International tax impact of Ind AS

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Where Passion Delivers Value

Roadmap to Ind AS

For companies other than banks, insurance companies, NBFC	
2015-16 Voluntary Phase	▪ Early Adoption
2016-17 Mandatory Phase I	▪ Companies with net worth of Rs.500 crore or more
2017-18 Mandatory Phase II	▪ All Listed Companies not covered in Phase I ▪ All Unlisted Companies with net worth of Rs. 250 crore or more

For banks, insurance companies, NBFC	
2018-19 Phase I	▪ Scheduled commercial banks ▪ Term lending refinancing institutions ▪ Insurer/insurance companies ▪ NBFC with net worth of Rs. 500 crore or more
2019-20 Phase II	▪ All Listed NBFC (or in the process of listing) & not covered in Phase I ▪ All unlisted NBFC with net worth of Rs.250 crore or more, but less than Rs. 500 crore

- Also applies to holding, subsidiaries, joint ventures & associate companies of the above companies
- Applies to both standalone & consolidated financial statements.
- Financial statements to be presented with an opening balance & comparative period.

Roadmap to Ind AS

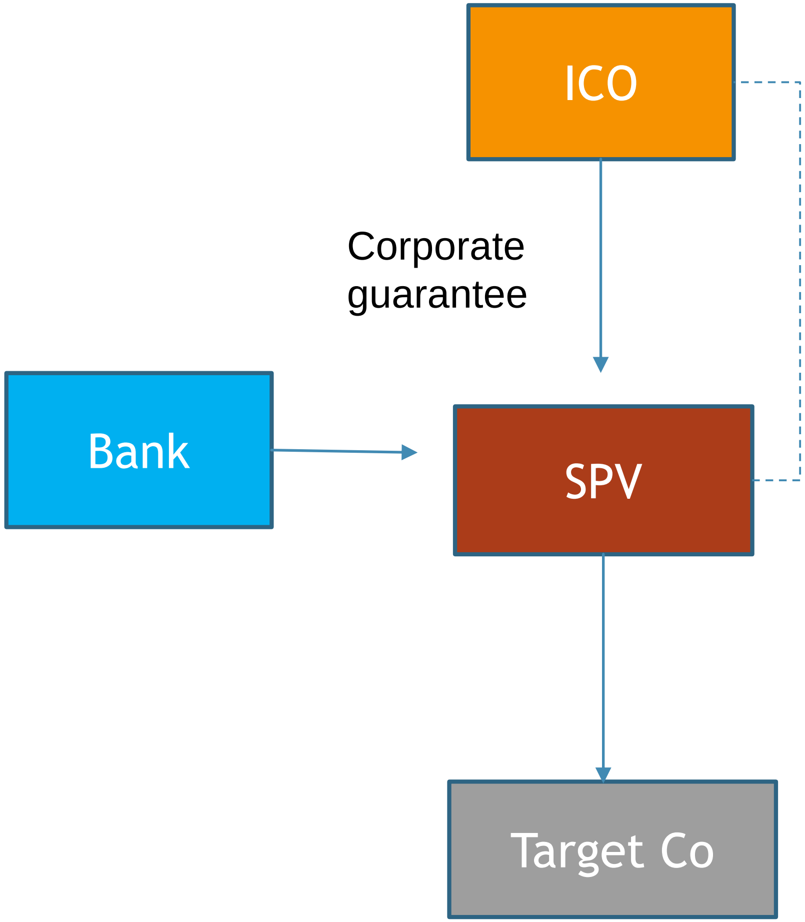
- Fundamental shift vis-à-vis IGAAP
  - Recognition of time value of money
  - Fair value accounting
  - Accounting based on substance over form
- Compulsory shift towards Ind AS accounting with limited options for first time adoption (FTA)
- All pervasive impact on finance, accounting, tax, information technology etc

