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

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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

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Objectives

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

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Impact on economy

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

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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**

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Exclusions

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

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

Transactions with Government which are of normal trading

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Criteria for recognition in the books

To recognise in the books only if reasonable Assurance :

a) **of receipt of the grant; and**
b) **that the entity will be able to comply with all the conditions**

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

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Classification of Grant

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

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

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Capital Approach & Income Approach

<u>Capital Approach</u> :
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

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

Manner of accounting / presentation

<u>Capital Approach</u>
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
<u>In respect of depreciable asset</u> –
- Amortised systematically over the assets useful life.

<u>In respect of non depreciable asset</u> –
- 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

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

Revenue Approach

1) On accrual basis – earned benefits on a prudent basis is credited to income
2) Contingency provision as per AS4 and AS29
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

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

Treatment upto AY 2015-16

- **Principles of Capital vs. Revenue**
- **Nature of Grant vs. Purpose of Grant**
- **The test whether a subsidy is taxable as revenue will depend on :**
- **Purpose for which subsidy is given**
– 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)

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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.**

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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

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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.**

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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.

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

ICDS and Government Grants

ICDS introduced and mandatory from AY 2016-17 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.

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

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.

ICDS and Government Grants

Transitional Provisions

–All the government grants which meet the recognition criteria on or after 1st April 2016 shall be recognized for the previous year commencing on or after 1st April 2016 in accordance with the provisions of this standard after taking into account grant already recognised

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CARBON CREDIT

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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

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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**

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Question Session

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THANK YOU

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