Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 9

'Ind AS Transition Facilitation Group' (ITFG) of Ind AS Implementation Committee has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, raised by preparers, users and other stakeholders. Ind AS Transition Facilitation Group (ITFG) considered some issues received from members and decided to issue following clarifications[1] on May 15, 2017:

Issue 1:

(i)P Ltd. holds 100% equity shares of S Ltd. i.e. S Ltd. is the wholly-owned subsidiary of P Ltd. During the year 2016, S Ltd. paid dividend of INR 100,000 to P Ltd. and paid Dividend Distribution Tax (DDT) of INR 20,000 (as per tax laws) to the taxation authorities.

(a) What would be the accounting treatment of the DDT in the consolidated financial statement of P Ltd?

(b) Would the answer be different, if P Ltd. in turn pays dividend of INR 150,000 to its shareholders and DDT liability thereon is determined to be INR 30,000.As per the tax laws, DDT paid by S Ltd. of INR 20,000 is allowed as set off against the DDT liability of P Ltd., resulting in P Ltd. paying INR 10,000 (INR 30,000 – INR 20,000) as DDT to tax authorities.

(ii) Whether deferred tax liability (DTL) on the accumulated undistributed profits of the Subsidiary company which may be distributed in the foreseeable future is required to be recognised in the consolidated financial statements of the Parent company, i.e. P Ltd.

Response:

It may be noted that the treatment of Dividend Distribution Tax (DDT) in the standalone financial statements of the parent entity and its subsidiary has been dealt with in the FAQ issued by the Accounting Standards Board (ASB) of ICAI on the treatment of Dividend distribution tax.

(i)

(a) In the consolidated financial statements of P Ltd., the dividend income earned by P Ltd. from S Ltd. and dividend recorded by S Ltd. in its equity will both get

[1] Clarifications given or views expressed by the Ind AS Transition Facilitation Group (ITFG) represent the views of the members of the ITFG and are not necessarily the views of the Ind AS Implementation Committee or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of each clarification is indicated along with the clarification. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the Group

eliminated as a result of consolidation adjustments. DDT of INR 20,000 paid outside the consolidated Group i.e. to the tax authorities should be charged as expense in the consolidated statement of Profit and Loss of P Ltd.

(b) If DDT paid by the subsidiary S Ltd. is allowed as a set off against the DDT liability of its parent P Ltd. (as per the tax laws), then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent P Ltd . Accordingly, in the given situation, DDT of INR 30,000 (INR 20,000 of DDT paid by S Ltd. and INR 10,000 of DDT paid by P Ltd.) should be recognised in the consolidated statement of changes in equity of parent P Ltd.. The basis for such accounting would be that due to Parent P Ltd's transaction of distributing dividend to its shareholders (a transaction recorded in Parent P Ltd' equity) and the related DDT set-off, this DTT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the Parent company.

(ii) Paragraphs 39 & 40 of Ind AS 12, *Income Taxes* states as follows:

39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

40 As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

In accordance with the above, it may be noted that the deferred tax liability (DTL) is not recognised on the accumulated undistributed profits of the subsidiary company in the consolidated financial statements of the parent entity, if it is determined that such accumulated undistributed profits will not be distributed in the foreseeable future.

However, if based on evaluation of facts and circumstances it is concluded that it is probable that the accumulated undistributed profits will be distributed in the foreseeable future, then DTL on accumulated undistributed profits of the subsidiary company should be recognised in the consolidated statement of profit and loss of the parent company. Where DDT paid by the subsidiary on distribution of its accumulated undistributed profits is allowed as a set off against the parent's own DDT liability, then the amount of such DDT can be recognised in the consolidated statement of changes in equity of parent by crediting an equivalent amount to deferred tax expense in the consolidated statement of Profit and Loss of P Ltd in the period in which the set-off is availed.

In this regard, it may also be noted that the tax credit is not recognised until the conditions required to receive the tax credit are met. The tax credit on account of DDT paid by the subsidiary is recognised in the year in which they are claimed against parent's DDT liability. This is important because the payment of dividend by Parent P is decided by its shareholders and therefore not to recognise a DTL or to recognise any tax credit prior to such shareholder actions may not be appropriate. For example shareholders of Parent P Ltd may decide not to distribute or even reduce the amount of dividends proposed by the Board of Directors of P Ltd.

