PwC Reporting*InBrief*

# Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 17

pwc

## *In brief*

The Ind AS Implementation Group of the Institute of Chartered Accountants of India (ICAI) constituted the Ind AS Transition Facilitation Group (ITFG) to address issues faced by preparers, users and other stakeholders on applicability and implementation of Ind AS. ITFG issues clarifications in the form of periodic bulletins.

This *InBrief* provides an overview of the clarifications issued by the ITFG in its bulletin 17 and our insights thereon, including related interpretative issues.

## *Let's talk*

1. The Ministry of Corporate Affairs (MCA) notified the Companies (Indian Accounting Standards) Second Amendment Rules, 2018 (the 'Rules') on 20 September 2018. The Rules are effective for annual periods beginning on or after 1 April 2018. Among other matters, the Rules amended Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance* to allow entities the option to record non-monetary government grants at a nominal amount. Prior to the Rules, Ind AS 20 required non-monetary government grants (both grant and asset) to be accounted for at fair value only. Accordingly, an entity transitioning to Ind AS in FY 2018-2019 i.e. a first-time adopter of Ind AS, which had accounted the non-monetary government grant at nominal amount under previous Indian GAAP, can measure such non-monetary government grant on the date of transition to Ind AS at nominal amount or fair value. For an entity which is not a first-time adopter of Ind AS, a change in accounting of non-monetary government grant from fair value to nominal amount, would be a voluntarily change in accounting policy since the Rules do not contain any transition provision. As per Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* such voluntary change in accounting policy is only permitted when the change results in the financial statements providing a reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

2. Where preference shares issued by an entity are classified as liability, dividend payable thereon is in the nature of interest and should be recognised in profit or loss in accordance with the effective interest method. The dividend distribution tax (DDT) payable on such preference dividend should be considered in determination of effective interest rate (EIR) of the preference shares.

3. Benefit received by a software technology park (STP)/special economic zone (SEZ) unit in the nature of exemption from payment of taxes and duties levied by government on import/export of goods upon fulfilment of certain conditions is a government grant. The classification of such government grant as 'asset' or 'income' related government grant will require exercise of judgement and examination of the facts, objective and conditions attached to the scheme of grant. The purpose of the grant and the costs for which the grant is intended to compensate would also need to be assessed.

4. Subsequent measurement of a financial asset (debt instrument) at amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVTPL) depends upon entity's business model for managing the financial asset and the contractual cash flows characteristics of the financial asset. Income from a financial asset subsequently measured at amortised cost or FVOCI is recognised using EIR method, irrespective of the legal form of income (interest or dividend). Depending upon the business model and the contractual cash flows characteristics test, if such preference shares are subsequently measured at amortised cost or FVOCI, then dividend income on such preference shares is recognised using EIR method.

5. When an investor acquires a control or joint control or significant influence over an investee, Ind AS 103, *Business Combinations* or Ind AS 28, *Investment in Associates and Joint Ventures,* requires goodwill or bargain purchase gain/capital reserve to be identified based on the fair value (and not book value) of the identifiable assets and liabilities of the investee as at the acquisition date. The fair value of the identifiable assets and liabilities of the investee on acquisition date is the cost of such assets or liabilities for the investor. Accordingly, appropriate adjustment arising out of fair valuation of assets/liabilities impacting profit or loss of the investee should be made by investor. For example, depreciation of investment property of investee shall be based on its fair value at acquisition date. The above requirement of Ind AS 103/Ind AS 28 to measure identifiable assets and liabilities of investee at fair value in the financial statements of the investor do not contradict with other Ind AS such as Ind AS 40, *Investment Property* that require cost-based measurement in the financial statements of the investee.

6. Supply of electricity by subsidiary (sole distributor of electricity in a specific geographical area) to parent is a 'related part transaction' that would attract the disclosures of Ind AS 24, *Related Party Disclosures*. The disclosures of Ind AS 24 are required for such transaction, notwithstanding the fact that parent is charged electricity tariffs as determined by an independent rate-setting authority i.e. the terms of supply of electricity are at par with those applicable to other customers. Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on arm's length basis. If the parent-subsidiary relationship did not exist and the only relationship between the entities was that of a supplier and a customer of electricity, then such parties are not considered as related parties as per Ind AS 24.

