

Ind-AS 115- Revenue from Contract with Customers



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Fundamentals of taxation

Normal Taxation

- No Tax on hypothetical income
- Tax is on real income
- No income from self
- There is no income in absence of accrual
- Specific provision of the Act /ICDS will override accounting treatment
- Legal form of transaction will prevail except in case of sham transaction
- Judicial precedents dealing with concept of income discussed in next slide

Minimum Alternate Tax (MAT)

- The financials prepared in accordance with Schedule prescribed under Companies Act and approved by statutory auditors, shareholders is final
- List of exhaustive /specific downward/ upward adjustments permitted by Section 115JB (Exception Auditor Qualification)
- Specific provision to capture impact of Ind-AS accounting
- Landmark decision- Apollo tyres

Normal Taxation - Judicial precedents

Sri Kikabai Premchand(24 ITR 506), (SC)

- No one can make profit out of himself

Hind Construction (83 ITR 211), (SC)

- A sale contemplates a seller and a purchaser. Higher revaluation of stock in books does not lead to taxable profit

Shoorji Vallabhdas & Co (46 ITR 144), (SC)

- A mere book-keeping entry cannot be income, unless Income has actually resulted

E.D.Sasoon & Co (26 ITR 27), (SC)

- The entries in the books represented only hypothetical income and the amounts in question did not represent the income which had really accrued to the assessee

Tuticorin Alkali Chemicals (227 ITR 172), (SC)

- Whether a receipt of money is taxable or not, the question has to be decided according to the principles of law and not in accordance with accountancy practice does not determine taxability”

Sale of Goods as per ICDS IV

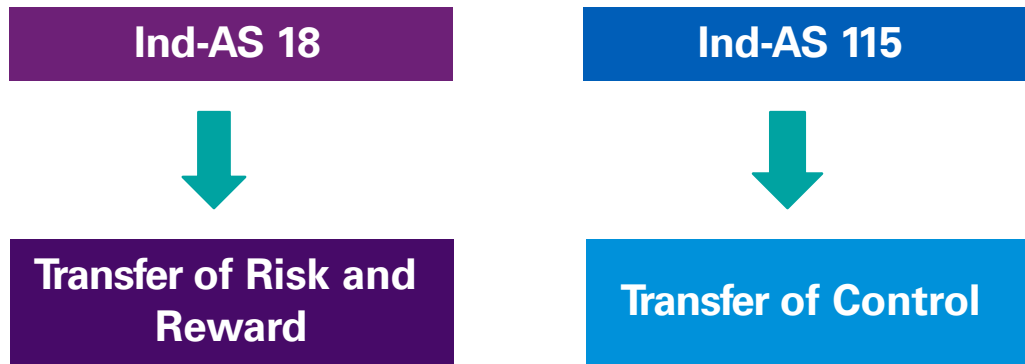
- In a transaction involving the sale of goods, the revenue shall be recognised when the seller of goods has ***transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control*** of the goods transferred to a degree usually associated with ownership. In a situation, where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognised at the time of transfer of significant risks and rewards of ownership to the buyer.
- Revenue shall be recognised when there is **reasonable certainty** of its ultimate collection.
- Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved.

Rendering of Services as per ICDS IV

- Subject to Para 7, revenue from service transactions shall be recognised by the **percentage completion method**. Under this method, revenue from service transactions is matched with the service transaction costs incurred in reaching the stage of completion, resulting in the determination of revenue, expenses and profit which can be attributed to the proportion of work completed. Income Computation and Disclosure Standard on construction contract also requires the recognition of revenue on this basis. The requirements of that Standard shall mutatis mutandis apply to the recognition of revenue and the associated expenses for a service transaction. However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period.
- Revenue from service contracts with duration of not more than ninety days may be recognised when the rendering of services under that contract is completed or substantially completed.

Introduction to Ind-AS 115

- The Ministry of Corporate Affairs (MCA) has notified the new revenue recognition standard – Ind-AS 115 which replaces existing Ind-AS 11 (Construction contract) and Ind-AS 18 (Revenue recognition)
- Ind-AS 115 is applicable from 1st April 2018 i.e. FY 2018-19
- The core principle of Ind-AS 115 is that revenue needs to be recognized when the entity transfers control of goods and services to customers at an amount that entity expects to be entitled



- More guidance on separating goods and services bundled in a contract
- More guidance on measuring transaction price
- Replace certain Guidance Notes (e.g.: Real Estate Revenue Recognition)
- Ind-AS 115 is based on the five step model

The Five Step Model

1- Identify contract with the customer

2- Identify the performance obligations in the contract

3- Determine the transaction price

4- Allocate the transaction price to the performance obligations in the contract

5- Recognise revenue when (or as) the entity satisfies a performance obligation

Identifying the Contract

- Parties approve the contract in writing / oral etc and are committed;
- Each parties rights and payments terms are identified;
- There is a commercial substance and it is probable that the entity shall receive the consideration for transfer of goods and services.

Revenue recognition in case of:

- Unilateral enforceable rights to terminate a wholly unperformed contract without compensation;
- No criteria met under the contract but the entity receives consideration:
 - Entity has no remaining obligations to transfer goods or services to the customer and all or substantially all consideration has been received by the entity and is non refundable;
 - The contract is terminated and the consideration received from the customer is non refundable.

