The Western India Regional Council

Impact Analysis of Indian Accounting Standards (“Ind AS”) and Income Computation and Disclosure Standards (“ICDS”) on

Business Combinations

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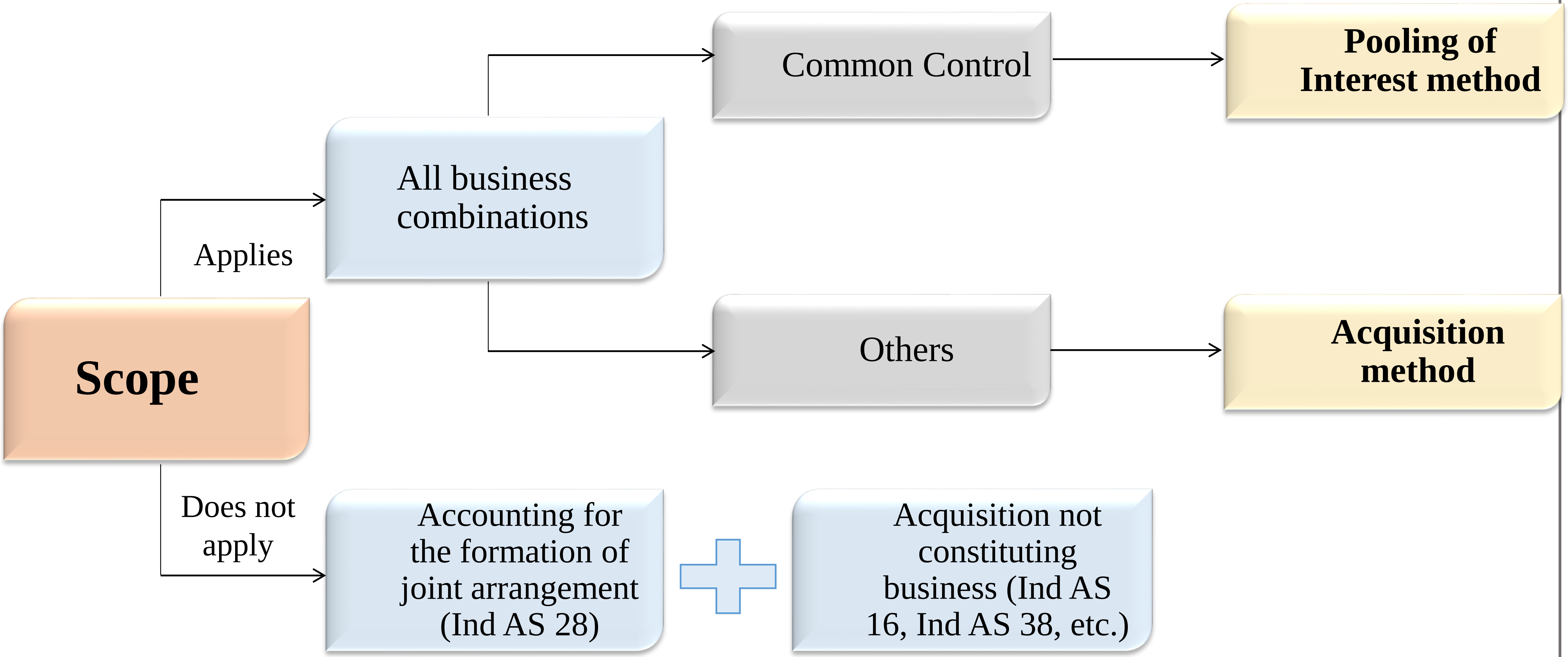
OVERVIEW

Background…

- “Purpose/ Intention”
  - Sale of Entire Company – Sale of Shares/Amalgamation
  - Sale of Division – Slump Sale/Demerger/Slump Exchange
- Accounting and Tax implications different for buyer/seller
- Earlier, AS 14 was applicable to amalgamations. Presently, to apply Ind AS 103 for business combinations
- Other considerations:
  - Indirect tax / Stamp duty implications
  - Time period for carrying out arrangement (Private Sale/Court Scheme)
  - Clear transfer of title in case of court approved scheme - Ease of transfer of existing contracts, etc.
  - Now in NCLT scheme - Tax Department NOC required – MCA General Circular 1/2014

…Background


Common Control
Pooling of Interest method
All business combinations
Applies
Others
Acquisition method
Scope
Does not apply
Accounting for the formation of joint arrangement (Ind AS 28)
Acquisition not constituting business (Ind AS 16, Ind AS 38, etc.)