7. As per Ind AS 32, *Financial Instruments: Presentation,* a derivative is a financial liability if it will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. A derivative that will be settled by the issuer only by exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments is classified as 'equity'. This is commonly referred to as the 'fixed for

fixed' requirement. The term 'fixed amount of cash' refers to an amount of cash fixed in functional currency of the reporting entity. Since, an amount fixed in a foreign currency has the potential to vary in terms of functional currency of the reporting entity due to exchange rate fluctuations, it does not represent "a fixed amount of cash". Ind AS 32 provides the following two exceptions to the 'fixed for fixed' requirement where the variation is due to foreign currency:

(i) Rights issue to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights issue pro rata to all of its existing owners of the same class of its own equity instruments.

(ii) Equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. This exception is a carve-out from IAS 32, *Financial Instruments: Presentation* issued by International Accounting Standards Board (IASB). This exception cannot be applied by analogy to equity conversion options embedded in other types of financial instruments denominated in a foreign currency such as preference shares.

8. An entity issues preference shares denominated in its own functional currency. The preference shares carry discretionary non-cumulative dividend of 12% per annum and are convertible at the option of the holder at any time during the term into fixed number of equity shares of the entity. The holder of the preference shares also has an option to put the preference shares back to the entity at any time for the par amount. Accordingly, the preference shares is a compound financial instrument containing both liability component (representing the redemption feature in cash) and equity component (representing the discretionary dividend and holder's equity conversion option) from issuer's perspective. Ind AS 113, *Fair Value Measurement* states that fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Since the entity has a contractual obligation to pay the par amount at any point in time at the option of the holder, preference shares represent a financial liability with a demand feature. Accordingly, the entire issue proceeds of the preference shares is allocated to the liability component and no amount is assigned to equity component.

9. Presentation of interest payable on delayed payment of taxes levied by local authority ('local taxes') depends upon whether the interest is compensatory in nature for time value of money or penal in nature. This requires exercise of judgement based on evaluation of facts of the case. If it is concluded that interest is compensatory in nature, then it shall be classified as 'finance cost'. If interest is penal in nature, then it shall be classified as 'other expenses'.

10. Under the Income-tax Act, 1961, the conversion of capital asset into stock-in-trade is taxable in the year of sale of stock-in-trade and not in the year of conversion. Accordingly, no current tax liability arises in the year of conversion. A deductible temporary difference exists where the asset is carried at historical cost in the books but its tax base is indexed i.e. adjusted for inflation. Deferred tax asset on such deductible temporary difference should be recognised, provided the recognition criteria of Ind AS 12 is met. The difference between the asset's indexed cost and its fair value on the date of conversion does not meet the definition of temporary difference as per Ind AS 12 and accordingly, no deferred tax has to be recognised for such difference.

## *In detail*

1. **Accounting of non-monetary government grant**
The MCA notified the Rules on 20 September 2018 which are effective from annual periods beginning on or after 1 April 2018. Amongst other matters, the Rules amended Ind AS 20 to allow an entity to recognise non-monetary government grant at fair value or nominal amount. Prior to the notification of the Rules, Ind AS 20 required an entity to account for non-monetary government grants (both grant and asset) at fair value. The accounting implication of the Rules in FY 2018-2019 are summarised below:
   - A first-time adopter of Ind AS: Ind AS 101, *First-time Adoption of Indian Accounting Standards* does not contain any mandatory exceptions or voluntary exemptions from retrospective application of Ind AS 20. A first-time adopter which had accounted the non-monetary government grant at nominal amount under the previous Indian GAAP, can opt to measure such non-monetary government grant on the date of transition to Ind AS at nominal amount or fair value depending on the accounting policy choice availed by the entity.
   - Entities other than first-time adopter of Ind AS: Such entities would have accounted for the non-monetary government grant at fair value in the previous year. The Rules do not contain any transition provision. Accordingly, a change in accounting of non-monetary government grant from fair value to nominal amount, would be a voluntarily change in accounting policy. As per Ind AS 8, such voluntary change in accounting policy is only permitted when the change results in the financial statements providing a reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

PwC Insights:
As per Ind AS 8, an entity should apply accounting policies consistently from one period to the next. A voluntary change in accounting policy is permitted only if the change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. The Rules do not contain any transition provision. Accordingly, an entity which intends to change its accounting policy of measuring non-monetary government grant from fair value to nominal amount should retrospectively apply the change in accounting policy i.e. it should adjust all comparative amounts to show the results and financial position of comparative periods as if the new policy had always been applied. The financial statements should include the disclosures required by Ind AS 8 relating to change in accounting policy. A third balance sheet as at the beginning of the preceding period shall also be presented, if the restatement has a material effect on the information in the balance sheet as at that date.