Ind AS P&L

Ind AS Statement of Profit and Loss	
Particulars	**Amount (₹)**
Revenue From Operations	XX
Other Income	XX
Total Income	**XX**
EXPENSES Cost of material consumed	XX
Purchase of Stock-in-Trade	XX
Employee Benefit Expenses	XX
Finance Cost	XX
Other expenses	XX
Total Expenses	**XX**
Profit / (loss) before tax	**XX**
Tax Expense: 1. Current Tax 2. Deferred Tax	XX
Profit / (Loss) for the period	**XX**
Other Comprehensive Income A. (i) Items that will not be classified to profit or loss (ii) Income tax relating to items that will not be classified to profit or loss B. (i) Items that will be reclassified to profit or loss (ii) Income tax relating to items that will be classified to profit or loss	XX
Total Comprehensive Income for the period (Comprising Profit (Loss) and other Comprehensive Income for the period)	**XX**

Corporate guarantee

Facts



Facts

- SPV obtained loan to acquire Target Co
- But for ICO, Bank was not willing to give loan to SPV
- ICO provided corporate guarantee for 5 year period
- ICO did not charge any guarantee commission by treating it as shareholder function

IGAAP

- Guarantee commission not recognised as income.
- Disclosed under RPT schedule and as contingent liability

Ind AS accounting

Meaning of financial guarantee

- Ind AS 109 defines FG contract as a contract that requires issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with original or modified terms of debt

Initial recognition

- FG is initially recognised and measured at fair value
- Subsequently, Ind AS is measured at higher of following two amounts:
  - Amount of loss allowance determined as per impairment requirement of Ind AS 109
  - Amount initially recognised less, where appropriate, cumulative amortization recognised under Ind AS 18
- Recorded as financial guarantee receivable on asset side with corresponding financial guarantee obligation on liability side

Ind AS accounting

Initial recognition

- If no guarantee commission is charged fair value is recognised as Investment in subsidiary

Valuation of guarantee

- FG needs to be valued considering Ind AS 113: fair value measurement
- ITFG Bulletin 16 provides following guidance:
  - Fair value of the financial guarantee (at initial recognition) could be the amount that an unrelated, independent third party would have charged for issuing the financial guarantee
  - Estimate the fair value of the financial guarantee as the present value of the amount by which the interest (or other similar) cash flows in respect of the loan are lower than what they would have been if the loan was an unguaranteed loan

Ind AS accounting

Valuation of guarantee

- ITFG Bulletin 16 provides following guidance:
  - Estimate the fair value of the financial guarantee as the present value of the probability-weighted cash flows that may arise under the guarantee (i.e. the expected value of the liability)

Ind AS accounting

- Initial fair value of guarantee is Rs 10 crs. The amortised cost value of guarantee over 5 year period is as under:

Period	Amortised cost (in crs)
31 March 2019	8
31 March 2020	6
31 March 2021	4
31 March 2022	2
31 March 2023	0

- Ind AS 109 provides detail guidance on accounting of FG in books of parent company. There is limited guidance on accounting by subsidiary

Ind AS accounting

Date	Particulars	Debit	Credit
1 April 2018	Investment is subsidiary (balance sheet)	10	
	To Financial guarantee obligation (balance sheet) (Initial recognition of FG at fair value)		10
Amortisation based on year end estimate of fair value			
31 March 2019	Financial guarantee obligation	2	
	To Guarantee commission (Amortisation of FG obligation)		2
31 March 2020	Financial guarantee obligation	2	
	To Guarantee commission (Amortisation of FG obligation)		2

Ind AS accounting

Date	Particulars	Debit	Credit
Amortisation based on year end estimate of fair value			
31 March 2019	Financial guarantee obligation	2	
	To Guarantee commission (Amortisation of FG obligation)		2
31 March 2020	Financial guarantee obligation	2	
	To Guarantee commission (Amortisation of FG obligation)		2
31 March 2021	Financial guarantee obligation	2	
	To Guarantee commission (Amortisation of FG obligation)		2

TP jurisprudence on CG

1 International transaction

- Even after FA 2012, provision of CG would still not constitute an 'international transaction' unless same had bearing on profits, income, losses or assets of taxpayer
- No cost to enterprise issuing CG

2 Quasi capital/shareholder support

- Purpose of providing CG was to enable SPV to make acquisition
- No independent lender would have provided loan but for CG
- Purpose of CG is to protect shareholder interest

3 Benchmarking of CG

- CG is different than bank guarantee and hence it cannot be benchmarked against naked bank quote
- Safe harbour – 1% of amount guaranteed
- Limited guidance on benchmarking of CG – in practice taxpayer have adopted interest saving approach

