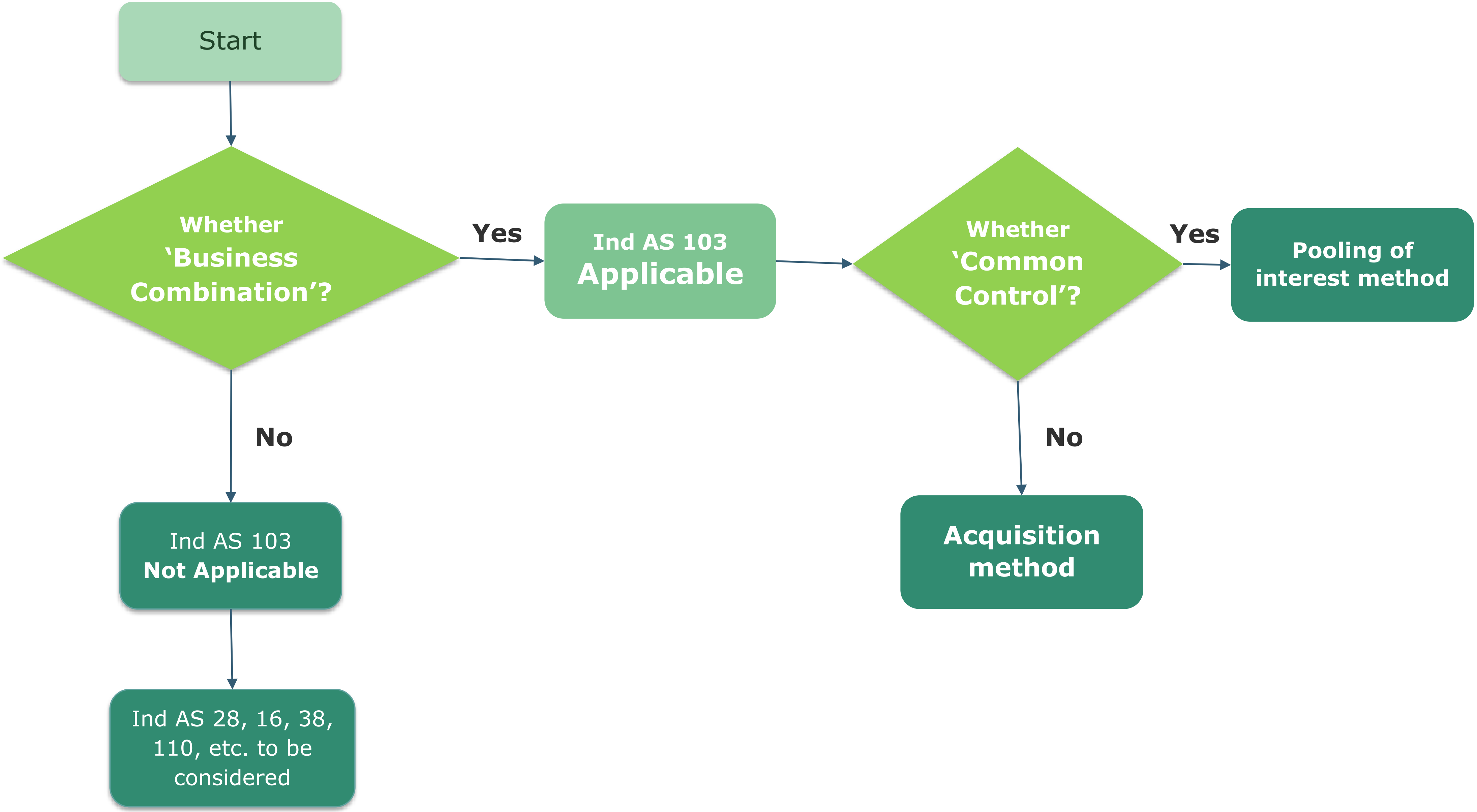
Improve the ***relevance***, ***reliability*** and ***comparability*** of information given by Company in its financial statements of Business Combinations, via prescribing '***principles and requirements'*** for the **"ACQUIRER"**

Recognises and measures identifiable assets and liabilities assumed;

Recognises and measures goodwill or bargain purchase; and

Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination

Ind AS 103 - Business Combination - Scope



Ind AS 103 - Business Combination – Key terms

Business Combination	Business	Acquisition Date
Control	Acquisition Method/Pooling of Interest Method	Tax Neutrality
	Goodwill/Bargain Purchase	

Ind AS 103 - Business Combination – Key terms

Business and Business combination

Business Combination

A transaction or other event in which an acquirer obtains control of one or more businesses

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participant.

Inputs + Process + Provide or ability to provide output = Business

If transaction ***does not*** constitute a business combination, the same is accounted as an ***'asset acquisition'*** i.e. purchase consideration is allocated to individual assets and liabilities

Ind AS 103 - Business Combination – Key Terms

Acquisition Date

Acquisition Date (Ind AS)

- Acquisition date = Date on which the acquirer obtains control of the acquiree
- Generally acquisition date should be the 'closing date' on which acquirer legally:
  - Transfers the consideration
  - Acquires the assets
  - Assumes the liabilities
- However, acquisition date may be earlier or later than the closing date based on terms of agreement

Appointed Date (Tax)

- Appointed date as per scheme considered for tax purposes
- <u>Marshall Sons & Co. (India) Ltd. v. ITO (SC)</u>
  - Amalgamation to take effect from the date mentioned in the Scheme as the transfer date i.e. Appointed date
- <u>Dalmia Cement Ltd. v. CIT (SC)</u>
  - Date of transfer is the date mentioned in the agreement, even though the actual transfer happened on a later date