2. **Accounting of DDT on preference shares classified as 'liability' by issuer**
Ind AS 32 paragraph 36 states that classification of financial instrument as financial liability or an equity instrument determines whether interest, dividend, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Accordingly, dividend payments on preference shares classified as liability in entirety (for example, redeemable preference shares with cumulative dividend) are recognised as expense in the same way as interest on a bond using the effective interest method. The DDT payable on such preference dividend should be considered in determination of EIR of the preference shares.

As per the FAQ issued by the ICAI Accounting Standards Board, DDT in India, is in substance, of the nature of withholding tax. The presentation of DDT paid on dividend should be consistent with the presentation of the transaction that creates those income tax consequences. For example, where preference shares is wholly classified as equity (for example, preference shares compulsory convertible into fixed number of equity shares of issuer with discretionary dividend), dividend and DDT thereon shall be recognised in equity. In case of compound financial instruments, bifurcated into debt and equity, the portion of DDT related to dividend/interest to the debt component should be recognised in profit or loss and that related to equity component should be recognised in equity.

3. **Exemption received by a SEZ/STP unit from payment of government taxes and duties**
Paragraph 3 of Ind AS 20 states that government grants are assistance in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to operating activities of the entity. Accordingly, benefit received by SEZ/STP unit in the form of exemption from payment of taxes and duties levied by the government on import/export of goods upon fulfilment of certain conditions is a government grant. Classification of the government grant as related to an asset or income will require exercise of judgement and careful examination of the facts, objective and conditions attached to the scheme. The purpose of the grant and the costs for which the grant is intended to compensate would also need to be ascertained carefully.

PwC Insights:
As per Ind AS 20, grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held. Grants related to income are government grants other than those related to assets. Government grants are recognised in the statement of profit and loss a systematic basis over the periods in which the related costs towards which they are intended to compensate are recognised as expenses.

Difficulties of identifying the related expenses that are intended to compensate for the grant may arise where the grant's terms do not specify the expenditure towards which it is intended to contribute. In practice, grants may be awarded to defray project costs comprising both income and capital expenditure. Project grants may be related, for example, to the project's capital expenditure costs and the number of jobs created or safeguarded. In such circumstances, the expenditure eligible for grant aid may be all the costs incurred that are directly attributable to the project. The terms of the grant itself often need to be carefully examined whether the intent is to defray costs or to establish a condition relating to the grant's entire amount.

Grants may be received as part of a package of financial or fiscal aids where a number of conditions are attached. Care is needed in identifying the conditions giving rise to costs and expenses that determine the periods over which the grant will be earned. It may be appropriate to allocate part of the grant on one basis (asset related grant) and part on another (income related grant). It will then be possible to account for each part of the grant differently according to the types of different costs and expenses towards which it is intended to compensate. If the grant requires the fulfilment of different obligations, it should then be recognised in the income statement over the periods in which the related costs and expenses of meeting the obligations are recognised.

The ITFG in its bulletin 11 dealt with the accounting of grant in the nature of custom duty exemption on capital goods with certain conditions related to export of goods under the export promotion capital goods (EPCG) scheme. ITFG clarified that if based on the terms and conditions of the scheme, the grant received is to compensate the import cost of assets subject to an export obligation as prescribed in the EPCG Scheme; recognition of grant in the statement of profit and loss should be linked to fulfilment of associated export obligations.

However, if the grant received is to compensate the import cost of the asset and based on the examination of the terms and conditions of the grant, it can be reasonably concluded that conditions relating to export of goods are subsidiary conditions, then it is appropriate to recognise such grant in profit or loss over the life of the underlying asset.

4. **Recognition of income on a debt instrument**

Recognition of income on a debt instrument will depend on the classification of the instrument as FVTPL, amortised cost or FVOCI. Classification of a debt instrument will depend upon the entity's business model for managing the financial asset and the contractual cash flows characteristics of the financial asset.