TP jurisprudence on CG

1 International transaction	2 Quasi capital/shareholder support	3 Benchmarking of CG
• Taxpayer could not have realised money by giving such guarantee to someone else during the course of its normal business • Possibility of default is hypothetical situation	• CG are in nature of the shareholder activity as it was to provide, or compensate for lack of, core strength for raising the finances from banks	• 0.5% accepted as ALP commission

TP jurisprudence on CG

1 International transaction

- Bharti Airtel Limited [2014] 63 SOT 113 (Del)

2 Quasi capital/shareholder support

- Tega Industries Ltd [2016] 76 taxmann.com 24 (Kolkata - Trib.)
- Micro Ink Ltd [2015] 63 taxmann.com 353 (Ahmedabad - Trib.)

3 Benchmarking of CG

- Everest Kento Cylinder [2015] 378 ITR 57 (Bombay)
- Piramal Enterprise Ltd [2018] 97 taxmann.com 352 (Mumbai - Trib.)
- Videocon Industries Ltd [2017] 79 taxmann.com 216 (Mum. - Trib.)

Issues post Ind AS

Reporting of CG in Form 3CEB

Since CG is recognised as income in profit and loss – whether position changes ?

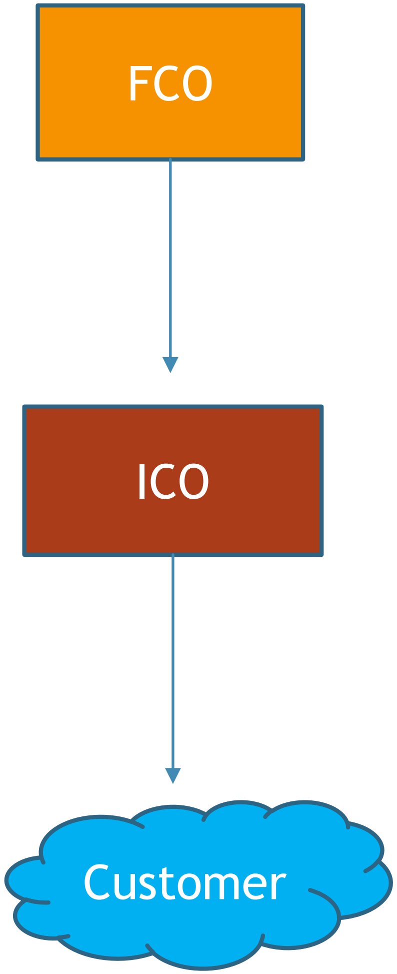
Impact on existing position in case of continuing arrangement on account of recording of CG under Ind AS

Whether CG income recorded basis Ind AS needs to be offered to tax ?

Whether fair valuation of CG basis Ind AS will impact TP benchmarking

Ind AS 115: Principal v/s agent

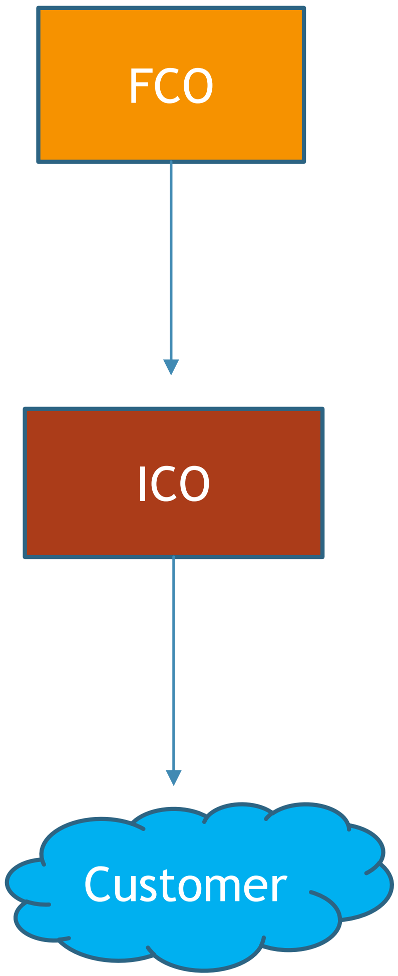
Facts



Facts

- ICO is distributor of high end machinery
- Marketing team of ICO meets customers, understands requirement and specification and provides information to FCO
- Basis information FCO provides proposal to ICO
- ICO adds mark up and concludes contract with customer
- ICO submits final proposal for FCO approval and basis approval closes contract with customer
- ICO appoints pre-approved contractor of FCO and install machinery. FCO is responsible for warranty and servicing
- ICO purchases machinery from FCO and immediately transfer the same to customer