Non refundable upfront fee

- The company obtains non refundable deposits for new dealership
- These deposits are recorded as Income immediately on receipt whenever an agreement is signed under existing IGAAP
- The upfront one-time set up fee paid shall be recognized over the period of contract rather than recognizing the same upfront at contract inception
- ICDS is silent on non refundable upfront fee received from customers
- As per the existing practice, upfront fee is taxed immediately on receipt basis

The current tax practice of offering non-refundable upfront fee immediately on receipt can be continued under ICDS if the conclusion is that of signing of agreement and granting of dealership is the consideration for charging of the non-refundable fee

Contract Modifications

An entity shall account for a contract modification as a separate contract if:

- The ***scope of the contract increases*** because of the addition of promised goods or services which are distinct
- The ***price of the contract increases*** by an amount of consideration that reflects the entity's stand-alone selling price of the additional promised goods or services and any appropriate adjustments to that price to reflect the circumstances of the particular contract
- Contract modifications ***should be accounted prospectively***
- If the entity does not account for contract modification as a separate contract then the accounting approach to account for termination of existing contract and creation of new contract if the remaining goods and services transferred are distinct. Else if the goods and services are not distinct then the same could be accounted as part of existing contract.

Illustration:

- Entity AB Ltd enters into a three-year service contract with a customer CD Ltd for Rs. 4,50,000 (Rs. 1,50,000 per year).
- At the beginning of the third year, the parties agree to modify the contract as follows:
- (i) the fee for the third year is reduced to Rs. 1,20,000 and
- (ii) CD Ltd agrees to extend the contract for another three years for Rs. 3,00,000 (Rs. 1,00,000 per year)
 - In the given case, modification shall be accounted as if the existing arrangement was terminated and a new contract was created because the remaining services to be provided are distinct.

At the end of 3rd Year:

- As per Ind-AS 115 AB Ltd shall reallocate the remaining consideration to all the remaining services to be provided, a total of Rs 4,20,000 (Rs 1,20,000 + Rs 3,00,000) i.e. the obligations remaining from the original contract and the new obligations over the remaining four- year service period.
- As per AS- 9, AB Ltd shall recognize Rs. 1,20,000 as revenue for the 3rd year onwards.

Contract Modifications

- Revenue from Operations from 3rd Year onwards are as under:

(Rs in '000')

Extract of Profit & Loss account as per I-GAAP				
Particulars	2018-19	2019-20	2020-21	2021-22
Revenue	120	100	100	100
Other Expenses	80	80	80	80
Net Profit	40	20	20	20

(Rs in '000')

Extract of Profit & Loss account as per Ind-AS 115				
Particulars	2018-19	2019-20	2020-21	2021-22
Revenue	105	105	105	105
Other Expenses	80	80	80	80
Net Profit	25	25	25	25

Multiple Performance Obligations

- Performance obligation is satisfied over a period of time or at a point of time. It is satisfied over a period of time if one of the following criteria is met:
 - the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
 - the entity's performance creates or enhances an asset that the customer controlsor
 - the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.
- Entity A enters into a contract with Customer B to manufacture and install machine for Rs. 8,00,000 as at March 2018
- The standalone value of the product is Rs. 7,00,000 and standard installation is Rs. 2,00,000
- The installation is completed by June 2018