A financial asset should be subsequently measured at amortised cost if both of the following conditions are met:

(i) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
(ii) the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

A financial asset should be subsequently measured at FVOCI if both of the following conditions are met:

(i) the financial asset is held within a business model whose objective is achieved by both holding financial assets in order to collect contractual cash flows and selling financial assets; and
(ii) the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

'Principal' is defined as the fair value of the financial asset at initial recognition. 'Interest' consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding, and for other basic lending risks (for example, liquidity risk) and costs (for example, servicing or administrative costs) associated with holding a financial asset for a period of time, as well as a profit margin. These are consistent with features of a basic lending arrangement.

If the financial asset does not pass the SPPI criteria, it is measured at FVTPL.

Income from a financial asset subsequently measured at amortised cost or FVOCI is recognised using EIR method, irrespective of the legal form of income (interest or dividend). In the case of a redeemable preference share, the issue whether the SPPI test is met or not requires consideration of whether payment of dividend on the preference share is non-discretionary (i.e., obligatory) or at the discretion of the issuer. Where payment of dividend is not at the discretion of the issuer, the contractual cash flows (dividends and redemption proceeds) associated with the preference share would be akin to those associated with a plain-vanilla loan or other plain-vanilla debt instrument unless the contractual terms of the preference share introduce exposure to risks and volatility in the contractual cash flows that is unrelated to a basic lending arrangement such as exposure to changes in equity prices. On the other hand, where the payment of dividend on the preference shares, whether cumulative or non-cumulative, is at the discretion of the issuer, the contractual cash flows characteristics in such cases differ from those of a basic lending arrangement. Accordingly, a preference share with a discretionary dividend feature cannot be said to represent a basic lending arrangement. Accordingly, such a preference share fails the SPPI test and cannot be classified at amortised cost or FVOCI. The appropriate classification of such preference share is FVTPL.

If the preference share meet the business model assessment and SPPI criteria and accordingly is subsequently measured at amortised cost or FVOCI, then dividend income on such preference shares will be accounted for using EIR method.

PwC Insights:
For financial assets measured at FVTPL, Ind AS 107, *Financial Instruments: Disclosures* provides an accounting policy choice with regards to presentation of interest income. The interest income can be reported as part of net gains or losses on such financial assets or can be disclosed separately as part of interest income.

**5. Acquisition of control or joint control or significant influence**

When an investor acquires control, joint control or significance influence over an investee, Ind AS 103/Ind AS 28 requires an investor to determine the goodwill or bargain purchase/capital reserve with reference to the fair value of the identifiable assets and liabilities on the acquisition date. The fair value of the identifiable assets and liabilities of the investee on acquisition date is the cost of such assets or liabilities for the investor. Accordingly, appropriate adjustment arising out of fair valuation of assets/liabilities impacting profit or loss of the investee should be made by investor. For example, depreciation of investment property of investee shall be based on its fair value at acquisition date. The above requirement of Ind AS 103/Ind AS 28 to measure identifiable assets and liabilities of investee at fair value in the financial statements of the investor do not contradict with other Ind AS such as Ind AS 40 that require cost-based measurement in the financial statements of the investee.

PwC Insights:

When an investor acquires significant influence over an investee or acquires joint control over a joint venture, then it accounts its investment in the associate/joint venture as per equity method of accounting in the consolidated financial statements. An investor undertakes a 'notional' purchase price allocation, identifying and valuing assets and liabilities of the associate or joint venture, as if it had acquired a business. These fair value adjustments are not recorded separately, because the investment itself is a single line item. However, the fair values identified form the basis for additional depreciation, amortisation and similar adjustments that are reflected in the investor's share of the results in subsequent years. Adjustments in the notional purchase price allocation include assets not recognised by the associate or joint venture (such as internally developed intangible assets, reserves of natural resources and similar assets). Adjustments might also be made to recognise the fair value of assets carried by the investee at cost (such as property, plant and equipment/investment property) and to recognise liabilities at appropriate values.

The notional goodwill that arises in the notional purchase price allocation is not amortised, and its separate disclosure is not required. It is not required to be separately tested for impairment, nor does it trigger an annual impairment test, because it is included in the carrying amount of the associate or the joint venture and not shown as a separate asset.