Facts



Facts

- ICO maintains margin of 3% which meets ALP considering distributor in similar business

IGAAP

- Gross revenue received from customer is booked as sales and purchase price paid to FCO is disclosed separately

Tax Issues

- Permanent establishment risk of FCO
- TP margin earned by ICO

Ind AS accounting

Entity has to determine whether it is performing its performance obligation in capacity of principle or agent

Principal

- Entity controls a promised good or service before the entity transfers the good or service to a customer
- Entity satisfies performance obligation either by itself or through another party
- Revenue is recognised on gross basis

Agent

- Not principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer
- Revenue is recognised to the extent of fees or commission

Ind AS accounting

Agent

- Not principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer
- Revenue is recognised to the extent of fees or commission
- Indicators of agent
  - another party is primarily responsible for fulfilling the contract
  - the entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping or on return
  - the entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;
  - the entity's consideration is in the form of a commission; and
  - the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services.

Jurisprudence

Revised Article 5(5)

Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and has, and habitually exercises, in a Contracting State, an authority to conclude contracts, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned
by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

Jurisprudence

Treaties impacted pursuant to MLI

- Netherland
- France
- Japan

India Position

- Reuters Limited [TS-511-ITAT-2015-Mum]
- Daimler Chrysler AG (39 SOT 418) (Mum)
- Daikin Industries Ltd 2018] 171 ITD 301 (Delhi - Trib.)
- OECD Commentary
- India Position on OECD Commentary

OECD Commentary

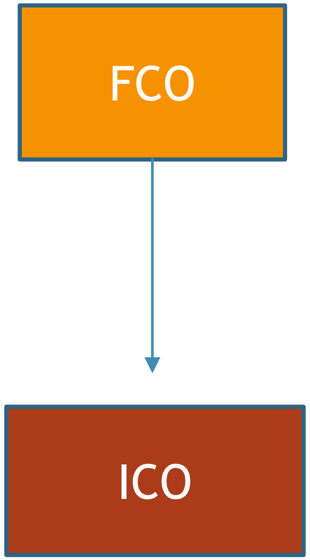
"96. The cases to which paragraph 5 applies must be distinguished from situations where a person concludes contracts on its own behalf and, in order to perform the obligations deriving from these contracts, obtains goods or services from other enterprises or arranges for other enterprises to deliver such goods or services. In these cases, the person is not acting "on behalf" of these other enterprises and the contracts concluded by the person are neither in the name of these enterprises nor for the transfer to third parties of the ownership or use of property that these enterprises own or have the right to use or for the provision of services by these other enterprises. Where, for example, a company acts as a distributor of products in a particular market and, in doing so, sells to customers products that it buys from an enterprise (including an associated enterprise), it is neither acting on behalf of that enterprise nor selling property that is owned by that enterprise since the property that is sold to the customers is owned by the distributor. This would still be the case if that distributor acted as a so-called "low-risk distributor" (and not, for example, as an agent) but only if the transfer of the title to property sold by that "low-risk" distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold) so that the distributor would derive a profit from the sale as opposed to a remuneration in the form, for example, of a commission"

India Position

"52. India does not agree with the interpretation given in paragraph 96 because it considers that distribution of goods owned by an enterprise by an associated enterprise or a closely connected enterprise, particularly in a case where the risks are not born by such enterprise, such as the so called "low risk distributor", may give rise to a permanent establishment of the enterprise, whose goods are being sold"

Redeemable preference shares

RPS



Facts

- FCO infused 10% RPS in ICO. Assume 10% as market rate for similar instrument
- ICO pays 10% dividend on yearly basis

Ind AS

- RPS classifies as ‘financial lability’ and needs to be recorded as liability as against equity under Ind AS
- Dividend payment are recorded as interest

Issue

- Whether to be considered as ‘interest or similar expenditure’ to test applicability of section 94B(1)?
- Dividend accounted as interest be considered for computing EBITDA under section 94B(2)?