Business…

Business Combination

A transaction or other event in which an acquirer obtains control of one or more **businesses**

Known as ‘True mergers’ or ‘Mergers of equals’

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants

Inputs + Process + Provide or have ability to provide output = **Business**

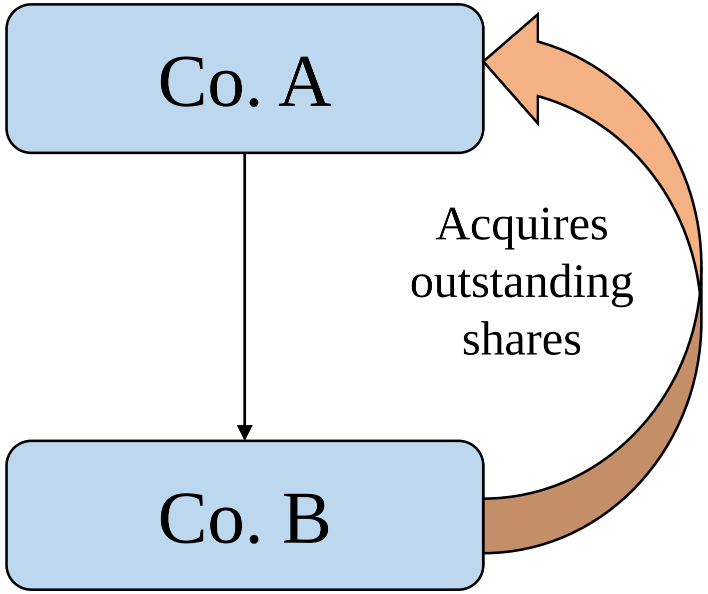
…Business…

- …Business
  - To determine whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a **market participant**
    - In evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business
  - <u>Outputs</u> are <u>not mandatorily required</u> for a set of activities and assets to qualify as a business
    - Example – Activities at development stage without outputs is still business

Rebuttable presumption – If goodwill is present in set of assets and activities, then acquisition is a business

However, a business need not have goodwill

…Business (Case Study 1/2)…



- ❑ Co. B is a start-up biotech company with a license
- ❑ Co. A acquires outstanding shares of Co. B
- ❑ Initial clinical tests are currently performed by 3 employees of Co. B (including the founder of Co. B)

Is the above a business combination or an asset acquisition?

…Business (Case Study 1/2)…

- Business
  - Inputs – Licence and employees
  - Processes – Operational and management processes associated with the performance and supervision of the technical tests
  - Outputs - None

…Business (Case Study 2/2)

- Co. A acquired Co. B that held only investments. Co B had no employees.
- Co. A accounted for the acquisition as subsidiary under AS using book values
- This resulted in significant goodwill in CFS of Co. A

Can Co. A apply business combination exemption to the acquisition of investment?

- Co. A to assess whether Co. B meets definition of business under Ind AS 103
- If Co. A concludes that the asset is not a business – it cannot apply business combination exemption
- In fact, Co. A to account such transactions as an asset acquisition

Acquisition Date…

- Co. B acquires the real estate division of Co. A by way of a NCLT approved Scheme
- The appointed date of the Scheme is April 1, 2016
- The NCLT approved the Scheme on March 1, 2017
- The effective date mentioned in the Scheme is the date when the Order is filed with the Registrar of Companies, which is March 15, 2017
- The lenders' and shareholders' approvals were received on February 25, 2017

What would be the acquisition date under Ind AS?

What would be the transfer date under the Income-tax Act, 1961?

…Acquisition Date…

- **Acquisition date** = Date on which the acquirer obtains **control** of the acquiree
- Generally, the closing date - the date on which the acquirer legally
  - Transfers the consideration
  - Acquires the assets
  - Assumes the liabilities of the acquiree
- However, acquisition date may be earlier or later than the closing date
  - Example – A written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date

- Since the control gets transferred when all the conditions are satisfied and the Scheme is filed with the Registrar, would March 15, 2017 be the acquisition date ?

…Acquisition Date…

Accounting

- <u>However,</u>
- Section 232(6) of the Companies Act, 2013 ("the 2013 Act") – Scheme to clearly provide an appointed date from which it will be effective
- Ind AS is a piece of delegated legislation – If such subordinate legislation is contrary to any law, then law to prevail
- Thus, appointed date in a Scheme as per section 232(6) to prevail over any other date
- Should April 1, 2016 be not the acquisition date ?

Taxation

- Marshall Sons & Co. (India) Ltd. v. ITO (1996) (223 ITR 809) (SC) – Amalgamation to take effect from the date mentioned in the Scheme as the transfer date, i.e., appointed date
- Possible view – April 1, 2016 is the transfer date

- Should the date of combination be different in accounting and taxation ? If that be the case, many issues may arise for all time to come.