- As per Section 232(6) of the Companies Act, 2013, scheme to clearly provide an appointed date from which it will be effective
- **August 2019 Circular clarified**
  - Appointed date as per scheme to be considered as Acquisition date
  - Appointed Date to be a specific calendar date or an event based date *(event to be expressly mentioned in Scheme)*
  - Appointed Date can be retrospective date; but only upto 1 year from the date of filing the application; incase the period exceeds 1 year, then the justification to be incorporated in the Scheme

Ind AS 103 - Business Combination – Key Terms

Control

Control

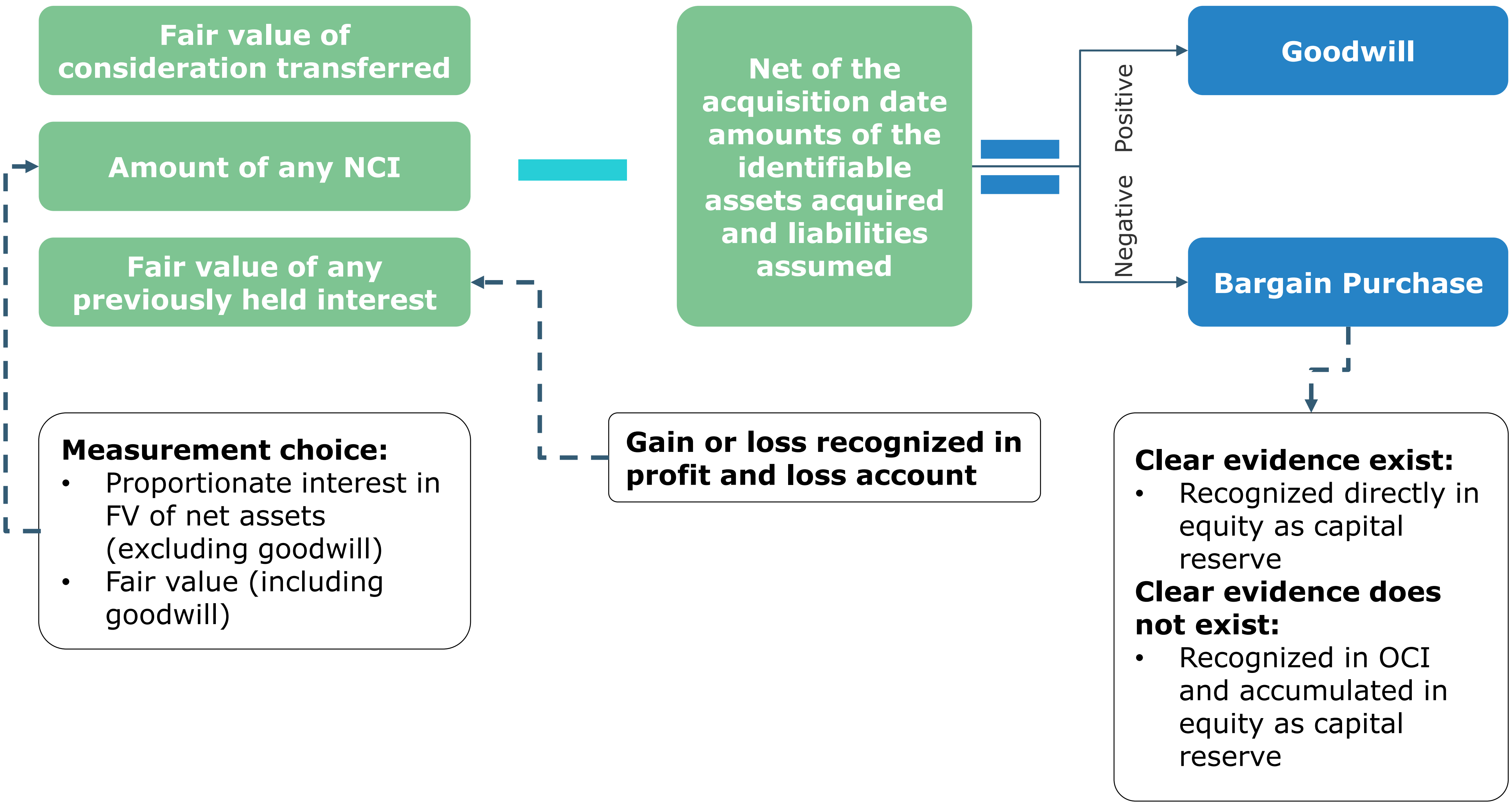
- An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee

Common control transaction

- A business combination involving common control transactions is a transaction in which
  - The combining entities or businesses are ultimately controlled by the same party (or parties) both before and after the transaction, and
  - Control is not transitory
- The extent of non controlling interests in each of the combining entities before and after the business combination is not relevant

Ind AS 103 - Business Combination – Key Terms

Goodwill / Bargain Purchase



Ind AS 103 – Business Combination Case studies

Case Study 1 – Merger + Non common control

Mechanics

- Co. A and Co. B are two independent entities i.e. not related or under common control
- Co. B merges into Co. A through a tribunal approved scheme of amalgamation
- In consideration, Co. A issues its equity shares to the shareholders of Co. B

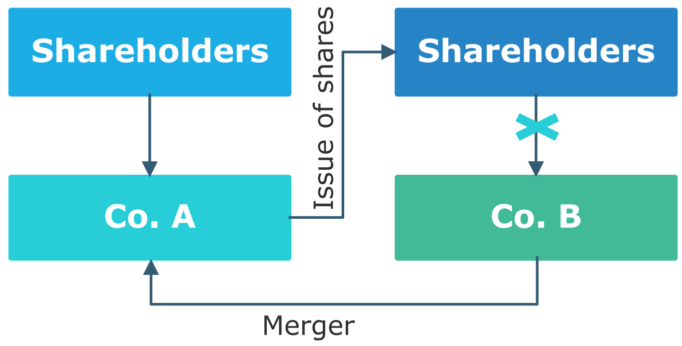
Accounting in books of Co. A (Acquirer)

