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Editorial

The new standard on leases, Ind AS 116, *Leases* is now applicable for Ind AS companies from the accounting period beginning on or after 1 April 2019. For lessees the standard is expected to bring operating leases on-balance sheet as if the entity has borrowed funds to purchase an interest in the leased asset. The standard will impact the statement of profit and loss of the lessees as well. Currently, operating lease expenses are charged to the statement of profit and loss on a straight-line basis over the life of a lease. Companies will now recognise a front-loaded pattern of expense for most leases even when they pay constant annual rentals. Therefore, in this edition of Accounting and Auditing Update (AAU), we have included an analysis of the Nifty 50 listed companies and our observations with respect to the disclosures provided by them for Ind AS 116 in the financial results for the quarter ended 30 June 2019. We have also analysed the disclosures provided in the annual reports by the Nifty 50 companies for the year ended 31 March 2019 with respect to operating lease accounting under erstwhile Ind AS 17.

Implementation of Ind AS 116 is also expected to pose many practical challenges for companies. Our article on the topic aims to discuss four key implementation issues of the standard with the help of practical examples.

In order to address the ambiguity relating to presentation of income tax consequences of payments on financial instruments classified as equity, the International Accounting Standards Board (IASB) amended the International Accounting Standard (IAS) 12, *Income Taxes*. Consequently, the Ministry of Corporate Affairs (MCA) also amended Ind AS 12, *Income Taxes* and clarifies the manner of presentation of dividend and consequent dividend distribution taxes in the financial statements. Recently, the Institute of Chartered Accountants of India (ICAI) has also issued a Frequently Asked Question (FAQ) in this regard. Our article provides an overview of the amendment in Ind AS 12 and the clarification provided by ICAI.

As is the case each month, we have also included a regular round-up of some recent regulatory updates.

We would be delighted to receive feedback/ suggestions from you on the topics we should cover in the forthcoming editions of AAU.

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CHAPTER 1

Ind AS 116, *Leases* - Impact analysis of Nifty 50 companies

This article aims to:

Highlight the disclosures made by the Nifty 50 companies under the new standard on leases i.e. Ind AS 116.