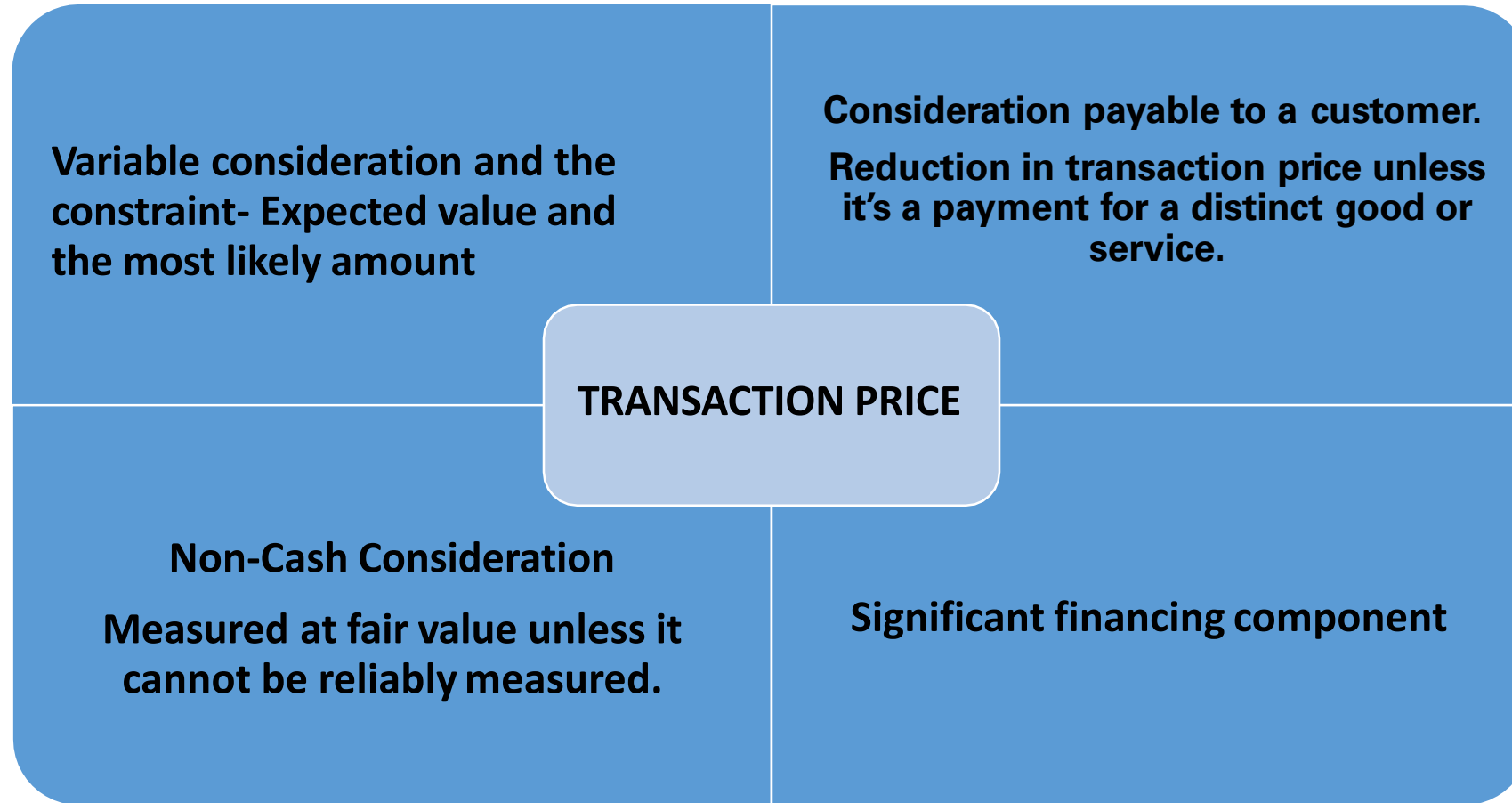


Multiple Performance Obligations

- **In the given case, company offers these services in combination and the customer cannot benefit from the installation services on its own or together with other readily available resources, i.e. only company A can install the machine because of its complicated nature, then there is only one performance obligation**
- The machine cannot be used before installation and the customer cannot obtain the benefits of using the product before installation, i.e. money received will have to be refunded unless the installation is successful
- **Ind-AS 115 recognizes revenue from sale of goods when the control of goods has passed to the customer and control includes the ability to prevent other entities from directing the use or obtaining the benefit from an asset**
- In the given case, company offers these services in combination and the customer cannot benefit from the installation services on its own or together with other readily available resources, i.e. only company A can install the machine because of its complicated nature, then there is only one performance obligation
- The machine cannot be used before installation and the customer cannot obtain the benefits of using the product before installation, i.e. money received will have to be refunded unless the installation is successful
- Ind-AS 115 recognizes revenue from sale of goods when the control of goods has passed to the customer and control includes the ability to prevent other entities from directing the use or obtaining the benefit from an asset

In such cases, revenue of Rs. 8,00,000 will be recognized when installation is complete, i.e. June 2018 and not when the risk, reward and ownership has been transferred i.e. March 2018 as per IGAAP.

Significance of Turnover - Step - 3 - Determination of Transaction Price



Significance of Turnover

- The base for computing the amount of gross receipts or turnover of business will be different under Ind-AS 115 as compared to earlier Ind-AS, IGAAP, thereby impacting applicability of some provision of Income Tax Act which are linked to quantum of “sales,” “gross receipts” or “turnover” of the business (for e.g.: Section 47(xiii b), section 44AB).
- Some examples of accounting change under Ind-AS are as follows:
 - In case of customer rewards programs, the fair value of reward points is reduced from transaction value and is recognized as revenue as and when the points are redeemed by customer
 - If there is an exception that some goods sold will be returned by the customer at a later date, under Ind-AS, revenue is adjusted for value of expected returns
 - Revenue recognition rules are required to be applied independently qua each separate identifiable component. For example, if a car is sold with extended warranty, the warranty element embedded in the selling price is required to be recognized separately as revenue over the extended period.

Recognition of revenue as and when performance obligation is satisfied

An entity transfers control of a good or service over time and therefore satisfies a performance obligation and recognises revenue over time

Illustration:

- An operator offers a subscriber 1000 call minutes @ 10p per minute for the March 2018 with the option of rolling over unused minutes to the following month
- The subscriber can use the unused minutes for the following 2 months, after which they expire.
- The operator has a history of enforcing expiry dates
- The subscriber shall use 700 minutes for March 2018 and 300 minutes shall be rolled over to the following months i.e. April and May 2018
 - Revenue is recognized in the accounting period in which the services are rendered, which in this case would be when the contracted call minutes are provided i.e., **the allocation is to minutes and not periods**
 - The operator **recognizes revenue when the minutes are used** and any unused minutes at the end of each month as contract liability

Extract of I-GAAP Profit & Loss Account

Expenses	Amount	Income	March'18	May'18
Other expense	20	Revenue	100	Nil
Construction profit	80			

Extract of Ind-AS Profit & Loss Account

Expenses	Amount	Income	March'18	May'18
Other expenses	20	Revenue	70	30
Net Profit	50			

Extract of Ind-AS Balance sheet as on 31 March 2018

Liability	Amount	Asset	Amount
Provision for unused minutes	30		

Discount and Rebate

- Under Ind-AS, revenue should be recognized at fair value of the consideration receivable net of discounts and rebates when it is probable that such discounts will be granted and the amount can be measured reliably.
- ABC Ltd offers certain cash discounts to customers for early settlements. Therefore, the estimate of cash discounts that would be given to the customers would also be deducted from revenue under Ind-AS.
- The definition of revenue under ICDS is similar to definition of revenue under AS 9
- Recognizing expected cash discount (not actually provided) as a reduction from revenue may not meet the requirement under ICDS. Therefore, such cash discounts would not be deductible from revenue for tax purposes. But the same would be allowed as an expense when actually incurred.