- **'Acquisition Method'** of accounting to be followed as per Ind-AS 103
- All the assets and liabilities of Co. B to be recognized at their **fair values**
- Equity share capital issued to the shareholders of Co. B to be credited to share capital account
- Difference between net fair value of assets and liabilities acquired and shares issued to be debited to **'Goodwill'**
- Goodwill will be tested for impairment in future and will not be allowed to be amortized over a period of time (as per Ind AS 36)
- If the difference is negative, then the same should be recognized as **'Bargain Purchase'** immediately in OCI and accumulated in equity as capital reserve

Accounting in books of shareholders of Co. B

- Shares of Co. B held by shareholders shall be extinguished and in exchange, shares of Co. A shall be received
- Investment in shares of Co. A shall appear at the same carrying value at which shares of Co. B were appearing in the books of shareholders or as per Ind-AS 109* i.e. FVTPL (option to irrevocably designate shares at FVTOCI at inception)
- Subsequent measurement as on every year end shall be as per Ind-AS 109* i.e. FVTPL

**Ind-AS 27 gives entities an option to measure their investment in subsidiaries, joint venture or associates either at cost or in accordance with Ind-AS 109*



TAX aspect - Whether 'Fair Value' of assets recorded in books of Co A available as tax WDV and thus Depn?

TAX aspect – For shareholder of Co. B ; MAT implications on FVTPL ?

Case Study 2 – Merger + Common control

Mechanics

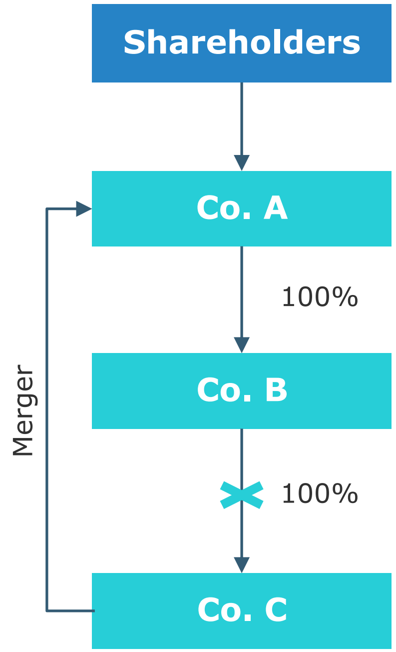
- Co. B is wholly owned subsidiary of Co. A.
- Co. C is wholly owned subsidiary of Co. B and step down subsidiary of Co. A
- Through a tribunal approved scheme of amalgamation, Co. C merges into Co. A
- In consideration, no shares are issued to Co. B since Co. B is subsidiary of Co. A

Accounting in the books of Co. A (Acquirer)

- **'Pooling of Interest'** method of accounting to be followed as per Ind-AS 103 since Co. C and Co. A are under common control
- Assets and liabilities of Co. C to be recorded at their respective '**Book Values'**. Since no consideration is being issued, difference of assets and liabilities to be adjusted in '**Capital Reserve'**
- Carrying value of shares of Co. B may not represent its correct recoverable value since value of shares of Co. C held by Co. B is written off. Hence impairment in value of shares of Co. B may be provided for in profit & loss account (As per Ind AS 36)
- Subsequent measurement as on every year end shall be as per Ind-AS 109* i.e. FVTPL

Accounting in the books of Co. B

- Shares held by Co. B in Co. C will be extinguished since Co. C will not remain in existence. Further, no consideration is being received by Co. B against such extinguishment
- Carrying value of shares of Co. C in the books of Co. B shall be written off in its profit & loss account



Can Goodwill arise / recorded in case of a common control business combination?

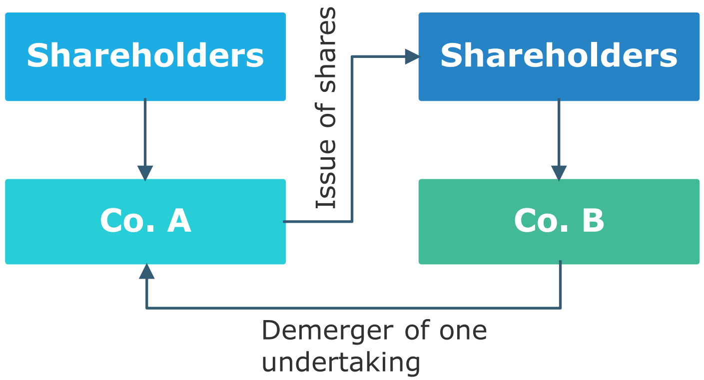
TAX aspect – Whether impairment / write off of shares will result in reduction of book profit under MAT?

**Ind-AS 27 gives entities an option to measure their investment in subsidiaries, joint venture or associates either at cost or in accordance with Ind-AS 109*

Case study 3 – Demerger + Non common control

Mechanics

- Co. A and Co. B are two independent entities i.e. not related or under common control
- Co. B demerges one of its business undertaking into Co. A through a tribunal approved scheme of arrangement
- In consideration, Co. A issues its equity shares to the shareholders of Co. B



Accounting in books of Co. A (Acquirer)

- **'Acquisition Method'** of accounting to be followed as Ind-AS 103

TAX aspect – For Co. A –
1. **Tax Neutrality ?**
2. **MAT implication on fair valuation of assets?**

Accounting in books of Co. B (Demerged company)

- **'Appendix A of Ind-AS 10'** – Distribution of non-cash assets to owners to be followed
- Assets and liabilities transferred pursuant to demerger shall be revalued to appear at their fair value. For e.g. Book value of net assets of transferred undertaking is Rs. 100 and fair value is Rs. 500. Then value of net assets to be revalued at Rs. 500

TAX aspect – For Co. B - MAT implication on fair valuation of assets through P&L?