…Acquisition Date…

- Co. B acquires the real estate division of Co. A by way of a Business Transfer Agreement (“BTA”)
- BTA specified that the business, all rights and obligations will be transferred with effect from April 1, 2016
- All benefits arising from April 1, 2016 till the fulfilment of conditions will be transferred by Co. A to Co. B
- Conditions precedent were obtaining the lenders’ and shareholders’ approvals, which were actually received on July 31, 2016
- The consideration as specified in BTA was paid on March 20, 2017

What would be the acquisition date under Ind AS?

What would be the transfer date under the Income-tax Act, 1961?

…Acquisition Date

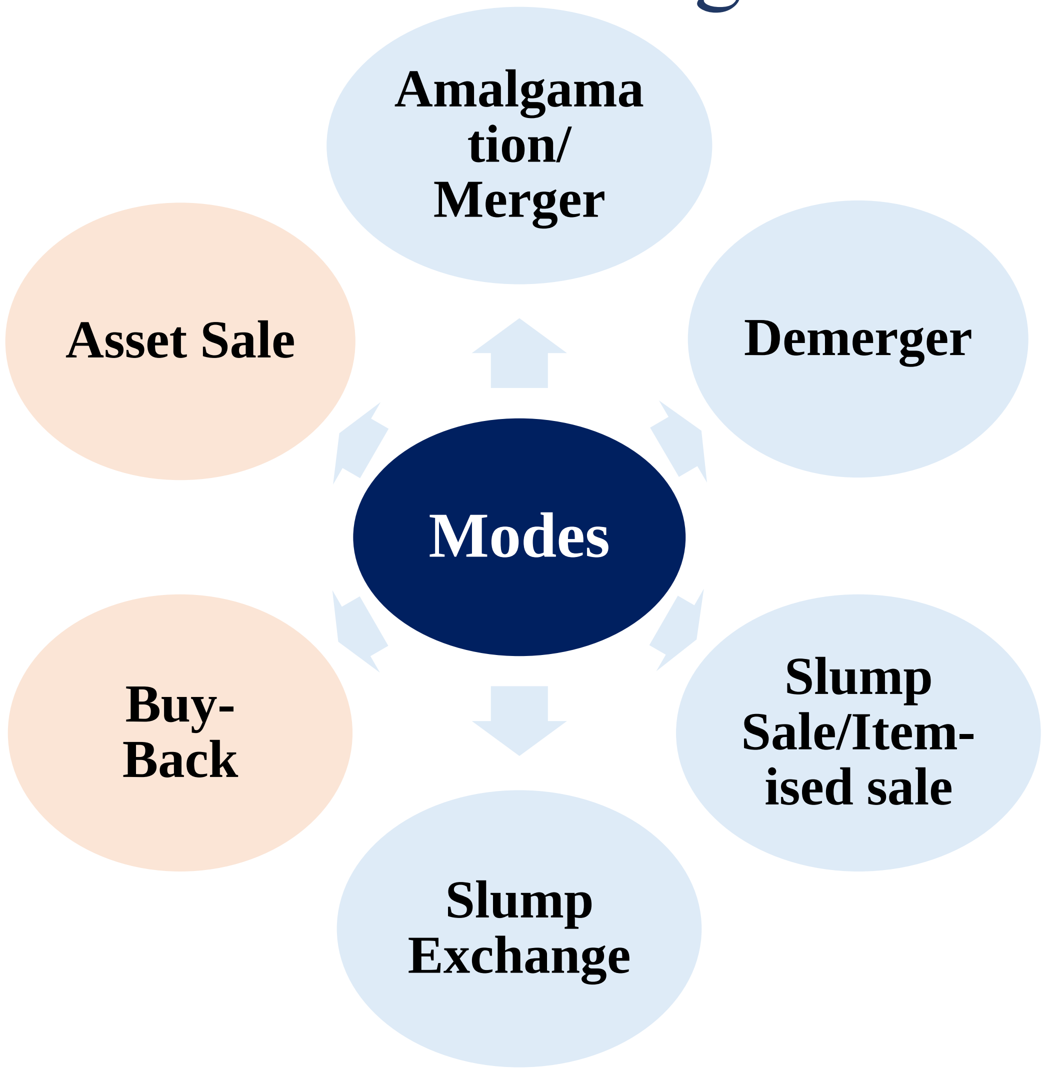
Accounting

- Rule of construction of a contract – Look into the language of the whole agreement and ascertain the real intention of the parties
- Further, control is said when investor has rights to variable returns
- In present case, the intention of parties is to transfer business from April 1, 2016
- Also, Co. B has power over variable returns from April 1, 2016
- Owing to "Substance over Form", April 1, 2016 is the acquisition date