Section 94B

94B. (1) Notwithstanding anything contained in this Act, where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, incurs any expenditure by way of interest or of similar nature exceeding one crore rupees which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of such borrower, the interest shall not be deductible in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2) :

Provided that where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise.

Section 94B

(2) For the purposes of sub-section (1), the excess interest shall mean an amount of total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less.

(5) For the purposes of this section, the expressions—

"debt" means any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession"

Ind AS defines financial instrument as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another

Compounded instrument

Compulsorily convertible debenture

- H Ltd issues 2000 convertible bonds
- The bonds have a 3 year term, and are issued at par with a face value of INR1,000 per bond, giving total proceeds of INR 2,000,000
- Interest is payable annually in arrears at a nominal annual interest rate of 6% (i.e. INR120,000 per annum)
- Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9% per annum
- The entity incurs issue costs of INR100,000.

Bifurcation

Year	Particulars	Cash flow	Discount factor (@ 9%)	NPV of cash flow
1	Interest	120,000	1/1.09	110,092
2	Interest	120,000	1/1.092	101,001
3	Interest & principal	2,120,000	1/1.093	1,637,029
	Total liability component at PV			1,848,122
	Equity component (balance)			151,878
	Total proceeds			2,000,000

Bifurcation

Particulars	Liability component	Equity component	Total
Gross proceeds	1,848,122	151,878	2,000,000
Issue cost (pro-rata)	92,406	7,594	100,000
Net proceeds	1,755,716	144,284	1,900,000

Bifurcation

Year	Opening liability	Interest @ 10.98%	Cash paid	Closing liability
1	1,755,716	193,094	(120,000)	1828,810
2	1,828,810	201,134	(120,000)	1,909,944
3	1,909,944	210,056	(2,120,000)	-
	Total finance cost	604,284		

INR 144,284 (151,878 minus 7,594) credited to equity is not subsequently remeasured

Conversion

- On conversion of a compound instrument at maturity, the entity should de-recognize the liability component and recognize it as equity.
- Equity issued on conversion is measured at the carrying amount of the liability component at the date of conversion.
- There is no gain or loss on conversion at maturity.
- The equity component of the instrument recognised initially is transferred to share capital. Other components of equity (like share premium) are recognised depending on the legal requirements

Yearly interest cost

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
31 March 2019	Bank Dr	2,000,000	
	To CCD (recorded as financial liability)		1,848,122
	To Other equity		151,878
31 March 2019	CCD	92,406	
	Other Equity	7,594	
	To Bank (Recording of issue expenses)		1,00,000

Yearly interest cost

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
31 March 2019	Finance cost	193,094	
	To CCD (recorded as financial liability) (Interest expense booked in FY 2018-19)		193,094
31 March 2020	Finance cost	201,134	
	To CCD (recorded as financial liability) (Interest expense booked in FY 2019-20)		201,134
31 March 2021	Finance cost	210,056	
	To CCD (recorded as financial liability) (Interest expense booked in FY 2021-22)		210,056

Yearly interest cost

- Entries in books of S Ltd

Date	Particulars	Debit	Credit
31 March 2021	CCD (recorded as financial liability)	2,00,000	
	To Equity shares/security premium		2,000,000
31 March 2021	Other Equity	144,284	
	To Equity		144,284

Tax implication

Normal tax

- Quantum of interest deduction – actual or as per books
- TDS responsibility – actual or as per books
- Section 94B/ section 14A – actual or as per books
- Can issue expense claim in totality ?

MAT

- Yearly interest provision deductible under MAT
- Not a provision for unascertained liability

TP

- Impact of effective interest rate on benchmarking of interest on CCD
- Quantum of disclosure in Form 3CEB

Impact on CbCR

Criteria for consolidation

Section 286 i.e. CbCR applies if total consolidated group revenue exceeds INR 5,500 crs in preceding financial year

IGAAP

AS 21 states that control means:

- Ownership directly or through subsidiaries more than one-half of voting power of an entity
- Control over composition of director

Ind AS

Investor control investee has all the following:

- Power over the investee
- Exposure, or rights, to variable returns from its involvement with investee
- The ability to sue its power over the investee to affect the amount of investors return