1. Net Assets ….. Dr. 400
 To P&L A/c 400
(Being Difference between fair value of assets and liabilities and their carrying value credited to P&L A/c)

2. P&L ….. Dr. 500
 To Divd payable A/c 500
(Being non-cash distribution of assets and liabilities to shareholders treated as dividend payable)

3. Divd payable ….. Dr. 500
 To Net Assets A/c 500
(Being non-cash distribution of assets and liabilities to shareholders)

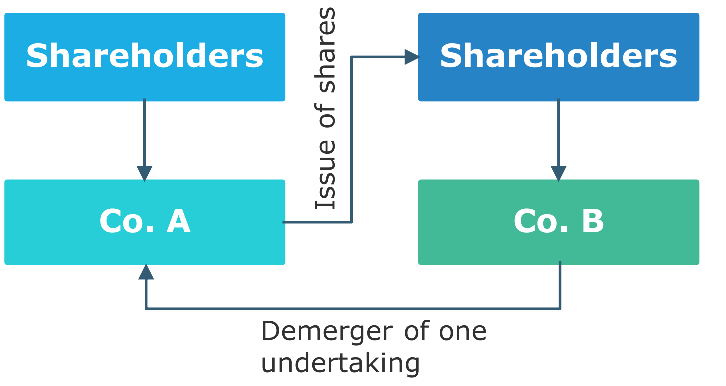
TAX aspect – For Co. B - DDT implication on non-cash distribution to shareholders?

Case study 3 – Demerger + Non common control

Accounting in the books of shareholders of Co. B

- Shareholders of Co. B continue to hold shares of Co. B. Further, shares of Co. A shall be received in consideration of demerger
- Investment in shares of Co. A received pursuant to demerger shall be recorded as –
  - Nil (no amount shall be recorded); though number of shares received pursuant to demerger shall be reflected in balance sheet; or
  - as per Ind-AS 109* i.e. FVTPL
- Carrying value of shares of Co. B may not be recoverable due to demerger and accordingly impairment loss need to be provided for in profit & loss account to reflect the shares of Co. B at their correct recoverable value
- Subsequent measurement as on every year end shall be as per Ind-AS 109* i.e. FVTPL

**Ind-AS 27 gives entities an option to measure their investment in subsidiaries, joint venture or associates either at cost or in accordance with Ind-AS 109*

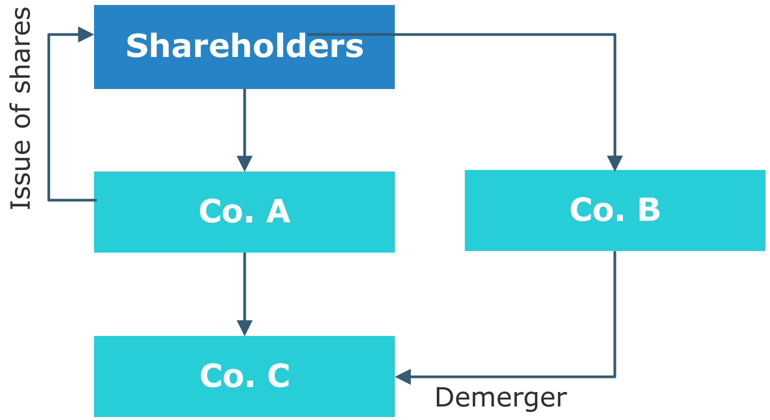


TAX aspect – Whether impairment of shares will result in reduction of book profit under MAT?

Case study 4 – Demerger + Common control

Mechanics

- Co. A and Co. B are related parties and under common control
- Co. C is wholly owned subsidiary of Co. A
- Co. B demerges one of its business undertaking into Co. C through a tribunal approved scheme of arrangement
- In consideration, Co. A instead of Co. C issues its equity shares to the shareholders of Co. B



Accounting in books of Co. C (Acquirer)

- **'Pooling of Interest'** method of accounting as per Ind-AS 103 to be followed
- Assets and liabilities of undertaking transferred by Co. B shall be recorded at their respective '**Book Values'**
- Difference between the value of assets and liabilities shall be credited to capital reserve.

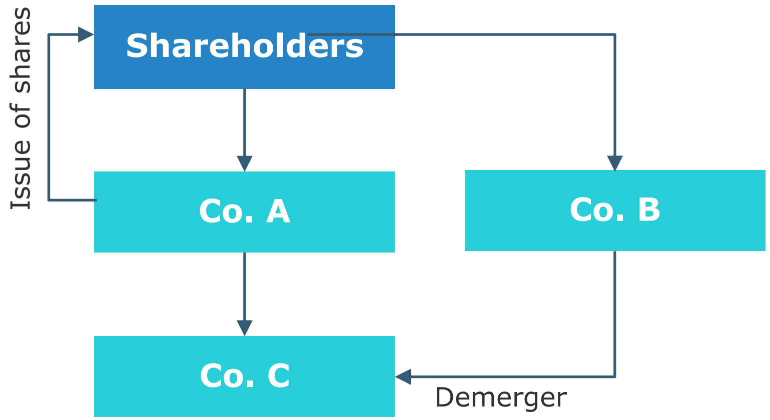
Can Goodwill arise / recorded in case of a common control business combination?