Sales with a Right to return

- Rights of return is a form of variable consideration
- Revenue recognition is limited to amounts for which it is “highly probable” a significant reversal will not occur, i.e. the goods shall not be returned
- In some contracts, an entity transfers control of a product to a customer with an unconditional right of return
- **Illustration:**
 - A Ltd, a manufacturer of garments sells garments @ Rs. 1000
 - The gross margin that it would earn per garment is Rs. 100
 - Full amount is refunded to retailers provided garments are undamaged
 - A Ltd is expecting that 5% of the goods sold during the year will be refunded in next financial year
- As per IGAAP, A Ltd shall recognize full consideration since risk, reward and ownership has been transferred and simultaneously shall provide for Provision for sales return
- However, as per Ind-AS 115, A Ltd shall recognize revenue only to the extent it expects to be entitled i.e. Rs. 950/- and simultaneously shall also recognize a refund liability for the balance 5%

Sales with a Right to return

I-GAAP

Extract of Profit & Loss Account for FY 2018-19

Expenses	Amount	Income	Amount
Other expenses	700	Sales	1,000
Provision for sales returns	50		
Net profit	250		

Extract of Balance sheet as on 31 March 2019

Liability	Amount	Asset	Amount
Provision for sales return	50		

Ind-AS 115

Extract of Profit & Loss Account for FY 2018-19

Expenses	Amount	Income	Amount
Other expenses	700*	Sales	950
Net profit	250		

Extract of Balance sheet as on 31 March 2019

Liability	Amount	Asset	Amount
Provision for refund liability	50	Goods to be returned	50

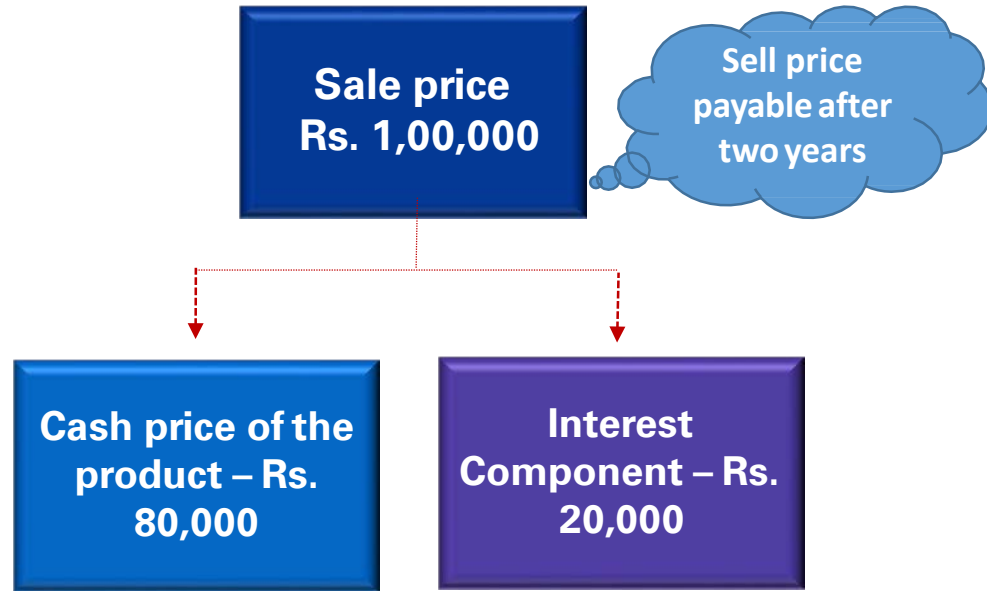
**Corresponding adjustment to cost of sales is recorded for items expected to be returned.*

The impact of accounting of right to return on provision may get disallowed for the purpose of tax computation since ICDS is silent on tax treatment of provision for sales return.

As per ICDS revenue is requires to be recognition on transfer of significant risks and rewards to the customer.

Deferred payment terms / Financing Agreement

Ind-AS 115 requires revenue to be measured based on fair value of sale consideration received or receivable. If the arrangement effectively constitutes a financing transaction, Ind-AS 115 requires that entity shall determine the fair value of the consideration by discounting all future receipts using an imputed rate of interest.



An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract

Illustration

- Entity X has entered into a contract to sell a television to a customer for a consideration of Rs. 1,00,000.
- The payment for the equipment is to be made after 2 years.
- The cash selling price of the product is Rs. 80,000 which represents the amount that customer would pay upon delivery for the same product sold under otherwise identical terms and conditions as at contract inception.
- Contract includes a significant financing component and this is evident from the difference between the amount of promised consideration of Rs. 1,00,000 and the cash selling price of NR 80,000 at the date when the television is transferred to the customer

Deferred payment terms / Financing Agreement

The revenue to be recognized under Ind-AS 115 and its tax implications shall be as under:

- An entity shall present the effect of financing, i.e. interest revenue separately from revenue from contracts with customers in the statement of Profit and loss
- Accordingly, Entity X will recognize revenue with a corresponding receivable equal to the cash selling price of Rs. 80,000 and the interest revenue shall be recognized in accordance with Ind-AS 109.