Taxation

- Dalmia Cement Ltd. v. CIT (1999) (237 ITR 617) (SC) – Date of transfer is the date mentioned in the agreement, even though the actual transfer happened on a later date
- Possible view – April 1, 2016 is the transfer date

Manner of Restructuring…



Business combinations

Acquisition which may not constitute business

…Amalgamation / Merger – Prior to Ind AS…

- Amalgamation of a company by way of court approved scheme [Now, National Company Law Tribunal (‘NCLT’)] – Process is time-consuming

Accounting

- Account either as per the merger method (on fulfilment of conditions) or purchase method
- Transferee - Record assets / liabilities / reserves either as per the pooling of interest method or the purchase method – Adjust difference in Reserves / Goodwill

Taxation

- Tax neutral if conditions u/s. 2(1B) fulfilled
- Other sections:
  - 47 - No capital gains in hands of shareholders and amalgamating company
  - 49 - Cost of acquisition (“COA”)
  - 2(42A) - Period of holding
  - 32 - Apportionment of depreciation
  - 43(1) - Actual cost of capital asset

…Amalgamation / Merger – After Ind AS…

Accounting

Amalgamation between companies under common control

- Pooling of interest method
- Transferee – Record assets / liabilities at existing carrying amounts; adjust the difference in capital reserve

Amalgamation between other companies

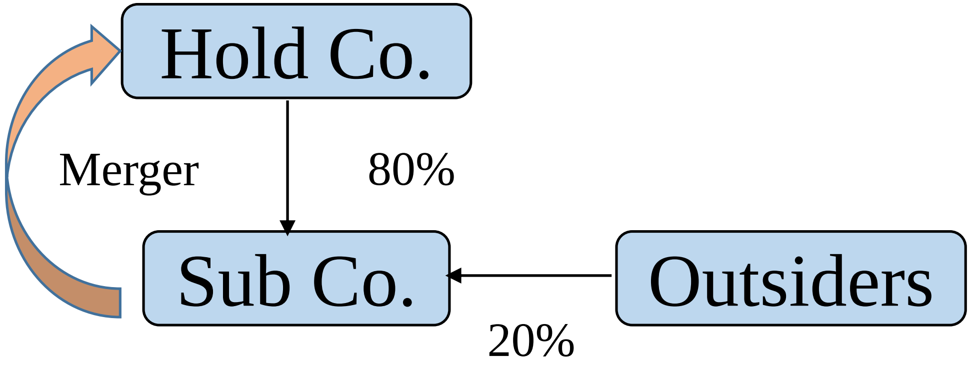
- Acquisition accounting
- **Acquirer – Record assets / liabilities at fair value and adjust difference in goodwill / capital reserve / gain from bargain purchase**

Taxation

Amalgamation between companies

- Tax neutral if conditions u/s. 2(1B) fulfilled-
- Other sections:
  - 47-No capital gains in hands of shareholders and amalgamating company
  - 49-Cost of acquisition ("COA")
  - 2(42A)-Period of holding
  - 32-Apportionment of depreciation
  - 43(1)-Actual cost of capital asset
- **Cost to previous owner (s. 49) - Ignore the effect of fair value / reverse the impact, when the amalgamated company sells the assets acquired in amalgamation**

…Amalgamation / Merger (Case Study 1/2)…



- **<u>Facts</u>:**
  - Sub Co. merges with Hold Co. through a Court approved Scheme
  - Hold Co. holds 80% shares in Sub Co. and 20% shares are held by outsiders
  - It issues shares to the outsiders which is not equal to the number of shares held by outsiders

- **<u>Issues – In standalone financial statements of Hold Co.</u>**
  1. Can goodwill be accounted?
  2. Whether goodwill is eligible for tax depreciation?