Accounting in books of Co. B (demerged company)

- Assets and liabilities of the transferred undertaking shall be transferred at their respective '**Book Values'**
- Difference between the value of assets and liabilities transferred shall be adjusted against reserves of Co. B

Whether Appendix A of Ind AS 10 applicable?

Case study 4 – Demerger + Common control



Accounting in the books of shareholders of Co. B

- Shareholders of Co. B continue to hold shares of Co. B. Further, shares of Co. A shall be received in consideration of demerger
- Investment in shares of Co. A received pursuant to demerger shall be recorded as –
  - Nil (no amount shall be recorded); though number of shares received pursuant to demerger shall be reflected in balance sheet; or
  - as per Ind-AS 109* i.e. FVTPL
- Carrying value of shares of Co. B may not be recoverable due to demerger and accordingly impairment loss need to be provided for in profit & loss account to reflect the shares of Co. B at their correct recoverable value
- Subsequent measurement as on every year end shall be as per Ind-AS 109* i.e. FVTPL

Accounting in the books of Co. A

- Face value of equity share capital issued by Co. A pursuant to demerger shall be credited to equity share capital account;
- Amount equivalent to face value of fresh equity shares issued will be debited to the investments in shares of Co. C account
- This investment to be either classified as per option granted under Ind-AS 27 i.e. cost or as per Ind-AS 109 i.e. FVTPL

**Ind-AS 27 gives entities an option to measure their investment in subsidiaries, joint venture or associates either at cost or in accordance with Ind-AS 109*

Case study 5 - Merger + No business

Mechanics

- Co. A and Co. B are two entities under common control
- Co. B do not have any business operations but owns certain assets lets say intangibles or some other standalone asset
- Co. B merges into Co. A through a tribunal approved scheme of amalgamation
- In consideration, Co. A issues its equity shares to the shareholders of Co. B equivalent to fair value of assets held by Co. B

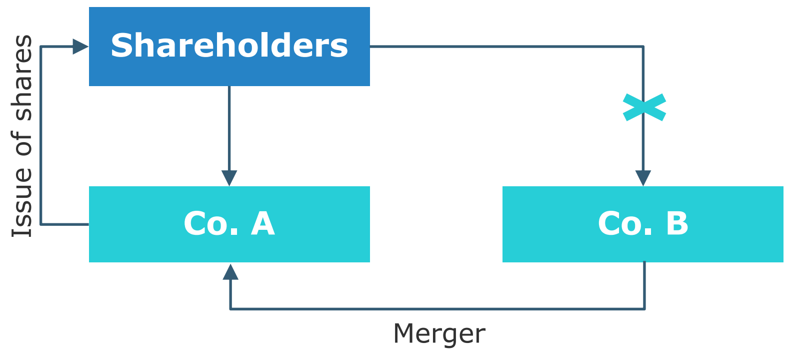
Accounting in books of Co. A (Ind AS 16, 38)

- Since there is no business in Co. B, **'Ind-AS 103 should not apply'**
- This should be accounted as asset or group of asset acquisition
- Fair value of consideration discharged to acquire assets should be **'allocated'** based on their respective fair values
- **'No goodwill or capital reserve'** arises in this case

Accounting in books of shareholders of Co. B

- Shares of Co. B held by shareholders shall be extinguished and in exchange, shares of Co. A shall be received
- Investment in shares of Co. A shall appear at the same carrying value at which shares of Co. B were appearing in the books of shareholders or as per Ind-AS 109* FVTPL (option to irrevocably designate shares at FVTOCI at inception)
- Subsequent measurement as on every year end shall be as per Ind-AS 109* FVTPL

**Ind-AS 27 gives entities an option to measure their investment in subsidiaries, joint venture or associates either at cost or in accordance with Ind-AS 109*



Tax Neutrality under ITA?

Will the conclusion differ in case Co. A and Co. B are independent third parties and not under common control?

Fair value of assets = 1000
Fair value of share = 1200/800?

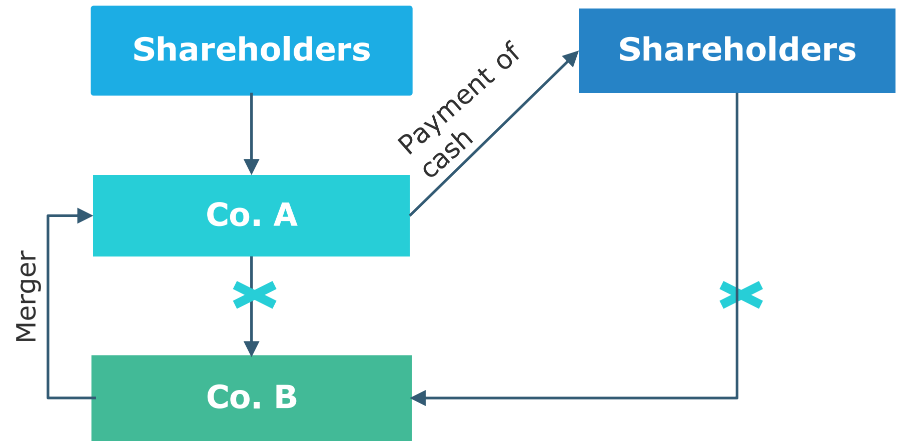
Case study 6 - Acquisition followed by merger

Mechanics

- Co. A and Co. B are two independent entities i.e. not related or under common control
- Co. A acquired entire share capital of Co. B from its shareholders by paying cash. Co. B becomes wholly owned subsidiary of Co. A post acquisition
- Co. B merges into Co. A through a tribunal approved scheme of amalgamation
- Shares of Co. B held by Co. A are cancelled pursuant to merger

Accounting in books of Co. A (Acquirer)