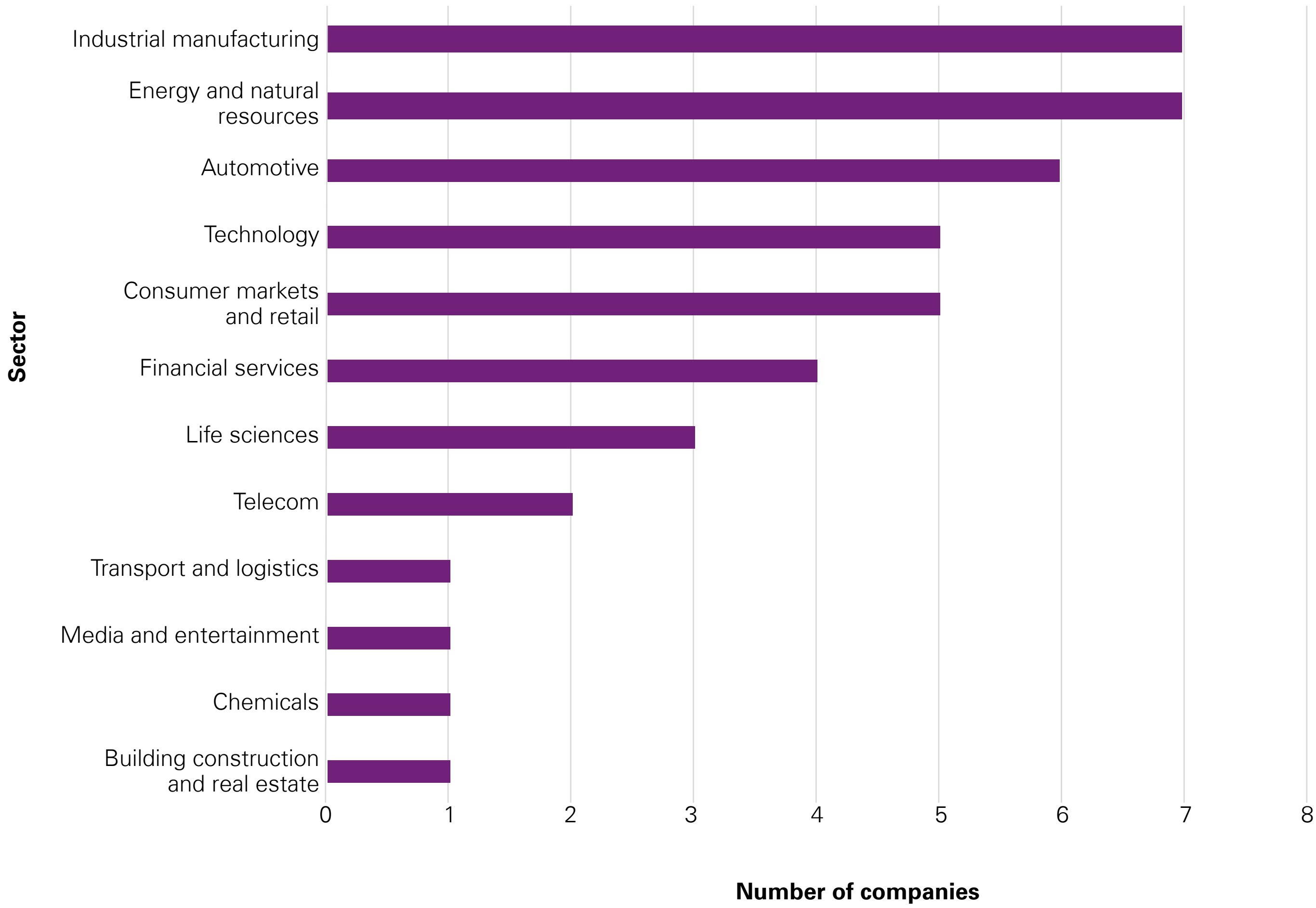
Basis of our analysis and observations

The new standard on leases, Indian Accounting Standard (Ind AS) 116, *Leases* is applicable to the companies (covered under Ind AS road map) for accounting periods beginning on or after 1 April 2019.

We have analysed the disclosures provided by the Nifty 50 companies as per Ind AS 116 in the financial results (both separate and consolidated) for the quarter ended 30 June 2019. However, the quarterly results do not contain detailed disclosures since listed companies are not mandatorily required to submit balance sheet at the end of first quarter. Therefore, our analysis is based on the impact of the new standard reported in the notes to the financial results.

We have also analysed the disclosures given in the annual reports by the Nifty 50 companies for the year ended 31 March 2019 with respect to operating lease accounting under erstwhile Ind AS 17, *Leases*. In our analysis of Nifty 50 companies, we have excluded seven companies that are banks as Ind AS is not yet applicable to banks. Accordingly, our analysis is based on balance 43 companies which include four Non-Banking Financial Companies (NBFCs).

The diagram below highlights the coverage of our analysis by sectors.



Source: KPMG in India's analysis based on Nifty 50 companies listed on National Stock Exchange.

Our observations

Type of assets on operating lease

As per the disclosures provided in the annual reports, most common type of assets on operating lease consist of office premises, office equipments, computers, stores and godowns. The terms of the lease arrangements vary depending upon the type of the asset under lease i.e. cancellable, non-cancellable, renewal period and period of the lease, etc.