…Amalgamation / Merger (Case Study 1/2)…

AS 14

- Assume merger method applies – Account all assets, liabilities and reserves at carrying amounts
- Difference = Share capital issued plus any additional consideration – Share capital of Sub Co. (Transfer to reserves, whether positive or negative)
- *Prima facie*, no goodwill recognition
- However, Para 42 states that Scheme to prevail over AS 14. Thus, if Scheme provides for goodwill recognition, then it has to be recognised

Ind AS 103

- Since it is a common control business combination, account as per pooling of interest method
- Account all assets, liabilities and reserves at carrying amounts (in the same manner as they were appearing in the CFS of the group) - Supported by ITFG Clarification Bulletin 9
- Difference = Share capital issued plus any additional consideration – Share capital of Sub Co. (Transfer to capital reserve, whether positive or negative)
- Unlike Para 42 of AS 14, no mention in Ind AS 103 with respect to applicability of Scheme over Ind AS
- Thus, goodwill recognition may not be possible

…Amalgamation / Merger (Case Study 1/2) - Tax…

- CIT v. Smifs Securities Ltd. (348 ITR 302) (SC) – Question raised was:
  - *"Whether goodwill is an asset within the meaning of Section 32 of the Income Tax Act, 1961, and whether depreciation on `goodwill' is allowable under the said Section?"*
  - The question does not say *"whether the Tribunal was right in granting depreciation on goodwill arising on amalgamation in spite of the provisions of Explanation 7 to section 43(1) of the Income-tax Act"*
- However, the SC has not examined the issue in light of Explanation 7 to section 43(1) – Even HC had not decided the issue in light of Explanation 7
- Since goodwill represents accounting difference, it is difficult to claim depreciation
- The position is same under AS and Ind AS

…Demerger – Prior to Ind AS…

- Hive off of an undertaking by way of court approved scheme (Now, NCLT)
- It is time consuming

Accounting

- No specific AS – Use Generally Accepted Accounting Principles
- Demerged company – Reduce the book value of assets / liabilities transferred and adjust the difference as per the Scheme
- Resulting company - Record assets and liabilities at carrying amounts, consideration paid at cost and adjust difference in Reserve or Goodwill as per the Scheme

Taxation

- Tax neutral if conditions u/s. 2(19AA) fulfilled
- Other sections:
  - 47-No capital gains in hands of shareholders and demerged company
  - 49(2C)/(2D)-Cost of acquisition ("COA")
  - 2(42A)-Period of holding
  - 32-Apportionment of depreciation
  - 43(6)-Written Down Value ("WDV")

…Demerger – After Ind AS…

Accounting

<u>Demerger between companies under common control</u>
- Pooling of interest method
- Transferee – Record assets / liabilities at existing carrying amounts. Adjust difference in capital reserve
- Transferor – Reduce the book value of assets / liabilities transferred. Adjust the difference in investment cost / profit or loss / equity

<u>Demerger between other companies</u>
- Acquisition accounting
- **Acquirer – Record assets / liabilities at fair value, consideration paid and adjust difference in goodwill / capital reserve / gain from bargain purchase**
- Acquiree – Reduce the book value of assets / liabilities transferred and adjust the difference in profit or loss

Taxation

<u>Demerger between companies</u>
- Tax neutral if conditions u/s. 2(19AA) fulfilled
- Other sections:
  - 47-No capital gains in hands of shareholders and demerged company
  - 49(2C)/(2D)-Cost of acquisition (“COA”)
  - 2(42A)-Period of holding
  - 32-Apportionment of depreciation
  - 43(6)-Written Down Value (“WDV”)
- **Ignore the effect of fair value / reverse the impact when the resulting company sells the assets acquired in demerger**

…Demerger – After Ind AS – Accounting – Common Control…

H Co. transfers to S Co.

- **Transferor**

  Liabilities
  Investment in subsidiary (if loss)
  To Assets
  To Profit or Loss (if gain)

- **Transferee - S Co.**

  Assets (at carrying amount)
  Capital Reserve (if loss)
  To Liabilities (At carrying amount)
  To Consideration
  To Capital Reserve (if gain)

S Co. transfers to H Co.

- **Transferor - S Co.**

  Liabilities
  Profit or Loss (if loss)
  To Assets
  To Equity (if gain)

- **Transferee - H Co.**

  Assets (at carrying amount)
  Capital Reserve (if loss)
  To Liabilities (At carrying amount)
  To Consideration
  To Capital Reserve (if gain)

…Demerger – After Ind AS – Issue – Common Control…

- Whether the principles of Appendix C would apply only to the accounting for transferees?
  - Ind AS 103 uses the terms - 'Acquirer' and 'Acquiree' and Para 1 states that it applies only to acquirers
  - However, Appendix C uses the terms - 'Transferor' and 'Transferee'
  - Also, Para 1 of Appendix C states that it deals with accounting for business combinations of entities or businesses under common control
  - Para 8 – Account for business combinations <u>involving entities or businesses</u> under common control using pooling of interest method
  - ITFG Clarification Bulletin 9 – Uses the words combining entities
  - Possible view – Appendix C applies to both, transferors and transferees
  - Accordingly, gains arising to transferors may also be recognised in capital reserve