Investments in associates and joint ventures are assessed for impairment where indicators of impairment are present. Impairment indicators are described in Ind AS 28. The recoverable amount of the associate or joint venture is determined in accordance with Ind AS 36, *Impairment of Assets*.

**6. Related party transactions**

A subsidiary is a sole distributor of electricity to customers in a specified geographical area. The supply of electricity by the subsidiary to its parent entity is a related party transactions covered within the scope of Ind AS 24 and should be appropriately disclosed. The disclosures of Ind AS 24 are required for such transaction, notwithstanding the fact that parent entity is charged the electricity tariffs as determined by an independent rate-setting authority (i.e. the terms of supply to parent entity are at par with those applicable to other consumers). Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on an arm's length basis.

PwC Insights:

A reporting entity is heavily dependent on a supply of electricity from an electricity utility. Does that mean that the electricity utility is a related party of the reporting entity?

Response:

Heavy dependence on a key supplier does not, by itself, mean that the electricity utility is a related party of the reporting entity. There would need to be an additional factor involved for a related party relationship to exist. The reporting entity and the electricity utility would be related parties if, for example, the electricity utility had a 30% interest in the reporting entity, which it treats as an associate. Transactions with the electricity utility would then be disclosable.

**7. Classification of financial instruments from issuer's perspective**

As per Ind AS 32, a derivative is a financial liability if it will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. A derivative that will be settled by the issuer only by exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instrument is classified as equity. This is commonly referred to as the 'fixed for fixed' requirement. The term 'fixed amount of cash' refers to an amount of cash fixed in functional currency of the reporting entity. Since, an amount fixed in a foreign currency has the potential to vary in terms of functional currency of the reporting entity due to exchange rate fluctuations, it does not represent "a fixed amount of cash". Ind AS 32 provides the following two exceptions to the 'fixed for fixed' requirement where the variation is due to foreign currency:

(i) Rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own equity instruments.

(ii) Equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. This exception is a carve-out from IAS 32 issued by IASB.

The ITFG clarified that exception in clause (ii) above is limited to convertible bond and cannot be applied by analogy to equity conversion options embedded in other types of financial instruments denominated in a foreign currency such as preference shares.

PwC Insights:

Examples:

(i) ABC Limited is listed in India and US stock exchanges. The functional currency of ABC Limited is INR. It offers a right issue to its existing equity shareholders. The rights offer price is fixed at INR 60 per equity share for Indian shareholders and USD 1 for overseas shareholders. Whether the rights offer to shareholders is an equity instrument or derivative?

Response:

As per Ind AS 32, rights issues are classified as equity if they are issued for a fixed amount of cash regardless of the currency in which the exercise price is denominated, provided they are offered on a pro rata basis to all owners of the same class of equity.

(ii) XYZ Limited issues convertible bonds denominated in USD with a coupon of 5% per annum. The bonds are redeemable in cash at the end of $5^{th}$ year and at the option of the holder are convertible into equity shares of XYZ Limited in the ratio of 1:1. The functional currency of XYZ Limited is INR. How should holder's conversion option be classified by XYZ Limited?

Response:

Convertible bond is a compound financial instrument. The holder's equity conversion option is classified as equity. This is a carve-out from IFRS. Under IAS 32 issued by IASB, such conversion option would be a derivative since the 'fixed for fixed' requirement is not met.

(iii) Assume facts in (ii) above, except that instead of bonds, the instrument issued is preference shares with a mandatory dividend coupon.

Response:

As per the ITFG clarification, the exception in Ind AS 32 discussed above cannot be extended to instruments other than bonds, although such convertible preference shares could be economically similar to convertible bond. Accordingly, the holder's equity conversion option would be classified as a derivative (financial liability).

**8. Accounting of compound financial instrument redeemable on demand**

An entity issues preference shares denominated in its own functional currency. The preference shares carry discretionary non-cumulative dividend of 12% per annum and are convertible at the option of the holder at any time during the term into fixed number of equity shares of the entity. The holder of the preference shares also has an option to put the preference shares back to the entity at any time for the par amount. Accordingly, the preference shares are a compound financial instrument containing both liability component (representing the redemption feature in cash) and equity component (representing the discretionary dividend and holder's equity conversion option). Ind AS 113 states that fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. Since the entity has a contractual obligation to pay the par amount at any point in time at the option of the holder, preference shares represent a financial liability with a demand feature. Accordingly, the entire issue proceeds of the preference shares is allocated to the liability component and no amount is assigned to equity component.