ICDS IV dealing with revenue recognition defines revenue as "gross inflow of cash, receivables or other consideration arising in the ordinary course of business from the sale of goods, rendering of services"

ICDS III also provides that contract revenue shall comprise of variations in contract work, claims and incentive payments

Measurement based on Ind-AS *should not* considered for "Normal Tax" purpose

Recognition of revenue in case of redemption of Bonus/ Loyalty points

- If in a contract, an entity grants a customer the option to acquire additional goods or services, that option gives right to a separate performance obligation only if the option provides a material right to the customer that it would not receive without entering into that contract
- The customer in effect pays the entity in advance for future goods and the entity recognises revenue when the goods are transferred
- Accordingly, an entity shall account for bonus points as a separate performance obligation of the sales transactions in which they are initially granted
- **Illustration**
 - A Ltd, owner of a resort under the scheme grants 1 point for every Rs. 100 spent for stay in the resort
 - As per the past experience, the likelihood of exercising of the points is 100%
 - The stand-alone price of each point is Rs. 5
 - Customer X spends Rs. 10,000 in one of the resorts and earns 100 points
 - Revenue recognized under IGAAP and Ind-AS 115 shall be as under:
 - ✓ Under I-GAAP, there is no guidance covering the situation of bonus points. Generally full amount of consideration including the bonus is considered in year 1 itself, as all the significant risk and rewards have been transferred
 - ✓ Under Ind-AS 115, A Ltd shall split the amount of consideration into revenue from customers at fair value i.e. $(10000/10500*10000)$ and revenue from bonus points at fair value i.e. $(500/10500*10000)$

Recognition of revenue in case of redemption of Bonus/ Loyalty points

I-GAAP

Extract of Profit & Loss Account for FY 2018-19

Expenses	Amount	Income	Amount
Other expenses	XX	Sales	10,000
Provision for bonus points	500		
Net profit	XXX		

Extract of Balance sheet as on 31 March 2019

Liability	Amount	Asset	Amount
Provision for bonus	500		

Deductibility of provision needs to be separately evaluated under ICDS – 10

Ind-AS 115

Extract of Profit & Loss Account for FY 2018-19

Expenses	Amount	Income	Amount
Other expenses	XX	Sales	9,524
Net profit	XXX		

Extract of Balance sheet as on 31 March 2019

Liability	Amount	Asset	Amount
Deferred revenue	476		

Rs. 476 shall be recognized in the year of redemption or on expiry of such points if the bonus points are not redeemed.

ICDS is silent on the treatment for customer loyalty points

Provisions of ICDS - IV is in line with AS 9 and whether reducing revenue upfront on account of loyalty point needs to be evaluated

Recognition in case of non-cash incentives

- Ind-AS 115 requires that revenue from sale of goods or services shall be recognized when the entity satisfies a performance obligation by transferring the promised good or services to a customer
- Further, Ind-AS 115 provides that, at the contract inception, an entity shall assess the goods or services promised in the contract with the customer and shall identify each promise as a performance obligation to transfer a good or service that is distinct and separately identifiable to the customer
- *Illustration:* Free goods or services are provided by a seller on purchase of 2 products, i.e. on purchase of two products, third product is free
- If, the third product is provided in the next year, the revenue recognized for sale of goods or services under Ind-AS 115 is:

Results in postponement of revenue. Similar situation not covered under ICDS, timing of recognition of revenue from tax perspective

Extract of P&L account as per I-GAAP - FY 2018-19

Expenses	Amount	Income	Amount
		Sales	200
Net profit	XXX		

Extract of P&L account as per Ind-AS 115 - FY 2018-19

Expenses	Amount	Income	Amount
		Sales [200*2/3]	133
Net profit	XXX		

Extract of P&L account as per I-GAAP - FY 2019-20

Expenses	Amount	Income	Amount
		Sales	Nil
Net profit	XXX		

Extract of P&L account as per Ind-AS 115 - FY 2019-20

Expenses	Amount	Income	Amount
		Sales [200*1/3]	67
Net profit	XXX		

Comparison between Ind AS 115 viz-a-viz ICDS

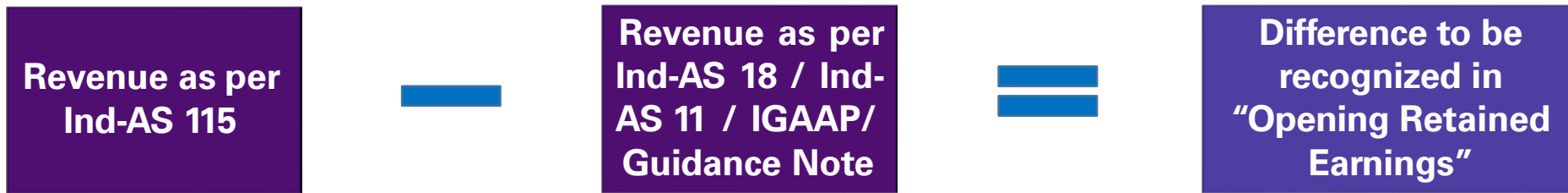
Particulars	Ind-AS 115	ICDS
Revenue recognition principle	Revenue is recognised based on five step model on transfer of control to customer	For goods, revenue is recognised on transfer of risk and rewards. For services, revenue is recognised to the extent of stage of completion of contract
Identification of performance obligation	Detail requirements apply for identifying and recognising revenue on multiple-element contracts	Do not require or prohibit identification of performance obligation.
Allocation of transaction price	Allocated to performance obligation identified based on relative standalone selling price.	Not covered in ICDS
Variable consideration	Methodology for estimating and recognizing variable consideration provided.	Currently, entities may defer measurement of variable consideration until uncertainty is removed. For e.g. claims in construction contracts are recognised on final certainty.
Sales return	Revenue is recognised after deducting estimated return. Sales returns result in variable consideration.	No guidance is provided in ICDS
Significant financing	Revenue is adjusted for significant financing and presented separately as finance cost/income	Revenue is not adjusted for time value of money