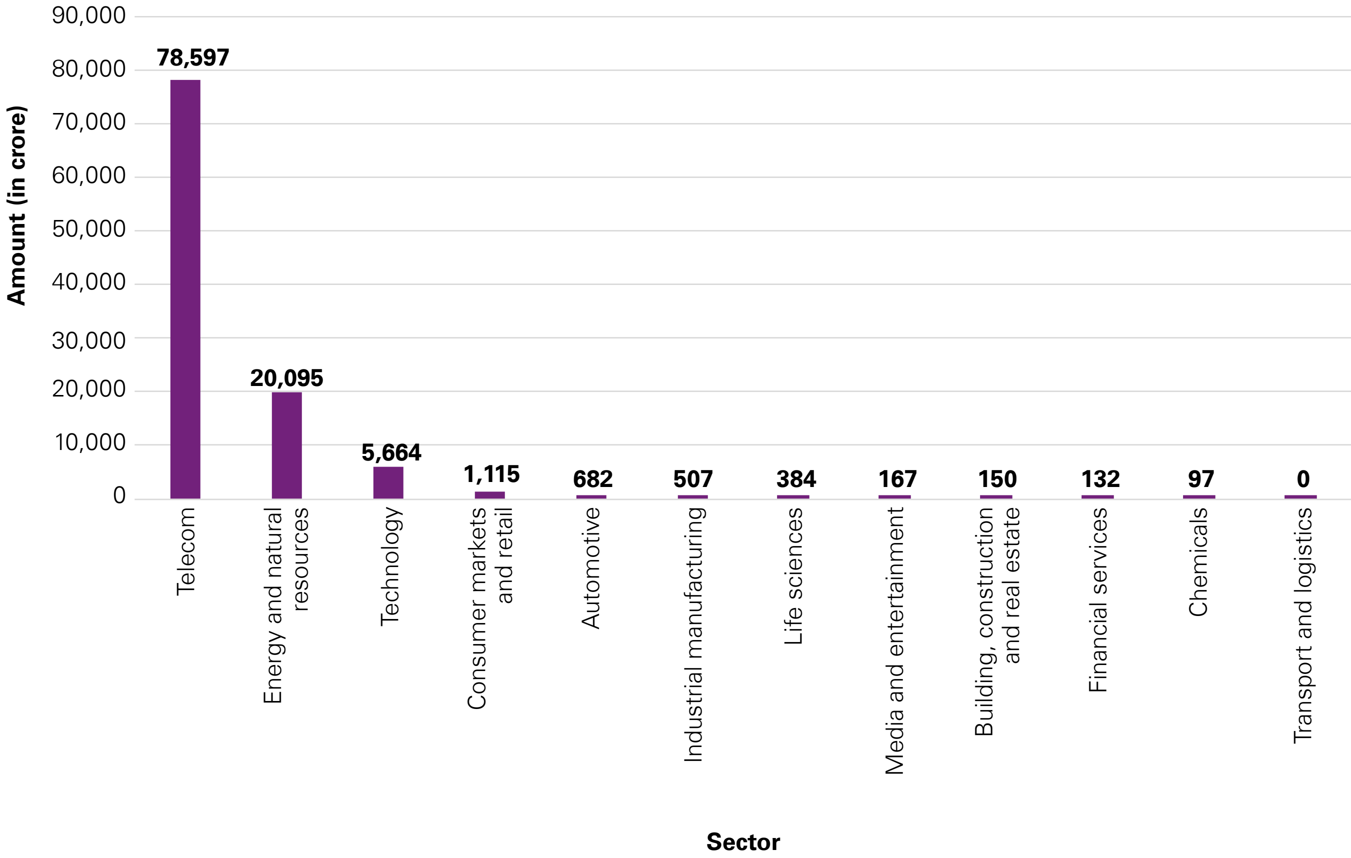
Lease payments

Requirement under Ind AS 17

Under Ind AS 17, lessees are required to recognise lease payments under an operating lease as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit or the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases.

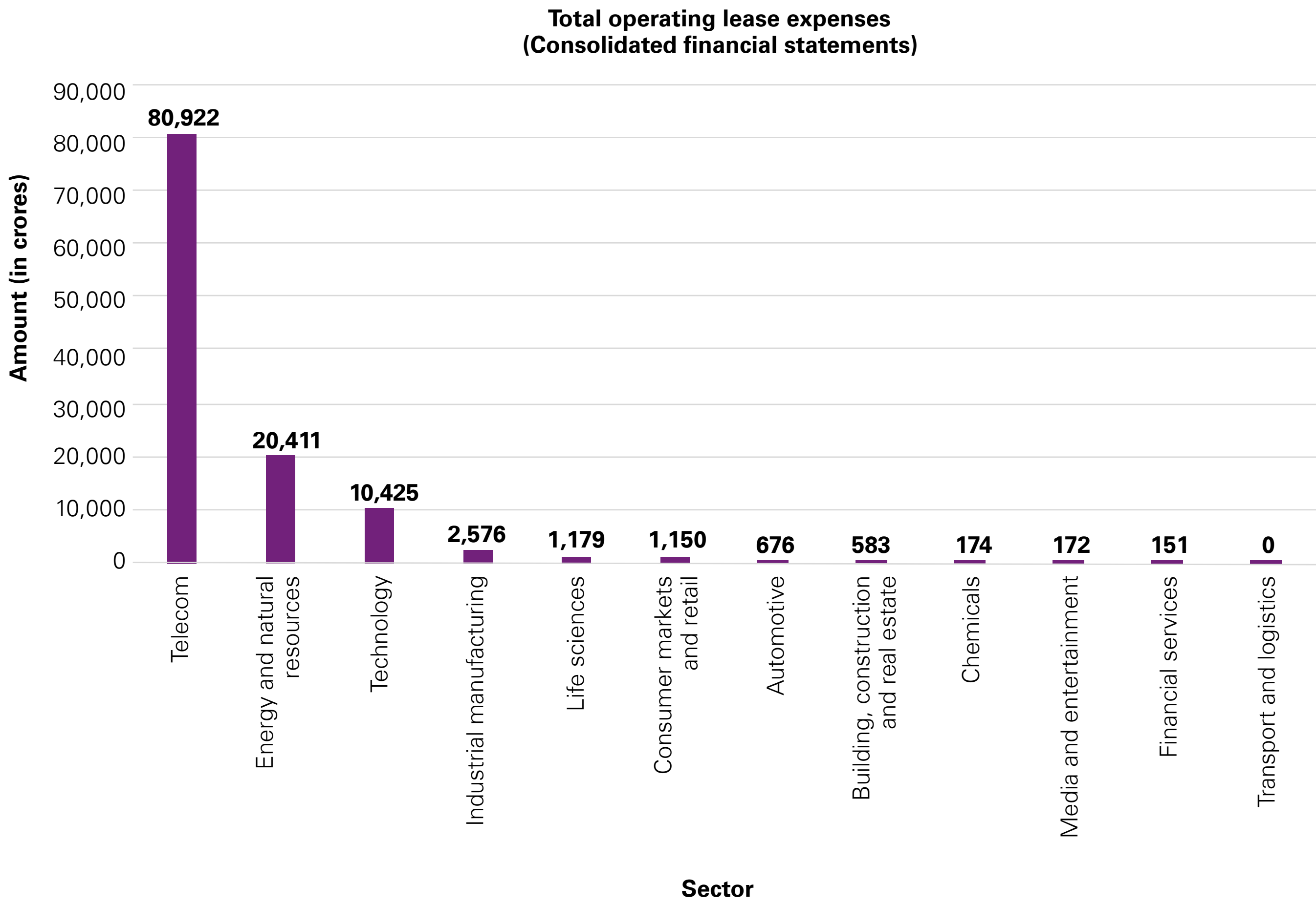
38 companies provided disclosures in their separate financial statements (annual reports) regarding total operating lease expenses for the year ended 31 March 2019 which amounts to INR107,591 crore. The sector-wise break-up of the operating lease expenses are as follows:

Total operating lease expenses (Separate financial statements)



Source: Annual reports of Nifty 50 companies (excluding banks) for the year ended 31 March 2019

Total operating lease expenses reported by 37 companies in their consolidated financial statements (annual reports) for the year ended 31 March 2019 amounts to INR118,418 crore. The sector-wise break-up of the operating lease expenses is given in the chart below:



Source: Annual reports of Nifty 50 companies (excluding banks) for the year ended 31 March 2019

Under Ind AS 17, apart from disclosing lease payments in the statement of profit and loss, lessees are also required to disclose total of future minimum lease payments under non-cancellable operating leases for each of the following period:

a. Not later than one year

b. Later than one year and not later than five years

c. Later than five years.

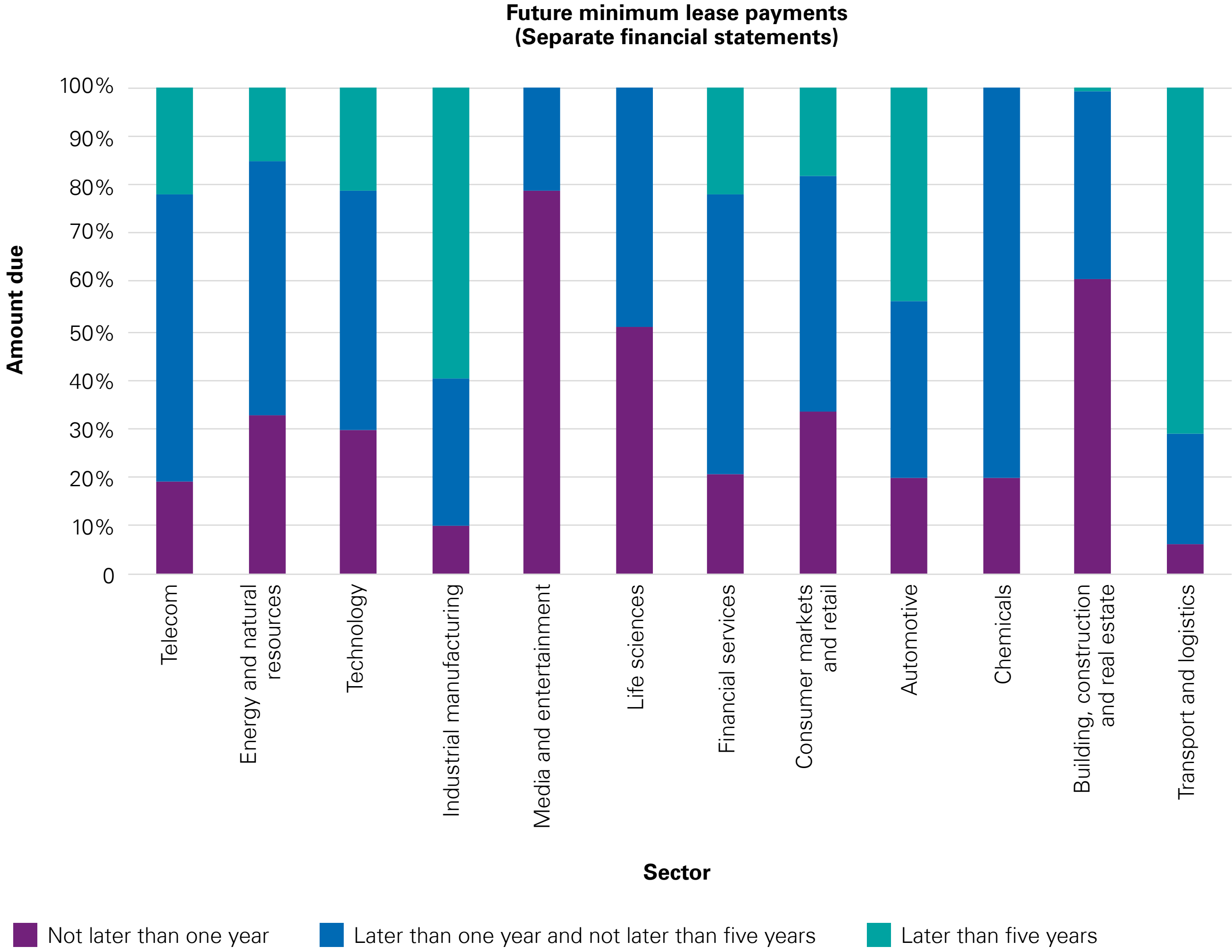
Minimum lease payments are the payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor together with any amounts guaranteed by the lessee or a by a party related to the lessee.