**9. Presentation of interest on delayed payment of local taxes**

Presentation of interest payable on delayed payment of local taxes depends upon whether the interest is compensatory in nature for time value of money or penal in nature. This requires exercise of judgement based on evaluation of facts of the case. If it is concluded that interest is compensatory in nature, then it shall be classified as 'finance cost'. If interest is penal in nature, then it shall be classified as 'other expenses'.

**10. Deferred tax implication on conversion of capital asset into stock-in-trade**

Under the Income-tax Act, 1961, the conversion of capital asset into stock-in-trade is taxable in the year of sale of stock-in-trade and not in the year of conversion. Accordingly, no current tax liability arises in the year of conversion. A deductible temporary difference exists where the asset is carried at historical cost in the books but its tax base is indexed i.e. adjusted for inflation. Deferred tax asset on such deductible temporary difference should be recognised, provided the recognition criteria of Ind AS 12 is met. The difference between the asset's indexed cost and its fair value on the date of conversion does not meet the definition of temporary difference as per Ind AS 12, and accordingly, no deferred tax has to be recognised for such difference.

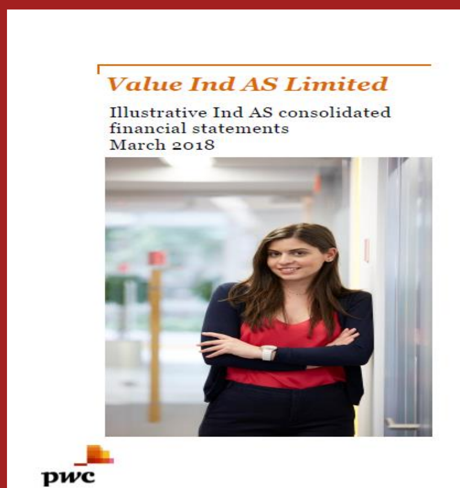
Example:
ABC Limited has a plot of land classified as PP&E. During FY 2017-2018, it converts the land into stock-in-trade. On the date of conversion, the carrying value of land is 100 crore INR and fair value of the land is 1,000 crore INR. The indexed cost of land is 150 crore INR. How should ABC Limited recognise deferred tax on conversion of capital asset into stock-in-trade in FY 2017-2018?

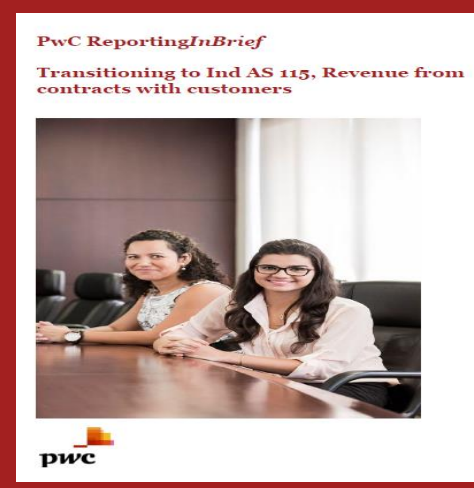
Response:
As per Income-tax Act, 1961, conversion of capital asset into stock-in-trade is taxable in the year of sale of the asset. Accordingly, there is no current tax liability in the year of conversion. As per Ind AS 12, temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. Tax base of the land is the indexed cost of 150 crore INR. The difference between land's carrying amount of 100 crore INR and its indexed cost of 150 crore INR results in a deductible temporary difference of 50 crore INR on which deferred tax asset shall be recognised, provided the recognition criteria of Ind AS 12 are met. The difference between the fair value of land of 1,000 crore INR and indexed cost of 150 crore INR does not meet the definition of temporary difference.