- Fair value accounting as per '**Acquisition Method'** to be followed under Ind-AS 103 since '**control is transitory'** in this case and hence will not be considered as business combination under common control



Case study 7 - Slump sale/exchange + Non common control

Mechanics

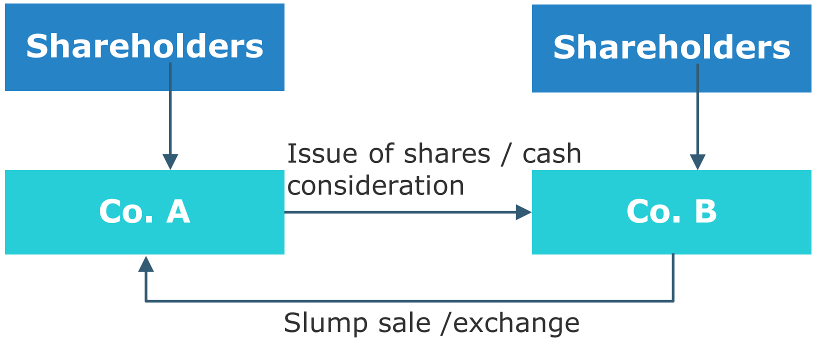
- Co. A and Co. B are independent parties i.e. not related or under common control
- Co. B transferred one of its undertaking to Co. A through a business transfer agreement or through a court approved scheme of arrangement
- Co. A discharges consideration in cash or
- Co. A issues its equity shares to Co. B

Accounting in books of Co. A (Acquirer)

- **'Acquisition Method'** of accounting as per Ind-AS 103 to be followed

Accounting in books of Co. B

- Difference between consideration and value of assets and liabilities transferred shall be credited to '**Profit & Loss Account'**
- Equity shares received as consideration to be recorded at its fair value i.e. as per Ind-AS 109 i.e. FVTPL
- Subsequent measurement as on every year end shall be as per Ind-AS 109 i.e. FVTPL



Case study 8 - Slump sale / exchange + Common control

Mechanics

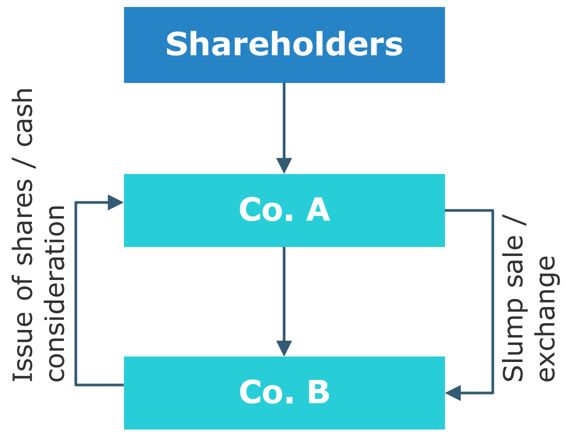
- Co. A and Co. B are under common control
- Co. B is wholly owned subsidiary of Co. A
- Co. A transfers one of its business undertaking to Co. B through a business transfer agreement or through a tribunal approved scheme of arrangement
- Co. B discharges consideration to Co. A either in cash or equity shares

Accounting in books of Co. B (Acquirer)

- **'Pooling of Interest'** method of accounting as per Ind-AS 103 to be followed
- Assets and liabilities to be recorded at their respective '**Book Values'**. Difference between value of assets and liabilities and consideration issued by Co. B shall be adjusted against capital reserve

Accounting in books of Co. A

- Assets and liabilities of transferred undertaking are transferred at their respective '**Book Values'**
- Difference between consideration received and value of assets and liabilities transferred is adjusted against capital reserve
- Equity shares of Co. B received as consideration to be recorded at cost i.e. as per Ind-AS 27 or FVTPL as per Ind-AS 109
- Subsequent measurement as on every year end shall be as per Ind-AS 109 i.e. FVTPL if this election is made



Ind AS 32, 107 and 109 – Financial instruments – Overview

Financial IND AS applicable to Financial Instruments

- **Ind AS changes the rules of accounting**

  Emphasis is on (i) substance over form; (ii) time value of money; and (ii) fair value

- **Ind AS 32** deals with the presentation and classification of **Financial Instruments**[1] by Issuer as **financial liabilities** or **equity**, and sets out the requirements regarding the offset of financial assets and financial liabilities in the balance sheet **in accordance with the substance of the contractual arrangement**[1]

- **Ind AS 107** sets out the disclosures required in respect of Financial Instruments

- **Ind AS 109** contains the guidance on the recognition, de-recognition, classification and measurement of Financial Instruments, including impairment and hedge accounting

[1] Para 11 of IND AS 32 defines Financial Instruments, Financial Liability, financial Asset and Equity; Para 15 provides for classification basis the substance of the contractual arrangement

What is a Financial Instrument

Financial Instruments*

A contract that gives rise to a financial asset of an entity and a financial liability or equity instrument of another entity

Financial liability

- A contract that will or may be settled in the entity's own equity instruments meeting certain criteria
- A contractual obligation to -
  - to deliver cash or other financial asset to another entity – ***Trade payables, borrowings***
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity – ***Derivatives with a liability portion***

Financial Asset

- Cash
- An equity instrument of another entity
- A contract that will or may be settled in the entity's own equity instruments meeting certain criteria
- A contractual right to –
  - to receive cash or another financial asset from another entity - ***Trade receivables, loan given***
  - to exchange financial assets or liabilities with another entity under conditions that are potentially favorable to the entity - ***Derivatives with an asset portion***

* Para 11 to Ind AS 32

Financial Instrument whether Equity or Liability ?