The amount of future minimum lease payments (as at 31 March 2019) was disclosed in the separate financial results by 33 companies and in the consolidated financial results by 35 companies. Following are the amounts:

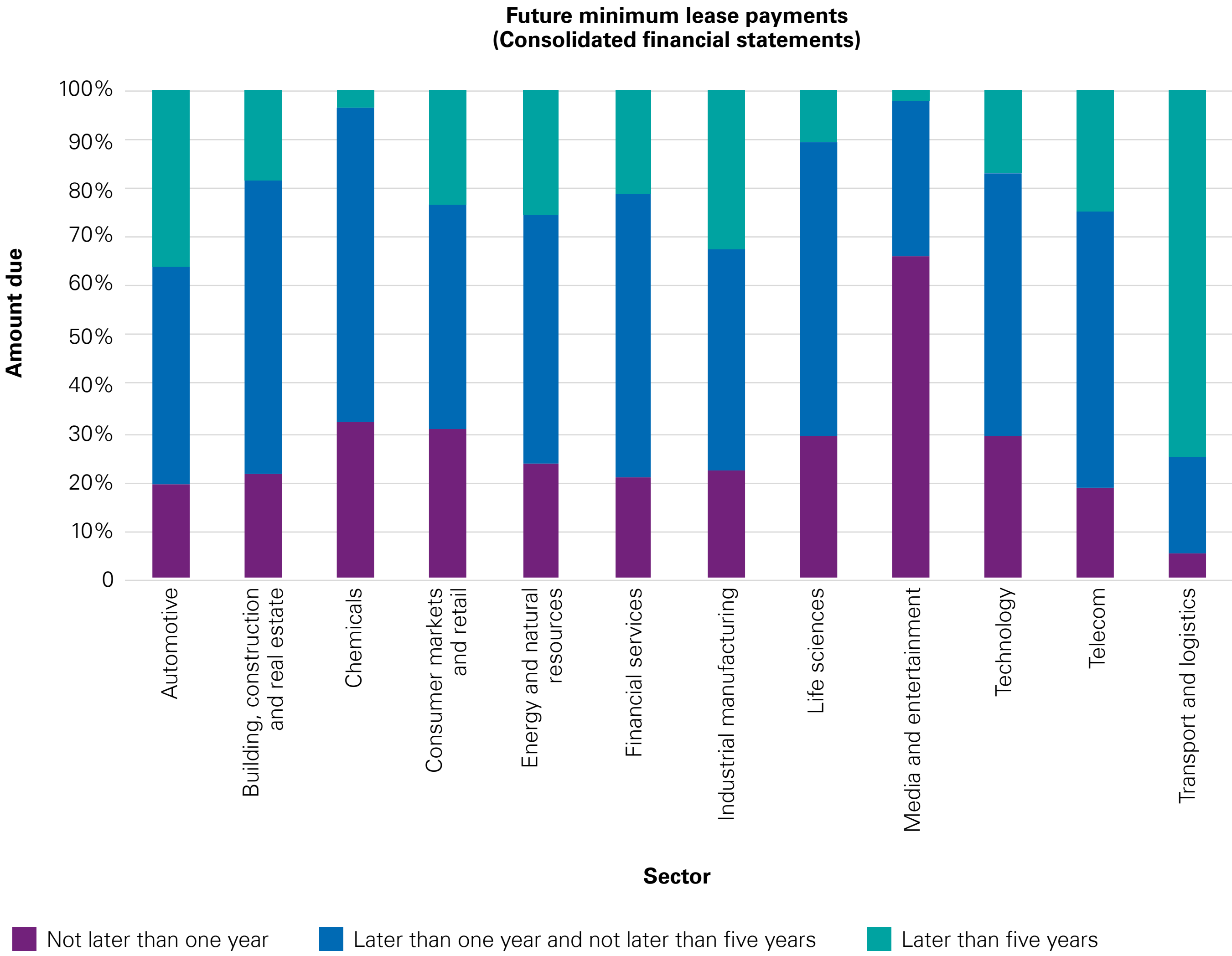
(Amount in INR-crore)

Particulars	Separate	Consolidated
Not later than one year	109,569	117,831
Later than one year and not later than five years	303,118	321,558
Later than five years	110,358	139,838

The sector-wise break-up of the future minimum lease payments is depicted below:



Source: Annual reports of Nifty 50 companies (excluding banks) for the year ended 31 March 2019



Source: Annual reports of Nifty 50 companies (excluding banks) for the year ended 31 March 2019

Impact of Ind AS 116

In this section, we have covered the transition related disclosures provided by the Nifty 50 companies (excluding banks) under Ind AS 116 in the financial results for the quarter ended 30 June 2019.