Issue 2:

As per Appendix C, *Business Combinations of Entities under Common Control* of Ind AS 103, *Business Combinations*, in case of common control business combinations, the assets and liabilities of the combining entities are reflected at their carrying amounts.

(A) For this purpose, should the carrying amount of assets and liabilities of the combining entities be reflected as per the books of the entities transferred or the ultimate parent in the following situations:

Situation 1: A Ltd. has two subsidiaries B Ltd. and C Ltd. B Ltd. merges with C Ltd.

Situation 2: B Ltd. is the subsidiary of A Ltd. B Ltd. merges with A Ltd.

(B) Further, also state whether the effect of the above business combination is required to be eliminated in the consolidated financial statements of A Ltd.

Response:

(**A**)***Situation 1:*** Paragraph 9 of Appendix C of Ind AS 103, states as follows:

"*9 The pooling of interest method is considered to involve the following:*

(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(ii) No adjustments are made to reflect fair values, or recognise any new assets or liabilities. The only adjustments that are made are to harmonise accounting policies.

(iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date."

Further paragraphs 11 and 12 of Appendix C of Ind AS 103 state as follows:

"*11 The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.*

12 The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination. The difference, if any, between the amounts recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor shall be transferred to capital reserve and should be presented separately from other capital reserves with disclosure of its nature and purpose in the notes."

In accordance with the above, it may be noted that the assets and liabilities of the combining entities are reflected at their carrying amounts. Accordingly, in accordance with paragraph 9 (a) (i) of Appendix C of Ind AS 103, in the separate financial statements of C Ltd., the carrying values of the assets and liabilities as appearing in the standalone financial statements of the entities being combined i.e B Ltd. & C Ltd. in this case shall be recognised.

Situation 2:

In this case, since B Ltd. is merging with A Ltd. (ie. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd. Accordingly, it would be appropriate to recognise the carrying value of the assets, liabilities and reservespertaining to B Ltd as appearing in the consolidated financial statements of A Ltd.Separate financial statements to the extent of this common control transaction shall be considered as a continuation of the consolidated group.

(B) Paragraph B86 of Ind AS 110, *Consolidated Financial Statements*, states as follows:

"*Consolidation procedures*

B86 Consolidated financial statements:

(a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

(b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Ind AS 103 explains how to account for any related goodwill).

(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. Ind AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions."

In accordance with the above, all intra-group transactions should be eliminated in preparing consolidated financial statement in accordance with Ind AS 110. The legal merger of a subsidiary with the parent or legal merger of fellow subsidiaries is an intra-group transaction and accordingly, will have to be eliminated in the Consolidated Financial Statements of the Parent.

Accordingly, in both the given situations, the effect of legal merger should be eliminated while preparing consolidated financial statements of A Ltd.

Issue 3: ABC Co. is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Co. from the government (which holds 100% shareholding in ABC Co.) which is in the nature of promoters' contribution have been recognised in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, *Accounting for Government Grants*.

1) **Whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS.**

2) **What will be the accounting treatment of the grants in the nature of promoters' contribution which ABC Co. receives post transition to Ind AS?**

Response:

1)Paragraph 2 ofInd AS 20, *Accounting for Government Grants and Disclosure of Government Assistance, inter-alia,*states as follows:

"2 This Standard does not deal with:
(a)…

(c) government participation in the ownership of the entity."

In accordance with the above, it may be noted that Ind AS 20 specifically scopes out the participation by the government in the ownership of an entity.

In this fact pattern, Government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will affect the statement of profit and loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly to shareholders' funds.

Where it is concluded that the contributions are in the nature of shareholder contributions are recognised in capital reserve under previous GAAP,, it is important to note the provisions of paragraph 10 of Ind AS 101, which states that,

"10 Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind ASs;

(b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and

(d) applyInd ASs in measuring all recognised assets and liabilities."

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under 'Other Equity' at the date of transition to Ind AS.

(2) The entity shall apply the same principles as mentioned above for accounting the contributions received by the entity subsequent to the transition date.