Comparison between Ind AS 115 viz-a-viz ICDS

Particulars	Ind-AS 115	ICDS
Non-cash consideration	Measured at fair value	No guidance provided
Onerous contract	Expected losses are recognised as an expense immediately.	Losses incurred on a contract will be allowed only in proportion to the stage of completion
Real estate revenue	If the entity has a right to receive payment for work completed to date, POCM is applied. Else completed contract method needs to be followed.	Exposure draft issued. Requires POCM.
Early stage contract	Revenue recognized to the extent of cost if there is no reasonable certainty.	Reasonable certainty threshold of 25% is specified. Revenue is recognised to the extent of costs incurred when up to 25% of the work is completed otherwise proportionate method will apply.
Service contract	Revenue is recognized on transfer of control.	POCM applied. Straight-line method, if service contract involves indeterminate number of acts over specific period of time. Completed contract, if duration < 90 days
Retention money	Retention monies are a deduction from the revenue bill, which is paid by the customer on satisfactory completion of contract or warranty period. The retention monies are treated as normal revenue.	Same as Ind AS. Retention is part of overall cont

Transition to Ind-AS 115

- Any impact of transition to Ind-AS 115 needs to be given in opening retained earnings as on 1st April 2018
- Following are the alternative approaches that the entity may adopt for transitioning to Ind-AS 115
 - The entity would compare the revenue recognized as per Ind-AS 18 / Ind-AS 11 / IGAAP / Guidance Note for each arrangement, in respect of open contracts as on 31st March 2018, with amount that would have been recognized as per Ind-AS 115
 - The difference between these two amounts would be accounted as a cumulative catch-up adjustment and would be recognized on 1st April 2018 in the opening retained earnings



- **Option I of Transition - Full Retrospective Approach**
 - Recasting comparatives of FY 2017-18 (presentation perspective) – 1st April 2017
 - Accounting entries to be passed on 1st April 2018
- **Option II of Transition - Cumulative effect Approach**
 - No recasting comparatives of FY 2017-18
 - Disclosure of quantitative effect of Ind-AS 115
 - Accounting entries will be passed on 1st April 2018

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

Illustration I:

- A Ltd has adopted Ind-AS prior to 1 April 2018
- A Ltd, as on 1 April 2018 has existing contracts of software license, professional services and post-delivery support service for Rs. 50,00,000 which were accounted for previously under Ind-AS 18
- A Ltd has recognized entire revenue of Rs.50,00,000, A Ltd treated the development of software and post-delivery support service as a “single performance obligation”
- However, had A Ltd adopted Ind-AS 115, it would have identified three performance obligations (Software License, Professional Service. Post delivery Service
- A Ltd would need to allocate the estimated transaction price based on relative stand-alone selling price (or any other appropriate method) to the newly identified distinct performance obligations

Performance obligation	Ind-AS - 18		Ind-AS - 115	
		Revenue FY 17-18		Revenue FY 17-18
Software License	✓	40,00,000	✓	40,00,000
Professional Service	✓	8,00,000	✓	8,00,000
Post delivery Service	✓	2,00,000	✗	
Total		50,00,000		48,00,000

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

- A Ltd would compare the revenue recognized as per Ind-AS 18 for each arrangement, in respect of open contracts as on 31st March 2018, with amount that would have been recognized as per Ind-AS 115
- A Ltd records an adjustment to opening retained earnings on 1st April 2018 to reflect the difference between revenue already recognized under Ind-AS 18 and the revenue that would have been recognized under Ind-AS 115 as on that date
- The difference between these two amounts would be accounted as a cumulative catch-up adjustment and would be recognized on 1st April 2018 in the opening retained earnings

Particulars	April 1, 2018
Revenue under Ind-AS 18	Rs. 50,00,000
Revenue under Ind-AS 115	Rs. 48,00,000 [40,00,000 + 8,00,000)
Adjustments in Opening Retained Earnings (Debit)	Rs. 2,00,000

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

- **Issue**
 - A Ltd had offered the entire amount of Rs. 50,00,000 to tax till FY 2017-18 under the normal provisions of the Act as well as under the MAT provisions
 - On account of introduction of Ind-AS 115, the amount of such revenue offered to tax in preceding years, would again be credited to P&L account of FY 2018-19 (assuming performance obligation is met in FY 2018-19) by corresponding adjustment to retained earnings as on 31 March 2018
 - Whether the amount of Rs. 2,00,000 credited to Profit & Loss account of FY 2018-19 as per Ind-AS 115, shall be liable to MAT?
 - Whether A Ltd will be able to claim the adjustment to opening reserves as part of the transition amount over a period of 5 years?
- As per explanation to sub-section 2(c) of section 115JB of the Income-tax Act, 1961 ('the Act') transition amount computed as on the convergence date shall be adjusted to the book profits of the Company for the purposes of MAT
- **Convergence date** means the first day of the first Ind-AS reporting period as defined in Ind-AS 101