…Demerger – After Ind AS – Accounting – Other than Common Control…

Transferor

Liabilities (at carrying amount)
Equity (fair value of shares of transferee)
Profit or Loss (if loss)
    To Assets (at carrying amounts)
    To Profit or Loss (if gain)

Transferee

Assets (at fair value)
Goodwill (if loss)
    To Liabilities (At fair value)
    To Consideration
    To Capital Reserve (if gain)

…Slump / Itemised Sale – Prior to Ind AS…

- Transfer of undertaking as a whole for lump sum consideration in cash

Accounting

- No specific AS – Use Generally Accepted Accounting Principles and AS 10
- Transferor – Reduce the book value of assets / liabilities transferred, record consideration at cost and adjust the difference in the Statement of Profit and Loss
- Transferee - Record assets and liabilities based on Purchase Price Allocation

Taxation

- S. 2(42C) – Slump sale – Transfer of undertaking as a result of sale for a lump sum consideration
  - Without assigning values to individual assets / liabilities
- S. 50B – Capital gains = Sale Consideration – Net worth of undertaking
- Net worth = Total assets [calculate WDV of depreciable assets as per s. 43(6)] – Total liabilities

…Slump / Itemised Sale – Under Ind AS…

Accounting

Slump sale between companies under common control

- Pooling of interest method
- Transferee – Record assets / liabilities at existing carrying amounts and consideration paid. Adjust difference in capital reserve
- Transferor – Reduce the book value of assets / liabilities transferred, record consideration at cost. Adjust the difference in investment cost / profit or loss / equity

Slump sale between other companies

- Acquisition accounting
- Acquirer – Record assets / liabilities at fair value and adjust difference in goodwill / capital reserve / gain from bargain purchase
- Acquiree – Reduce the book value of assets / liabilities transferred, record consideration received and adjust the difference in profit or loss

Taxation

S. 2(42C) – Slump sale – Transfer of undertaking as a result of sale for a lump sum consideration

- Without assigning values to individual assets / liabilities

- S. 50B – Capital gains = Sale Consideration – Net worth of undertaking
- Net worth = Total assets (ignore revaluation) – Total liabilities

- Depreciation in the hands of transferee on what value?

…Slump Exchange – Prior to Ind AS…

- Transfer of undertaking as a whole for lump sum consideration in shares, etc.

Accounting

- No specific AS – Use Generally Accepted Accounting Principles and AS 10
- Transferor – Reduce the book value of assets / liabilities transferred, record consideration at cost and adjust the difference in the Statement of Profit and Loss
- Transferee - Record assets and liabilities based on Purchase Price Allocation

Taxation

- Slump exchange is different from slump sale – R. R. Ramakrishna Pillai (1967) (66 ITR 725) (SC) and Motors & General Stores (P.) Ltd. (1967) (66 ITR 692)
- Thus, slump exchange is not covered by s. 2(42C) or 50B – ACIT v. Bharat Bijlee Ltd. (2014) (365 ITR 258) (Bom.)

…Slump Exchange – After Ind AS…

Accounting

<u>Slump exchange between companies under common control</u>

- Pooling of interest method
- Transferee – Record assets / liabilities at existing carrying amounts. Adjust difference in capital reserve
- Transferor – Reduce the book value of assets / liabilities transferred, record consideration at fair value. Adjust the difference in investment cost / profit or loss / equity

<u>Slump exchange between other companies</u>

- Acquisition accounting
- Acquirer – Record assets / liabilities at fair value and adjust difference in goodwill / gain from bargain purchase
- Acquiree – Reduce the book value of assets / liabilities transferred, record consideration at fair value and adjust the difference in profit or loss

Taxation

- Slump exchange is different from slump sale – R. R. Ramakrishna Pillai (1967) (66 ITR 725) (SC) and Motors & General Stores (P.) Ltd. (1967) (66 ITR 692)
- Thus, slump exchange is not covered by s. 2(42C) or 50B – ACIT v. Bharat Bijlee Ltd. (2014) (365 ITR 258) (Bom.)