Impact on CbCR

- Consolidation will depend upon contractual right and conduct over investee
- Accordingly, an entity may qualify as subsidiary even though parent does not hold more than 50%
- Form 3CEAD requires submission of quantitative and qualitative data
- Transaction with such entity may form part of RPT schedule even though such entity may not satisfy requirement of section 92A

Impact on Comparability

Setting the context

- MAM shall be determined in manner prescribed by Rule 10B
- Uncontrolled transaction is comparable to an international transaction provided:
  - Differences, if any, are not likely to materially affect the price or cost charged or paid in or profit arising from such transaction in open market
  - Reasonably accurate adjustments can be made to eliminate material effects of such differences
- Adjustment can be made in comparable companies and not in computation of tested party
- Multiple year data and range concept:
  - Current year data available – use of current year data and preceding 2 years data if available
  - Current year data not available – use proceeding 1 year or 2 years data based on availability
  - Current year data if available during assessment can be used
  - If transaction not comparable in current year – reject company as comparable

Impact on PLI/Comparability

Revenue Recognition

- **Multiple performance obligation:**
  - Each element to be recorded separately and appropriate consideration to be allocated to each one of them (e.g. sale of goods with free 2 years maintenance contract, warranties)
  - Possible that revenue may be deferred or comparability may be impacted or filter may impact comparability per se
- **Time value of money :**
  - Adjust the transaction price for the time value of money if the contract includes a significant financing component (e.g. deferred sale)
  - Price adjustment is treated as financial asset and notional interest is accounted
  - AE sales with differed consideration, likely to impact WC adjustment as also benchmarking of sales

Impact on PLI/Comparability

Revenue Recognition

- **Excise duty/GST:**
  - Under IGAAP, excise duty was reduced from sales and net sales were disclosed
  - Ind AS requires revenue to be reported at gross and excise duty/GST treated as cost in P&L
  - Likely to impact operating cost (cost plus model) and margin computation
- **Cash discount and incentive linked to volume of sales :**
  - Under IGAAP, divergent accounting policies were followed
  - Under Ind AS, all discounts and incentives (which are linked to volume of sales) are required to be presented as reduction from revenue. However, other sales promotional expenses are shown as expense
  - Likely to impact operating cost. Tribunal has unanimously held exclusion of such expenditure to compute AMP ratio

Impact on PLI/Comparability

Employee Cost

- Actuarial gain/loss are recognised separately in OCI
- Accordingly, employee cost is split between P&L and OCI
- Need to aggregate to compute employee cost filter for IT/ITES industry

Depreciation

- Ind AS 16 provides following one time option to companies to recognise plant, property and equipment
  - Previous IGAAP values
  - Fair value on convergence date as deem cost
  - Retrospective application of fair value as deem cost
- Likely to impact operating profit of comparable. Adjustment possible only if accurate information is available. Likely to impact net profit/assets ratio

Impact on PLI/Comparability

Share based payment

- Mandatory to record ESOP and other share based payment at fair value as against intrinsic value under IGAAP
- In case of group company ESOP, subsidiary to record charge even if Parent does not cross charge subsidiary
- Whether such amount to be disclosed in Form 3CEB?
- Impact on operating cost and margin computation in case of captive company operating under Cost plus model

Various scenario

Scenario 1: Tested party IGAAP

IGAAP	→	IGAAP	Ind AS	Data N/A	Ind AS
	Year 1	IGAAP	Ind AS	Ind AS	IGAAP
	Year 2	IGAAP	IGAAP	IGAAP	Data N/A

- First Time Adoption (Ind AS 101) requires entity to give reconciliation between IGAAP profits and Ind AS in year of convergence
- Adjustment should otherwise be in accordance with Rule 10B – adjustment should be material and reasonably accurate
- Ind AS changes on non-operating items unlikely to impact ALP computation

Various scenario

Scenario 1: Tested party Ind AS

Ind AS →	IGAAP	Ind AS	Data N/A	Ind AS
Year 1	IGAAP	Ind AS	Ind AS	IGAAP
Year 2	IGAAP	IGAAP	IGAAP	Data N/A

- Accounting adjustment possible only in comparable companies
- Exclude comparable if accurate adjustment not possible

Thank You

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