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

- Whether “First Ind-AS reporting period” under Ind-AS 101 (First time Adoption of Indian Accounting Standards) is to be determined every time a newly notified Ind-AS is adopted or whether the same is only to be determined in the financial year in which the transition from I-GAAP to Ind-AS occurs
- A Ltd has adopted Ind-AS prior to FY 2018-19, pursuant to notification of new Ind-AS 115 effective (*from 1 April 2018*), A Ltd. will apply Ind-AS 115 instead of Ind-AS 18
- Ind-AS 101 defines ‘first Ind-AS reporting period’ as the latest reporting period covered by an entity’s **‘first Ind-AS financial statement’**.
- Thus, on the combined reading of above two definitions provided in Ind-AS 101, **‘convergence date’** means the first day of latest reporting period covered by an entity’s first annual financial statement
- Hence, ‘convergence date’ will occur only once in the lifetime of the company when A Ltd adopts Ind-AS either mandatorily or voluntarily
- Substitution of one Ind-AS with another pursuant to notification of new Ind-AS by MCA does is different from ‘convergence date’ .

Any amount though adjusted in ‘other equity’ but not on convergence date will not be eligible for 1/5th deduction under MAT

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

If above adjustment does not qualify for transition amount, can A Ltd claim deduction from MAT profit?

Possible argument against claim of deduction :-

- No specific adjustment for reduction has been prescribed for such amount credited to P&L account under section 115JB
- As per the landmark decision of Supreme Court in the case of Apollo Tyres (122 Taxman 562), the profit and loss account prepared in accordance with Schedule prescribed under Companies Act and approved by statutory auditors, shareholders is final and amendable only by way of specific downward / upward adjustments permitted by Section 115JB
- The only exceptions to the above is when accounts are qualified by the auditor or in a situation involving an admitted fraud or misrepresentation as a result of which accounts cease to be authentic
- Thus, the aforesaid amount of Rs. 2,00,000 credited to P&L account of FY 2018-19 (or of subsequent years) may be liable to MAT in FY 2018-19

Apollo Tyres v/s Principle of Double Taxation

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

If above adjustment does not qualify for transition amount, can deduction can be claimed from MAT profit

Possible argument in favour of claim of deduction

- Andhra Pradesh High Court in the case of Nagarjuna Fertilizers & Chemicals Ltd (373 ITR 252) did not permit taxation of an item under the MAT provisions which were earlier taxed under computation of income in earlier years
- **CBDT Circular No. 24 / 2017** dated **25 July 2017 FAQ** also support, that book profit of the tax year in which revalued Property, Plant & Equipment are retired, disposed, realised or otherwise transferred shall be increased or decreased by the revaluation amount after adjustment of depreciation on revaluation amount relating to the asset

Clarification from CBDT may be expected to resolve unintended consequences

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

Illustration II:

- M Ltd has adopted Ind-AS 115 from 1st April 2018. It had entered into a 18 month contract with B Ltd to provide marketing services on 1st Jan 2018
- The consideration includes a fixed amount of Rs. 15,00,000 plus an additional amount of Rs. 5,00,000, if certain service levels are achieved by May 2018 and Rs. 3,00,000 if they are achieved by June 2018
- Till March 2018, M Ltd followed Ind-AS 18 in accounting for the above contract and it recognized revenue on a straight line basis over the contract term
- M Ltd determines service level at each reporting period and assessed whether additional consideration was earned
- Under Ind-AS 115, M Ltd determines that the contract consisted of a single performance obligation and the contractual terms indicates that revenue will continue to be recognized on a straight line basis over the contract term
- As per Ind-AS 115, the variable consideration is estimated at Rs. 3,00,000 at the inception date, using the most likely amount method. The entity determines that at the inception date, Rs. 3,00,000 would have been included in the transaction price, because it was probable that it would not have been subject to a significant reversal in the future
- M Ltd records an adjustment to opening retained earnings at 1st April 2018 to reflect the difference between revenue recognized under Ind-AS 18 and what would have been recognized under Ind-AS 115 at that date

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

- M Ltd records an adjustment to opening retained earnings at 1st April 2018 to reflect the difference between revenue recognized under Ind-AS 18 and what would have been recognized under Ind-AS 115 at that date

Particulars	April 1, 2018
Revenue under Ind-AS 18	Rs 2,50,000 (15,00,000/18*3)
Revenue under Ind-AS 115	Rs 3,00,000 [(15,00,000+3,00,000)/18*3]
Adjustments in Opening Retained Earnings (Credit)	Rs 50,000

- Normal Taxation – Rs.50,000 shall be taxable – In accordance with ICDS
- MAT Computation – Whether Apollo Tyres decision will still prevail ?