…Asset Sale – Prior to Ind AS…

- Asset Sale - Sale of individual assets for specific consideration

Accounting

- Use Generally Accepted Accounting Principles and respective AS
- Transferor – Reduce the book value of individual assets / liabilities transferred, record consideration received and adjust the difference in the Statement of Profit and Loss
- Transferee - Record individual assets at carrying amounts, consideration paid and adjust difference in the Statement of Profit and Loss

Taxation

- No specific provisions – Tax treatment depends on the nature of item sold, whether capital item or business item
- To refer judicial pronouncements

… Asset Sale – After Ind AS…

Accounting

- No difference in accounting for transactions with companies under common control or with other companies except treatment of gain / loss
- Use Generally Accepted Accounting Principles and respective Ind AS
- Transferee – Record assets at cost / fair value, depending on the nature of item and options selected
- Transferor – Reduce the book value of assets /, record consideration at cost / fair value. Adjust the difference in investment cost (if companies under common control) / profit or loss

Taxation

- No specific provisions – Tax treatment depends on the nature of item sold, whether capital item or business item
- To refer judicial pronouncements

Key Differences between previous GAAP and Ind AS 103

Key Differences…

Sr. No	Under AS	Under Ind AS
1	<u>Scope</u>	
	• Limited scope • Applies **only** to business combinations in nature of **amalgamations** • Different standards provide guidance for different aspects of business combinations – ▪ AS 21 – Accounting for investments in subsidiaries ▪ AS 23 - Accounting for investments in associates ▪ AS 10 (Revised) – Accounting for a demerged unit under a slum sale	• Wider scope • Applies to **almost all business combinations** • Includes amalgamations, mergers, demergers, slump sale and slump exchange • Includes acquisitions and common control business combinations

…Key Differences…

Sr. No	Under AS	Under Ind AS
2	Meaning of the term ‘business’	
	• AS was not based on whether the acquired group of assets or undertaking constitute ‘business’	• Applies only if an acquisition of an asset/group of assets constitutes a ‘business’

…Key Differences…

Sr. No	Under AS	Under Ind AS
3	Accounting for Business Combination	
	• No bifurcation between business combinations • Amalgamation in nature of merger – Accounting as per ‘Pooling of interest method’ • Other combinations as per various AS – Accounting as per ‘Purchase method’	• Business combinations between entities under common control - Accounting as per ‘Pooling of interest method’ • Other combinations – Accounting as per ‘Acquisition method’

…Key Differences…

Sr. No	Under AS	Under Ind AS
4	<u>Acquisition Date</u>	
	• Date of acquisition/amalgamation as per the **NCLT approved scheme**	• Date when the acquirer **effectively** obtains control of the acquiree
5	<u>Cost of Acquisition</u>	
	• Consideration for amalgamation comprises of – ▪ Securities; ▪ Cash; or ▪ Other Assets • Fair value assessment of above elements is undertaken at time of acquisition	• Consideration for business combination comprises of – ▪ Assets transferred ▪ Liabilities incurred ▪ Equity interests issued

…Key Differences…

Sr. No	Under AS	Under Ind AS
6	<u>Acquisition related costs</u>	
	• No specific guidance for accounting of acquisition related costs • EAC has opined that cost incurred for carrying out due diligence for acquisition of another business should be expensed in period incurred	• Acquisition related costs to be expensed out in the period incurred
7	<u>Minority/Non-controlling interests</u>	
	• Minority interest is valued at its proportionate share of historical book value of net assets	• Non-controlling interest to be measured at fair value on acquisition date or the minority's proportionate share of the acquiree's identifiable net assets

…Key Differences…

Sr. No	Under AS	Under Ind AS
8	<u>Contingent Consideration</u>	
	• As per AS 14 - ▪ If the contingent consideration is probable and can be reasonably estimated at date of amalgamation - Inclusion in value of consideration ▪ In other cases – adjustment to be made when the amount is determinable • No guidance for contingent consideration in other business combination – General parlance is to adjust in goodwill amount	• Acquirer recognises the fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree

…Key Differences – Contingent Consideration…

- When a business combination provides for an adjustment to the cost of combination that is contingent on future events – Acquirer to recognise the acquisition date fair value of contingent consideration as part of consideration transferred
- This would affect the amount of goodwill / capital reserve
- In case if the event does not occur – **Whether goodwill amount to be adjusted or recognise it in profit or loss?**
- Subsequent adjustments to contingent consideration are not adjusted to goodwill, except for 12-month measurement period adjustments
- Taxation:
  - Whether depreciation can be claimed on such goodwill wherein the consideration included a contingent amount?
  - What would be the tax treatment in subsequent years when the event does not occur and the amount is reversed and recognised in the Statement of Profit and Loss?