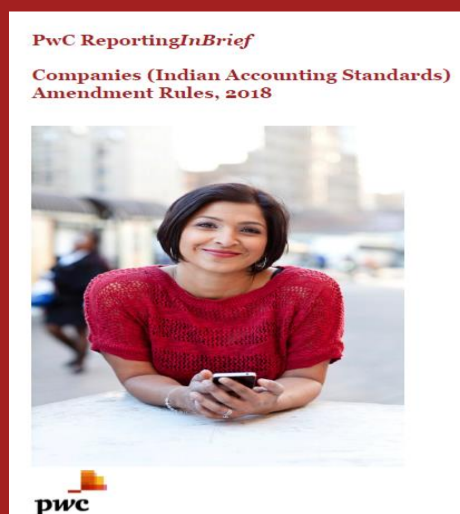
## *The takeaway*

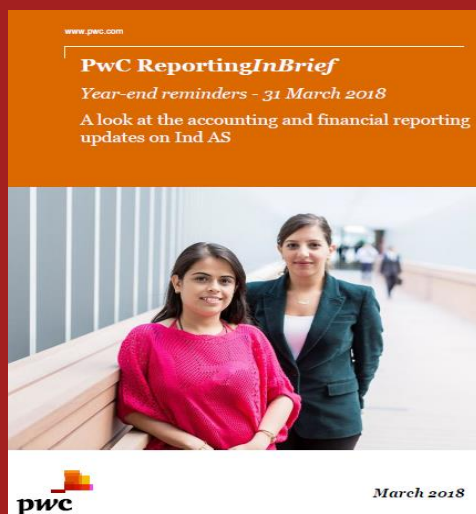
Clarifications by ITFG is useful for the companies and other stakeholders as they navigate their journey through Ind AS. The current bulletin provides clarity on some of the key issues commonly faced by the stakeholders such as classification of financial instruments, accounting for government grants, disclosure of related party transactions and deferred tax implication of conversion of capital asset into stock-in-trade. The clarifications will promote consistency in interpretation and implementation of Ind AS. Entities should however exercise judgement and carefully evaluate the ITFG clarifications whilst applying them to their specific facts and circumstances.

# Previous publications





# Our offices

**Ahmedabad**

1701, 17th Floor, Shapath V
Opposite Karnavati Club
S G Highway
Ahmedabad, Gujarat 380 051
Phone: [91] (79) 3091 7000

**Bengaluru**

The Millenia, Tower D
#1 & 2 Murphy Road, Ulsoor
Bengaluru, Karnataka 560 008
Phone: [91] (80) 4079 4000

**Chennai**

Prestige Palladium Bayan,
8th Floor
129–140, Greams Road
Chennai, Tamil Nadu 600 006
Phone: [91] (44) 4228 5000

**Hyderabad**

Plot no. 77/A, 8-624/A/1
3rd Floor, Road no. 10
Banjara Hills
Hyderabad, Telangana 500 034
Phone: [91] (40) 4424 6000

**Kolkata**

Plot nos 56 & 57
Block DN-57, Sector V
Salt Lake Electronics Complex
Kolkata, West Bengal 700 091
Phone: [91] (33) 2357 9100

**Mumbai**

252 Veer Savarkar Marg
Next to Mayor's Bungalow
Shivaji Park, Dadar
Mumbai, Maharashtra 400 028
Phone: [91] (22) 6669 1000

**Delhi NCR**

Building 8, Tower B
DLF Cyber City
Gurgaon, Haryana 122 002
Phone: [91] (124) 462 0000

**Pune**

Tower A - Wing 1, 7th Floor
Business Bay
Airport Road, Yerawada
Pune, Maharashtra 411 006
Phone: [91] (20) 4100 4444

**Jamshedpur**

GDR Siddha, Level 2
N-Road, Opposite Saint Mary School,
Bistupur, Jamshedpur,
Jharkhand 831 001
Phone: [91] (657) 2320 535 / 595

# About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 158 countries with more than 236,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com

In India, PwC has offices in these cities: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Jamshedpur, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit **www.pwc.com/in**

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

© 2019 PwC. All rights reserved

# pwc.in

Data Classification: DC0

This document does not constitute professional advice. The information in this document has been obtained or derived from sources believed by PricewaterhouseCoopers Private Limited (PwCPL) to be reliable but PwCPL does not represent that this information is accurate or complete. Any opinions or estimates contained in this document represent the judgment of PwCPL at this time and are subject to change without notice. Readers of this publication are advised to seek their own professional advice before taking any course of action or decision, for which they are entirely responsible, based on the contents of this publication. PwCPL neither accepts nor assumes any responsibility or liability to any reader of this publication in respect of the information contained within it or for any decisions readers may take or decide not to or fail to take.

© 2019 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.