Apollo Tyres v/s Principle of Double Non- Taxation

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

Illustration:

DP Realty is a real estate developer has one on-going project, details of which are as under:

- DP Realty has sold all the flats and has received 30% advance from all the buyers and will receive balance consideration in 6th year on transfer of possession / conveyance
- Estimated profit of entire project is Rs. 6000. Project takes 6 years to complete
- Conveyance is executed in 6th year on receipt of balance 70%
- The recognition of profit is tabulated below:

Year	Year ending	As per ICAI Guidance Note	Profit as per Ind-AS 115
1	31 March 2015	1000	-
2	31 March 2016	1000	-
3	31 March 2017	1000	-
4	31 March 2018	1000	-
5	31 March 2019	1000	-
6	31 March 2020	1000	6,000

**Derecognize profit
up to 31 March 2018**

- DP Realty adopts Ind-AS for first time on 1 April 2018

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

Convergence date is 1st April 2018 in line with Ind-AS 115 – MAT Implication

- Section 115JB(2A) read with section 115JB(2C) requires the company to increase or decrease book profit by 1/5th of transition amounts
- Explanation(i) to section 115JB(2C) of the Income Tax Act defines “Transition amount” as the amount adjusted in “other equity” on convergence date
- Explanation(ii) to section 115JB(2C) defines “convergence date” to be the first date of the first Ind-AS reporting period as defined in Ind-AS 101
- Ind-AS 101 defines first Ind-AS reporting period as “the latest reporting period covered by an entity’s first Ind-AS financial statements”
- Accordingly, convergence date would be 1st April 2018 and any adjustment made in other equity as on 1st April 2018 may qualify as transition amount requiring adjustment on 1/5th basis as required under 115JB(2C)
- Since deduction of Rs. 4000 is allowed over a period of 5 years there will be no double taxation when entire profit of Rs. 6000 enters into financial statement

There could be a mismatch in period in terms of taxability and deduction – In this case Rs.6000 will be taxed under MAT in FY 2019-20, however benefit of 1/5th adjustment is spread over 5 years (till 31 March 2023)

Transition requirement while adopting Ind-AS 115 - Illustration - Tax Implications

Normal Tax Implication

- ICDS III / IV is not applicable to real estate developer
- Expert Committee had recommended separate ICDS
- In absence of ICDS, income is to be computed as per provision of the Act. CIT v/s Wood word Governor India Pvt. Ltd (2009) (312 ITR 254) commercial profit is relevant for taxation

Post Ind-AS adoption- New Project

- Post notification of Ind-AS 115, Guidance note of ICAI is withdrawn and hence such previous policy may no longer be valid even for tax purpose
- Profit taxable as per Ind-AS 115 till the time specific ICDS is prescribed
- ICDS- I permits tax payer to change tax computation if change is on account of reasonable clause

Post Ind-AS- 115- ongoing project

- Can tax officer continue to tax profit of Rs. 1000 in each year 5 and 6 ?
- Can tax payer adopt a view that Rs. 2000 is taxable in year 6 pursuant to Ind As-115 ?

Service Concession Agreement

Illustration:

- Indian Company enters into a service concessionaire agreement with NHA for construction, operation and maintenance of toll road

Particulars	Amount (Rs.)
Cost of constructing Toll road	2000
Notional construction profit	200
Notional construction revenue	2200
Construction period (Prior to FY 2016-17, when Co was covered by IGAAP)	3 years
Revenue (Toll) collection period (Post FY 2016-17, when Co is covered by Ind-AS)	20 years
Estimated Revenue (Toll) to be collected each year	300
Other Operating and maintenance expenses ('Other expenses')	50

- Earlier service concessionaire agreement was covered under Ind-AS -11; Now it is covered under Ind-AS 115.
- The above example assumes that conditions of 5 Step model of revenue recognition is satisfied under Ind-AS 115

Extract of Balance sheet as per I-GAAP

Liability	Amount	Asset	Amount
Capital / Loan	2,000	Financial Asset (Intangible asset)	2,000

Extract of Profit & Loss Account as per I-GAAP (post completion of construction)

Expenses	Amount	Income	Amount
Amortization of Intangible assets	100	Toll road revenue	300
Other expenses	50		
Net Profit	150		

Under the I-GAAP:

- Cost of construction is capitalized to "Intangible asset" and shall be amortized over the concessionaire period (i.e. 20 years)
- Toll Revenue is recognized in the Profit & Loss account every year

Service Concession Agreement

Extract of Ind-AS Profit & Loss Account (construction period)

Expenses	Amount	Income	Amount
Construction cost	2,000	Construction revenue	2,200
Construction profit	200		

Extract of Ind-AS Balance sheet

Liability	Amount	Asset	Amount
Capital / Loan	2,000	Intangible asset	2,200
Reserves	200		

Extract of Ind-AS Profit & Loss Account (post completion of construction)

Expenses	Amount	Income	Amount
Amortization	110	Toll road revenue	300
Other expenses	50		
Construction profit	140		

Under Ind-AS:

- Under Appendix A of Ind-AS 11, accounting is as per “substance” of the arrangement:
 - During the construction period, fair value of construction service (inclusive of notional construction profit) recognized as revenue as per Percentage of Completion Method
 - Corresponding increase in made in the cost of “Intangible Asset”
 - Over concessionaire period, Intangible Asset is amortized and toll collection is recognized as revenue

Normal tax impact:

- Notional construction profit is income from self- Not taxable during construction period
- Tax treatment as prevailed under I-GAAP continues under Ind-AS

The legal form of the transaction and the legal rights and obligations as per concessionaire agreement will be relevant for determining the normal tax implications

In absence of express provision it seems that notional construction profit may get taxed under MAT and the same may get neutralized with higher book depreciation in future

Industry wise impact- Thoughts for discussion

- Industry wise Impact
 - Real Estate Industry;
 - Technology and IT sector
 - Telecommunication;
 - Media and Entertainment
 - Engineering and Construction

Thank You