Method of transition

Ind AS 116 prescribes two optional approaches to transition. They are as follows:

a. **Full retrospective approach:** Under this approach, the lessee applies the new standard retrospectively in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. A lessee following retrospective approach applies the standard retrospectively to each prior period presented.

b. **Modified retrospective approach:** Under this approach, a lessee applies the new standard from the beginning of the current period. Therefore, a lessee following modified retrospective approach is not required to restate its prior period financial information.

Out of 43 companies, transition approach has been disclosed by 37 companies in their quarterly financial results. Six companies did not disclose their Ind AS 116 transition approach.

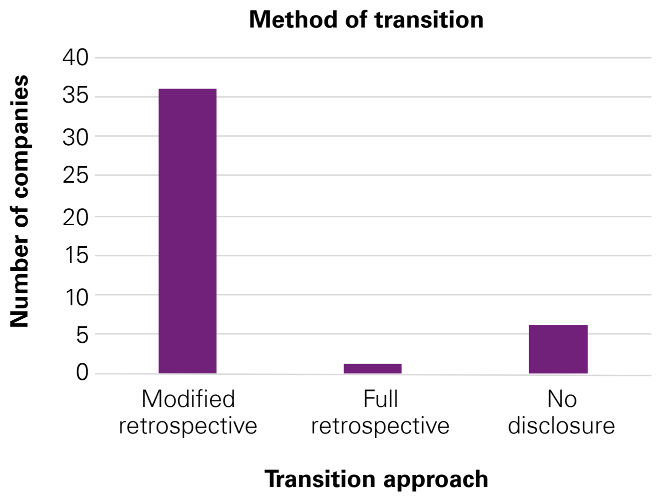
Out of the disclosures made by 37 companies, 36 companies have opted modified retrospective approach for transitioning to Ind AS 116. Accordingly, such companies would be recognising right-of-use assets and lease liabilities as at 1 April 2019. The lease liability will be calculated at the present value of the remaining lease payments by using incremental borrowing rate as at 1 April 2019 as the discount rate. The standard provides two options to measure right-of-use asset under modified retrospective approach as at 1 April 2019:

Option 1: At its carrying amount as if the standard had been applied since the commencement date but discounted using the lessee's incremental borrowing rate at the date of initial application.

Option 2: At an amount equal to lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet immediately before the date of initial application.

The cumulative effect of applying Ind AS 116 would be recognised as an adjustment to equity as on 1 April 2019.

Only one company has chosen retrospective approach to transition. This company would have applied Ind AS 17 while preparing its financial statements for year ended 31 March 2019. It will be applying Ind AS 116 to prepare comparative financial information to be included in its 2019-20 financial statements.



Source: Financial results of Nifty 50 companies (excluding banks) for the quarter ended 30 June 2019

Lease definition - Practical expedient

On transition to Ind AS 116, an entity has the option to apply:

a. The new definition of a lease to all of their contracts or

b. A practical expedient to 'grandfather' their previous assessment of which existing contracts are, or contain, leases.

If the practical expedient is chosen, then it applies to all contracts entered into before the date of initial application (i.e. entered before 1 April 2019), and the requirements of Ind AS 116 apply to contracts entered into (or changed) on or after the date of initial application.

Out of 43 companies, one company has specifically disclosed in the quarterly results that they have adopted the practical expedient to grandfather their previous assessment of which existing contracts are, or contain, leases. However, 42 companies did not provide this disclosure.

Recognition exemption

On transition and subsequently, a lessee may elect not to apply the lease accounting model to:

a. Leases with a lease term of 12 months or less that do not contain a purchase option i.e. short term leases.

b. Leases for which the underlying asset is of low value when it is new - even if the effect is material in aggregate. Ind AS 116 does not contain any threshold for an asset to be qualified as a low value asset. However, examples of low-value underlying assets include tablet and personal computers, small items of office furniture and telephones.

Out of 43 companies, only two companies have provided disclosure in the quarterly results regarding their decision to elect the recognition exemption i.e. both the companies will not account short-term leases and leases for which the underlying asset is of low value. However, they have not disclosed the benchmark that they have used to qualify assets as low value assets for recognition exemption.

Impact on balance sheet

Under Ind AS 116, a lessee is required to recognise a right-of-use asset with a corresponding lease liability for all leases (unless recognition exemption has been taken) which may significantly increase reported assets and liabilities.

Right-of-use asset

Out of 43 companies, 15 companies have disclosed the amount of right-of-use assets they would be recognising in the balance sheet (separate and consolidated) on account of application of Ind AS 116. The total amount of right-of-use asset disclosed in the separate financial results amounts to INR30,914 crore and INR47,586 crore in the consolidated financial results.

Lease liability

Out of 43 companies, 15 companies have disclosed the amount of lease liability they would be recognising in the balance sheet (separate and consolidated) on account of application of Ind AS 116. The total amount of lease liability disclosed in the separate financial results amounts to INR32,214 crore and INR48,559 crore in the consolidated financial results.

Impact on statement of profit and loss

Ind AS 116 requires a lessee to present interest expense on lease liability and depreciation charge on the right-of-use asset separately in the statement of profit and loss.

