Accounting issues, treatment and recent judicial pronouncements on Incentives and Grants

Presented by :-

CA Kusai Goawala

1st June 2019

Seminar by Pune Branch of WIRC of ICAI

Meaning of Grants

Transfer of Resources from :

- Government
- Government Agencies
- Similar bodies – whether local, national or international

For past or future compliances with conditions

Grants are also called :

- Subsidies
- Subvention
- Cash incentives
- Duty Drawbacks
- Forgivable loans

Objectives

- Develop deprived areas
- Generate employment opportunities
- Garner foreign exchange
- Provide import substitution
- Promote green energy
- Redistributive

Impact on economy

- Subsidy injects money into circulation
- Leads to lower prices of commodity and increases its demand
- Ripple Effect – Keynes Theory of Economics

Accounting Standard AS 12

Accounting for Government Grants

<u>Background and scope</u>

- ➢All entities covered
- ➢Recognition principles
- ➢Classification – Capital vs. Revenue
- ➢Non monetary grants
- ➢Refunds

Exclusions

Effects of Changes in prices etc
Government Assistance
Government participation in the ownership
Grants which cannot have any value

- Indirect benefits like **80**IA etc
- Improvement to infrastructure
- Keeping trade constraints on competitor Infrastructure

Transactions with Government which are of normal trading

CA Kusai Goawala

Criteria for recognition in the books

To recognise in the books only if reasonable Assurance :

a) of receipt of the grant;
b) Benefit have been earned; and
c) that the entity will be able to comply with all the conditions

Mere receipt is not conclusive evidence that the condit will be fulfilled

CA Kusai Goawala

Classification of Grant

<u>Thin line of classification</u> :

- ➢Capital Approach – Treated as Shareholders Fund
- ➢Income Approach – Taken to Profit and Loss

CA Kusai Goawala

Capital Approach & Income Approach

Capital Approach :
a) If the nature of grant is that of shareholders fund
b) Characteristics similar to that of promoters contribution
c) Represents an incentive provided by Government without related cost
d) Contribution towards its capital outlay
e) Given to meet specific cost of assets

Income approach :
a) For operations of the business
b) For subsidising business expenses/losses
c) Other than capital grant

CA Kusai Goawala

Manner of accounting / presentation

Capital Approach
1) For Grants given to meet specific assets
Primary condition that the grant should be used for acquiring specific assets
a) Deduct from the cost of asset specifically subsidised
If the grant amount equals cost – show asset at nominal value
b) Show as Deferred Income
In respect of depreciable asset –
- Amortised systematically over the assets useful life.

In respect of non depreciable asset –
- If grant does not require any further obligations to be fulfilled = credit to capital reserves
- If grant requires cost to be incurred for obligations = amortise the same to P&L in proportion to the cost being incurred

CA Kusai Goawala

Issues under this Deferred Income method

a) Deferred Tax implications
b) Impairment implications

- Check impairment with respect to net value

2) For other capital grants in the nature of shareholders funds
Given as contribution towards total capital outlay

Should be disclosed under Capital Reserve under Shareholders Funds

CA Kusai Goawala

Revenue Approach

1) On accrual basis – earned benefits on a prudent basis is credited to income
2) Contingency provision as per AS**4** and AS**29**
3) If grant is given to specific enterprise only – Extra Ordinary Item
4) If expenses incurred in previous year – Grant received in subsequent year – Extra Ordinary Item – Prior Period Disclosures
5) Present as Other Income
6) Present as deduction for relevant expenses

CA Kusai Goawala

Non Monetary Grant

- Example – Land or other resources given at concessional rates.
- Account for the assets at acquisition cost
- If given free of cost, account for at nominal value

Refunds of Grant

<u>In the event conditions are not fulfilled</u> :

a) In case of Capital Grants
- Increase book value and charge increased depreciation prospectively
- Reduce Capital Reserve
- Reduce Deferred Income – Excess paid over credit to be debited to P&L

b) In case of Revenue Grants
- Debit to P&L – Extraordinary Item

Exemption & Scheme

Sales tax Exemption / Deferral Scheme – Government Grant ?

- Gramin Bhandaran Yojana – Capital Grant
- Concessional or Interest free loans

Taxability

Finance Act,2015 has introduced Section 2(24) (xviii) w.e.f. AY 2016-17
Taxability of Grants will be different :

(a) Upto AY 2015-16 different treatment will apply for taxability of Grants
(b) From AY 2016-17, capital grants will be taxable as income

Taxability

Prior to Finance Act 2015:
(a) No explicit provision in Income tax Act
(b) Based on judicial pronouncements

Treatment upto AY 2015-16

- Principles of Capital vs. Revenue
- Nature of Grant vs. Purpose of Grant
- The test whether a subsidy is taxable will depend on :
- Purpose for which subsidy is given.. Apply "Purpose Test"

– If the object is to enable assessee to set up a new unit than capital receipt and not taxable
– Bombay High Court **(2013)** – Chapalkar Brothers – **33** Taxman **431** (Bom)

Principles laid down by Supreme Court in the matter of Sahney Steel & Press Works Ltd. **94** Taxman **368** (SC)

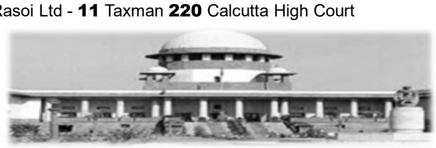
- The purpose for which the subsidy is given is critical.
- The point of time at which the subsidy is paid is not relevant.
- The source is immaterial.
- The form of subsidy is immaterial.