Financial Instrument

Does the instrument, in substance, represent a residual interest in the assets of the issuer after deducting all of its liability;

AND

Issuer has unconditional right to avoid the obligation to deliver cash or other asset

Yes

Equity Instrument

Fixed for fixed criteria to be tested

No

Liability

Compound Financial Instrument whether Equity or Liability?

Compound Financial Instrument

Does the instrument terms provide for fixed conversion ratio at the time of inception?

No

Liability

- Convertible into variable number of equity shares – classified as liability in entirety

Yes

Does the instrument carry interest?

Yes

Part Liability and part Equity

- **Liability component** determined basis fair value and reported as 'liability' – this includes
  - principal component of liability; and
  - present value of interest
- Residual amount allocated to **Equity**

No

Entire amount Equity

Financial Instrument with embedded derivatives are financial instruments with an Option either with an issuer or holder need to be recognized as liability or equity

Ind AS 32, 107 and 109 – Financial instruments – Case Studies

Financial Instruments – Tax Aspects

Instrument	Equity shares
Terms	Normal terms- Dividend payable at the option of the issuer (Other than associate/JV/ subsidiary or related parted or linked transaction)

From the point of view of holder/ investor:	
Classification under IndAS	Financial asset at **FVTPL** (Holder has the option of irrevocably designating equity shares at FVTOCI at inception, the same is discussed in the ensuing slide)

Stages	IndAS treatment	Tax treatment
Initial recognition	Fair value as transaction price	Not applicable as no impact on P&L
Subsequent recognition	Gain/ loss realized	Normal provisions- not deductible or not taxable as the case may be; MAT- no adjustment required (part of book profits)
At the time of disposal	Gain/ loss realized in P&L	Same as was under IGAAP
Revenue flows	Dividends- P&L	Normal provisions- Exempt income MAT provisions- Excluded from book profits

Financial Instruments – Tax Aspects

Instrument	**Equity shares**
Terms	Normal terms- Dividend payable at the option of the issuer (Other than associate/JV/ subsidiary or related parted or linked transaction)

From the point of view of holder/ investor:	
Classification under IndAS	Irrevocable designation of financial asset at **FVTOCI** at inception

Stages	**IndAS treatment**	**Tax treatment**
Initial recognition	Fair value as transaction price	Not applicable as no impact on P&L
Subsequent recognition	Gain/ loss realized in OCI	No impact on book profits
At the time of disposal	Gain/ loss realized in OCI reserve (not reclassified to P&L)	Normal provisions- taxable as Capital Gains MAT provisions- As per second proviso to section 115JB(2A), the amount carried to the OCI reserve shall be increased/ decreased from the book profits at the time of disposal
Revenue flows	Dividends- P&L	Normal provisions- Exempt income MAT provisions- Excluded from book profits

Financial Instruments – Tax Aspects

Instrument	Issue of 10%, CCPS
Terms	Compulsorily convertible into fixed number of equity shares in 3 years
From the point of view of holder/ investor:	
Classification under IndAS	Financial asset – FVTPL (Since the instrument will fail the contractual cash flow test)

Stages	IndAS treatment	Tax treatment
Initial recognition	Fair value as transaction price	Not applicable as no impact on P&L
Subsequent recognition	The contract in its entirety will be recognized at fair value at each reporting date, with the changes in fair value recognized in P&L;	Normal provisions- MTM gains/ losses should not be taxable/ allowable under normal provisions; MAT provisions- MTM to be included in the book profits as per clarification from CBDT.
At the time of conversion	No gain/ loss to arise on conversion date	Normal provisions- Conversion of CCPS into equity is exempt from taxation; MAT provisions- No adjustment to arise in book profits.
Revenue flows	10% coupon payments may or may not be presented separately in P&L (to be classified as other income along with fair value gains and losses). Under IndAS, all gains and losses to be recognized in P&L (including divided, forex Gain / loss, impairments, interest).	Normal provisions- Income should be separated from other gains/ losses on CCPS and considered as dividend, hence exempt from taxation; MAT provisions- Income to be considered as dividend and excluded from the book profits (analogy is adopted from the clarification from CBDT on interest expense on preference shares treated as liability).

Compound financial instruments – Tax Aspects

Treatment of Convertible Instruments like **CCD's**

IGAAP

Considered as
Debt

Ind-AS

Considered as
Equity

Impacts
Rule 11UA valuations

Balance Sheet of Target Co.

Equity and Liabilities	INR	Assets	INR
Equity share capital	250	Assets	1,800
Securities Premium A/c	250		
Other Liabilities	300		
CCD's - FV 100 - Premium 900	**1000**		
Total	**1,800**	**Total**	**1,800**

On Transfer of Shares of Target Co;
Say Cost for Seller – Rs. 800
Sale Consideration –Rs. 1100

Compound financial instruments – Tax Aspects

Calculation as per Rule 11UA

	IGAAP	Ind AS
Total Assets	1800	1800
Less: Liabilities		
Other Liabilities	(300)	(300)
CCD's	**(1000)**	--
Rule 11UA value	**500**	**1500**

On Transfer of Shares of Target Co;
Say Cost for Seller – Rs. 300
Sale Consideration –Rs. 1100

CCD's Considered as **Equity**

Illustrative Computation

	IGAAP	Ind AS
As per S.56(2)(x) – Buyer; being recipient of Property	No 56(2)(x) implications since Consideration paid in excess of S.56 FMV	**Rs. 400**; **Taxable** being diff between FMV and Consideration paid
As per S.50CA – Seller being transferor	NA; as sold for more than S.56 value	**Rs. 1200; taxable** being 1500 - 300

Increased tax outflow

Compound financial instruments – Tax Aspects

When CCPS is treated as Financial Liability – any dividend on preference shares is treated as interest and debited to P&L account; MAT treatment ?