Only four companies have disclosed the impact of Ind AS 116 with respect to recognition of depreciation and interest expense for operating leases in the separate financial results. As per the disclosure made by such companies, total amount of INR1,047 crore has been shown as an increase in depreciation and interest expenses on application of Ind AS 116.

In the consolidated financial results, an amount of INR476 crore has been disclosed as an increase in depreciation and interest expense by three companies.

Adjustment to retained earnings

Based on the transition approach followed under Ind AS 116, companies would be recognising transition related adjustment against retained earnings.

Out of 43 companies, only nine companies following modified retrospective approach have disclosed the amount of adjustment made to retained earnings as on 1 April 2019. The total amount adjusted against retained earnings disclosed in the separate financial results amounts to INR2,890 crore and INR4,077 crore in the consolidated financial results.

Balance 34 companies did not provide this disclosure.

Others - Reclassification of asset and liability

Application of Ind AS 116 may also result in change in classification of assets/liability held under finance lease under Ind AS 17 from items of Property, Plant and Equipment (PPE) and other liability to right-of-use asset and lease liability.

Out of 43 companies, only three companies have disclosed that there is a reclassification of leased asset from PPE to right-of-use asset and one company has disclosed that there is a reclassification from other financial liability to lease liability on account of application of Ind AS 116.

The amount of reclassification from PPE to right-of-use asset disclosed in the separate financial results amount to INR889 crore and INR931 crore in the consolidated financial results.

The amount of reclassification from other financial liability to lease liability disclosed in the separate financial results amount to INR39 crore and INR62 crore in the consolidated financial results.

Conclusion

The requirement to recognise additional assets and liabilities arising from lease transactions is expected to affect key financial ratios which are used commonly, in credit and investment making decisions. Changes to the lessee's balance sheet resulting from the new requirements will also impact a lessee's compliance with financial covenants. The existence and magnitude of the impact will depend on lessee-specific facts and circumstances. Companies should consider providing such qualitative disclosures together with the information provided on the face of the financial results, so that they could enable users of the financial results to assess the effect the leases have on the company's financial position, financial performance and cash flows.

CHAPTER 2

Ind AS 116, *Leases*: Emerging implementation challenges

This article aims to:

Discuss key implementation issues of the new standard on leases - Ind AS 116 with the help of practical examples.

The new standard on leases, Ind AS 116, *Leases* is effective for companies from 1 April 2019. Ind AS 116 eliminates the classification of leases as either finance or operating lease as required by Ind AS 17, *Leases*. Ind AS 116 introduces a single on-balance sheet accounting model that is similar to current finance lease accounting model. Therefore, a company is expected to report majority of its operating leases on-balance sheet as if the company has borrowed funds to purchase an interest in the leased asset (i.e. it would be recognising a right-of-use asset and a corresponding lease liability in its balance sheet). Apart from the balance sheet, statement of profit and loss of a company would also undergo a change as operating lease expenses will be bifurcated into depreciation on the right-of-use asset and interest expense on the lease liability.

Implementation of the new standard is likely to pose many practical challenges for companies which extend beyond general and financial reporting including areas such as legal, treasury, internal audit, taxation, budgeting, regulatory, etc.

In this article, we aim to discuss some of the key challenges faced by the companies while implementing the requirements of Ind AS 116 with the help of practical examples.

Common transition approaches

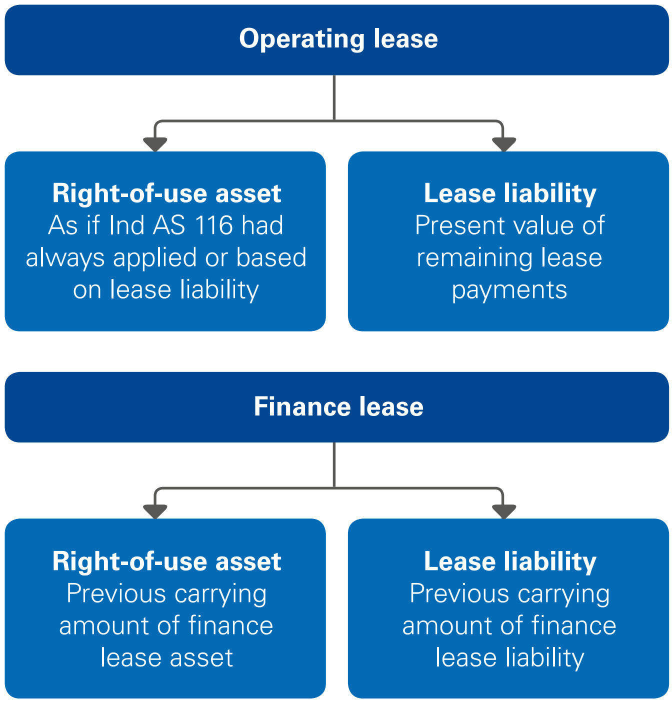
Ind AS 116 provides two optional approaches to transition. They are as follows:

a. **Full retrospective approach:** Under this approach, the lessee applies the new standard retrospectively in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. For this purpose, the lessee applies the standard retrospectively to each prior period presented and recognises an adjustment in equity at the beginning of the earliest period presented.

b. **Modified retrospective approach:** Under this approach, a lessee applies the new standard from the beginning of the current period. For this purpose, the lessee calculates lease assets and lease liabilities as at the beginning of the current period and recognises an adjustment in equity at the beginning of the current period. Accordingly, a lessee will not restate its prior period financial information under this approach.