Also refer Ponni Sugars and Chemicals Ltd (2008) 306 ITR 392 SC
CBDT circular 142 (F No 204/25/74-IT(A-II) dated 1.8.74

Principles laid down by Supreme Court in the matter of Sahney Steel **94** Taxman **368** (SC)

- If the subsidy is to enable the assessee to run the business more profitably then the receipt is on revenue account
- Subsidy received under Industrial Promotion Scheme

For Expansion of capacities and modernisation
Held – Capital Receipt
Rasoi Ltd - **11** Taxman **220** Calcutta High Court



Deduction of subsidy from "Actual Cost" – **43(1)**

- **Ratio laid down by Supreme Court in the matter of P J Chemicals 76 Taxman 611 (SC)**
- **Only if the subsidy has direct nexus with the acquisition of the cost – deduct from Actual Cost.**
- **Section 43(1) requires deduction from actual cost, the amount of cost which has been met – directly or indirectly – by any other person or authority.**

Point of taxation

- Income vs. Deemed Loan
- If certain conditions are not fulfilled
– that will not qualify for classification as loan till conditions are fulfilled
- Agarwal Industries – Rajasthan High Court (**225** ITR **901**)
In this case, the assessee was required to continue production for five years
In case of default, grant can be withdrawn.
Held taxable and need not wait for five years

Taxability – AY 2016-17 onwards

Deeming fiction created – scope of income widened.

Section 2(24)(viii) : Income - subsidy, grant, cash incentives, duty drawback, waiver, concessions, reimbursements (by whatever name called) from CG/SG or any authority or body or agency

Capital grants taxable as income u/s 2(24)(xviii)

In case of grants granted for acquiring specific assets, the same to be reduced from actual cost u/s 43 (1)

Supreme Court judgements overruled.

Different treatment in Accounts and Tax

Taxability - Reimbursement

A Government of Chhattisgarh introduces a scheme under Industrial Promotion Scheme 2018 – reimbursement of the amount of VAT paid by it for a period of 10 years.

Whether this reimbursement of VAT is liable to tax u/s 2(24)(xviii) ?

Yes. Reimbursement is covered under above section and hence liable to tax.

Taxability – Interest free loan

Central Government introduces a scheme under Infrastructure and Industrial Investment Policy – eligible for interest free loan for setting up new plant and machinery which is to be repaid after 10 years.

Whether this notional interest to be taxed u/s 2(24)(xviii) as waiver?

No. Although waiver is covered under above section, but this is not strictly not waiver. It is non charging in first place. Further, under Income tax Act there is no provision for notional interest.

Taxability - Exemption

Government of Uttarakhand introduces a scheme under Industrial Policy, 2003 – exemption from excise duty for 10 years.

Whether this exemption is liable to tax u/s 2(24)(xviii) ?

No. Exemptions are not covered under above section and hence liable to tax.
Although, concessions or waiver is mentioned, exemption is not covered.
Exemption is the case where tax or duty is not levied.
Whereas in case of waiver or concessions – power to levy remains but not levied.

CA Kusai Goawala

ICDS and Government Grants

ICDS introduced and mandatory from AY 2017-18 onwards

ICDS for Government Grants – ICDS VII

Government grants should either be treated as revenue receipt or should be reduced from the cost of fixed assets based on the purpose for which such grant or subsidy is given. (Also refer Section 145B(3)

Recognition of Government grants shall not be postponed beyond the date of actual receipt. AS-12 provide for postponement of government grant beyond the date of actual receipt where condition attached to the grant are not fulfilled. Whereas, as per ICDS such postponement is not possible.

Compliance of conditions should not be a reason for postponement

CA Kusai Goawala

ICDS and Government Grants

Disclosures:

Nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost *of the asset or assets or from the written down value of block of assets during the previous year.*

Nature and extent of Government grants recognised during the previous year as income.

Nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost *of the asset or assets or from the written down value of block of assets and* reasons thereof.

Nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

CA Kusai Goawala

ICDS and Government Grants

Transitional Provisions

–All the government grants which meet the recognition criteria on or after 1st April 2017 shall be recognized for the previous year commencing on or after 1st April 2017 in accordance with the provisions of this standard after taking into account grant already recognised

CA Kusai Goawala

Various scenarios wef AY1718

Grant in respect of	ICDS VII	AS 12	IndAS 20
Depreciable Asset	Deduct from cost/wdv – refer section 43(1) expl 10	Either deduct from gross value or show as deferred income	Recognise in PL on systematic basis in relation to expenses incurred
Non Depreciable Asset	Credited to Income over the period when cost of meeting obligation is charged	Credited to Capital Reserve If require fulfilment of obligation same as ICDS VII	Same as above

Taxability - Effective

Whether Section 2(24)(xviii) applies from retrospective

Limtex Tea & Industries Ltd vs ACIT (2016) ITD 900 Kolkata Tribunal

Section operates prospectively.

CARBON CREDIT

Carbon Credits – Guidance Note

- Kyoto Protocol – Green House Gases.
Companies can take up Clean Development Management (CDM) Project
CDM to be registered with United Nations Framework for Climate Change (UNFCC)
UNFCC will verify the project achievements for reduction in emissions

- Issue Certified Emission Reduction (CER) Units
1 CER = **1** MT of Carbon dioxide equiv.
CER can be traded in international market

Carbon Credits – Guidance Note

Polluting Companies/countries will be required to buy CER

Accounting treatment :

- Consider as Inventory as meant for sale
- Apply AS **2** for Valuation of cost
- Cost of certification by UNFCC is cost
- Recognition only after Certificate is issued

CA Kusai Goawala

Question Session

CA Kusai Goawala

THANK YOU

CA Kusai Goawala