…Key Differences…

Sr. No	Under AS	Under Ind AS
9	Subsequent adjustments to assets and liabilities	
	• No adjustments is permitted except for deferred tax adjustment	• Adjustments permitted for a maximum period of one year from the acquisition date if new information is obtained of facts as existing on acquisition date • Retrospective adjustments to be made
10	Pre-existing relationships, re-acquired rights, indemnification assets and replacement share-based payment awards	
	• No specific guidance	• Guidance with respect to initial as well as subsequent recognition of those items • Such items not to be recognised as goodwill

Implications u/s. 115JB of the Act

MAT Implications…

On transition- Sub-section (2C)
Book profit to be increased/decreased every year for five years by 1/5th of the transition amount
Transition amount = Aggregate of adjustments made in Other Equity excluding capital reserve/securities premium on the convergence date
6 exclusions for determining the transition amount – Explanation to section 115JB(2C)(iii)

Subsequent years- Sub-sections (2A) and (2B)	
Addition to profits	Deduction from profits
Amounts credited to OCI for items not to be re-classified to profit or loss	Amounts debited to OCI for items not to be re-classified to profit or loss
Amounts debited to P/L on distribution of non-cash assets to SH on demerger	Amounts credited to P/L on distribution of non-cash assets to SH on demerger
2 exclusions from 'items not to be re-classified to profit or loss' for addition/deduction from book profits – First proviso to section 115JB(2A)	

…MAT Implications…

- **Exclusions from transition amount adjusted on transition date - <u>On transition</u>**
  - Amount adjusted in OCI and subsequently re-classified to profit or loss
  - Revaluation surplus for assets
  - Gains/losses from investments in equity instruments designated at fair value through OCI
  - Adjustments relating to PPE and intangible assets recorded at fair value as deemed cost
  - Adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost
  - Adjustments relating to cumulative translation differences of a foreign operation

…MAT Implications

- **Exclusions from "Items not to be re-classified to profit or loss" for addition/deduction from book profits – <u>Post transition</u>**
  - Revaluation surplus for assets in accordance with Ind AS 16 and Ind AS 38; and
  - Gains/losses from investments in equity instruments designated at FVOCI as per Ind AS 109

- The above amounts to be adjusted in book profits when the related asset/investment/foreign operation is sold/disposed/otherwise transferred

Issues – Optionally Convertible Preference Shares…

- Assume Co. A issued optionally convertible preference shares of face value Rs. 100. On maturity, the holder has an option either to receive cash payment of Rs. 100 or 10 equity shares
- Under AS, Rs. 100 was shown as part of share capital
- Under Ind AS, depending on the terms, the instrument is classified as compound financial instrument whereby Rs. 80 pertains to financial liability component
- Accordingly, on the date of transition, Co. A to pass following entries

Share Capital	100	
To Other Equity (Deemed Capital Contribution)		20
To Financial Liability		80

…Issues – Optionally Convertible Preference Shares…

- On subsequent measurement, Co. A to measure financial liability at amortised cost by using effective interest rate method whereby Co. A would pass the following journal entries:

Interest expense (at EIR)	9	
To Financial Liability		9
Financial Liability	5	
To Cash		5

- Therefore, effectively, the financial liability increase by Rs. 4 such that at the end of the tenure, the liability would be reflected at Rs. 100

…Issues – Optionally Convertible Preference Shares…

- **If holder elects to receive shares**
  - Co. A to derecognize the liability (Rs. 100) and recognise increase in equity of same amount – No gain/loss

Financial Liability	100	
To Equity		100

- **If holder elects to receive cash**
  - Co. A to derecognize the liability Rs. 100 and recognizes a corresponding decrease in cash

Financial Liability	100	
To Cash		100

…Issues – Optionally Convertible Preference Shares

- **Normal tax / ICDS**
  - No impact on date of transition
  - Even on subsequent measurement, there will be no impact on account of effective interest rate
  - Actual interest on preference shares – Not Allowable under the Income-tax Act

- **MAT**
  - Since Rs. 20 is adjusted in other equity on convergence date, it will be liable to MAT for 5 years
  - On subsequent measurement, adjustment made to financial liability on account of effective interest rate will be recognised in profit or loss and thereby, liable to MAT

…Issues – Optionally Convertible Preference Shares

- **MAT**
  - However, Tribunals have held that capital receipt should not be included while computing book profits since it is not an ‘income’ in the first place:
    - Sicpa India (P.) Ltd. v. DCIT (2017) (80 taxmann.com 87) (Kol)
    - M/s. JSW Steel Limited v. ACIT (ITA No. 923/Bang/2009)
    - Shivalik Venture (P.) Ltd. v. DCIT (2015) (60 taxmann.com 314) (Mum)
    - DCIT v. M/s. Binani Industries Ltd. (2016) (3) TMI 873 (Kol)

THANK YOU!!!

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