For MAT, **such dividend is to be added back** *[CBDT Circular July 2017, clarifies for dividend only on CCPS]*

If debt instruments are considered as '**equity**' for IND AS, interest on such debt instruments are recognized in Other Equity and not debited to P&L. Whether such interest can be reduced from book profits

No clarification for 'debt instruments'

Apollo Tyres – SC ?

Interest on CCDs recognized in books basis effective rate whether subject to withholding tax and whether deductible expense?

Preference dividend if recognized as interest in books – whether subject to withholding tax or dividend distribution tax ? Whether it can be claimed as deductible expense

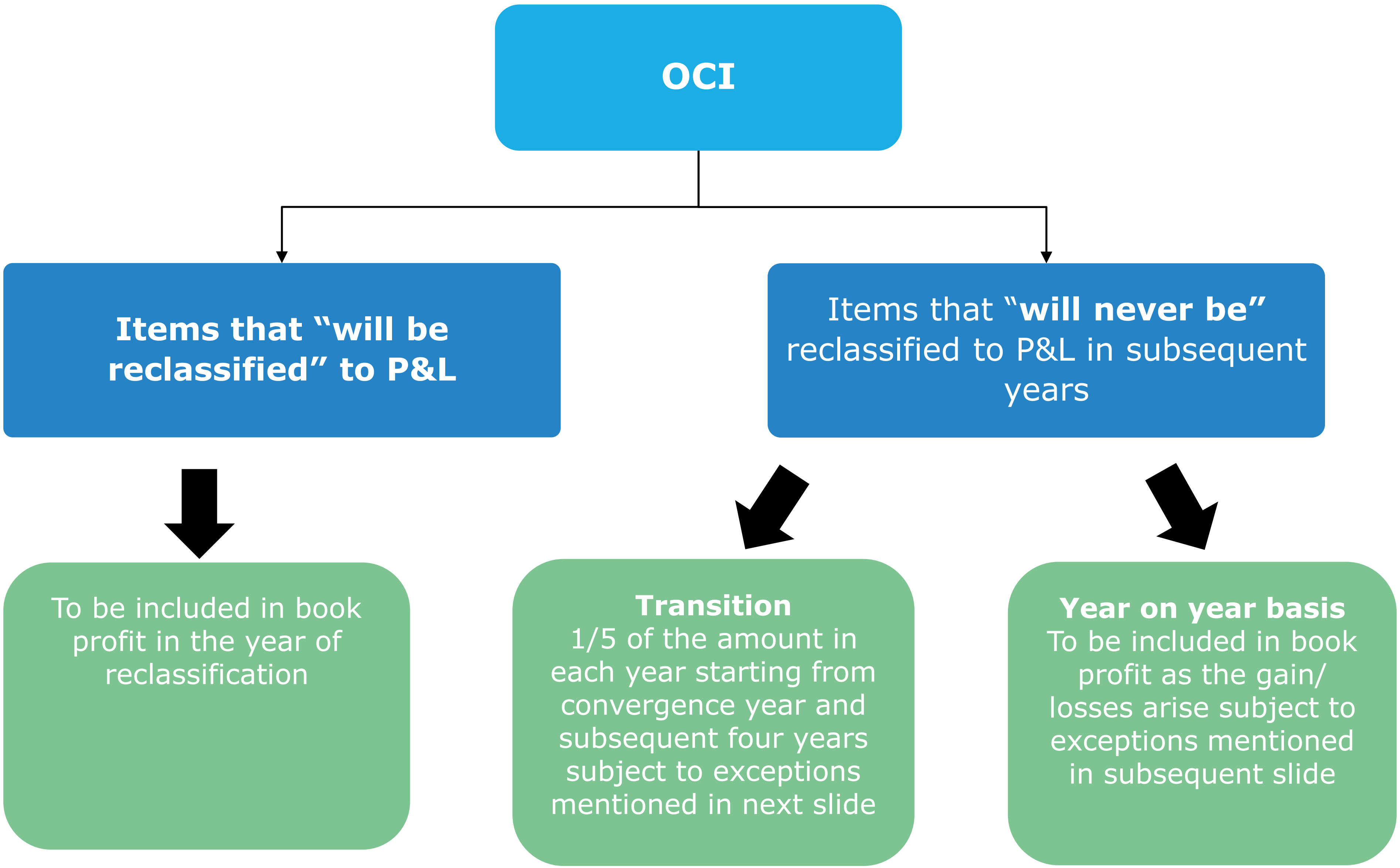
Whether interest recognized as dividend in books be subject to dividend distribution tax ? Whether it can be claimed as deductible expense

?

Ind AS MAT Interplay

MAT implications pursuant to Ind AS

Treatment of OCI items



MAT implications pursuant to Ind AS

Transition amount

Transition amount means the amount or aggregate of the amounts adjusted in the other equity (excluding, capital reserve and securities premium reserve) on the convergence date

EXCLUDING

Amount or aggregate of the amounts adjusted in the OCI on the convergence date which shall be subsequently re-classified to the P&L

Revaluation surplus for assets in accordance with the Ind AS 16 and Ind AS 38 adjusted on the convergence date

Gains or losses from investments in equity instruments designated at FVTOCI in accordance with the IND AS 109 adjusted on the convergence date

Adjustments relating to items of PPE and intangible assets recorded at fair value as deemed cost in accordance with Ind AS 101 on the convergence date

Adjustments relating to cumulative translation differences of a foreign operation in accordance with para D13 of the Ind AS 101 on the convergence date

Adjustments relating to investments in subsidiaries, JVs and associates recorded at fair value as deemed cost in accordance with Ind AS 101 on the convergence date

Thank You