A lessee is required to apply the election (out of the two approaches) consistently to all of its leases in which it is a lessee.

A modified retrospective approach would be applied as follows:



Measurement of right-of-use asset - Practical expedient for leases previously classified as operating leases

Under modified retrospective approach, for leases previously classified as operating leases, a lessee is permitted to choose either of the following options to measure the right-of-use asset at the date of initial application:

- **Option 1:** At its carrying amount as if the standard had been applied since the commencement date but discounted using the lessee's incremental borrowing rate at the date of initial application.
- **Option 2:** At an amount equal to lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet immediately before the date of initial application.

Issue: Whether the above options are available on a lease-by-lease basis or to a company as a whole?

Ind AS 116 specifies that the options under modified retrospective approach are available to a company on a lease-by-lease basis. This allows companies to make their own trade-off between cost and comparability when designing their transition approach. In case relevant information is available to compute the incremental borrowing rate at the date of initial application, then companies can opt option 1 (i.e. calculate right-of-use asset at its carrying amount as if Ind AS 116 had always been applied).

In practice, we have observed that option 1 is being opted by companies. The initial carrying amount under option 1 will be lower than option 2. This is because option 1 depicts the right-of-use asset amortisation profile (depreciated on a straight-line basis) whereas option 2 depicts the lease liability amortisation profile (measured using the effective interest method). Also, depreciation charge under option 1 will be lower as compared to option 2.

This is explained with the help of an example.

Example: A retailer J, enters into a lease for a retail store for a fixed rent of INR100 per annum paid at the end of each year. The lease commences on 1 April 2014 when J's incremental borrowing rate is 7 per cent. The non-cancellable period of the lease is 10 years, renewable for a further five years.

Under Ind AS 17, J classifies the lease as an operating lease and recognises the lease payments as an expense on a straight-line basis.

J adopts the new standard following modified retrospective approach with a date of initial application being 1 April 2019. At that date:

a. J is not reasonably certain to exercise renewal option. Therefore, the remaining term of the lease is five years.

b. J's incremental borrowing rate is 5 per cent.

Given the facts of the case, J will be required to measure lease liability as at 1 April 2019 based on the lease payments over the remaining lease term (five years at INR100 per annum) discounted at its incremental borrowing rate at that date i.e. 5 per cent - giving a lease liability of INR433.

J may calculate the carrying amount of the right-of-use asset in either of the following manner:

Option 1: *Retrospective but using the incremental borrowing rate at 1 April 2019:* Measure right-of-use asset at the present value of the lease payments over the 10 year term (10 years at INR100 per annum) discounted at J's incremental borrowing rate on transition i.e. 5 per cent - giving an amount of INR772.

Considering that J choses to depreciate right-of-use asset on a straight-line basis over the lease term, the carrying amount of the right-of-use asset on transition date is 5/10 x INR772 = INR386.

The balance amount of INR47 (i.e. INR433-INR386) will be debited to retained earnings.

Option 2: *Equal to lease liability:* Measure the right-of-use asset at an amount equal to lease liability i.e. INR433.

The initial carrying amount under option 1 is lower than option 2. Accordingly, the depreciation charge computed under option 1 is lower than depreciation charge as per option 2:

Option 1: 1/5 x INR386 = INR77

Option 2: 1/5 x INR433 = INR87.

(Source: KPMG IFRG Ltd.'s publication 'Leases transition options - What is the best option for your business? November 2018)

Deferred tax implications

Currently, for operating leases, a lessee generally records a Deferred Tax Asset (DTA) for the accrued rent liability that exists, which equals the difference between the cumulative rent deductible for income tax purposes (sometimes based on the cash paid) and the cumulative rent recognised for book purposes (generally on a straight line basis). Since a lessee does not recognise any underlying asset or any right-of-use asset for book purposes, the only temporary difference created is the difference between the rent expense recognised for tax purposes and book purposes.

Issue: Whether deferred taxes would be required to be computed with respect to right-of-use asset and lease liability on transition to Ind AS 116 when an entity applies modified retrospective approach and measures right-of-use asset at its carrying amount and discounted using incremental borrowing rate at the date of initial application? If yes, then where such deferred taxes should be accounted?

On initial application of Ind AS 116, a lessee that applies modified retrospective approach and measures right-of-use asset at its carrying amount and discounted using incremental borrowing rate at the date of initial application and a lease liability would recognise any deferred tax impact in retained earnings.

However, the tax base of the right-of-use asset would be nil because there are no associated tax deductions from recovering the asset. The lease liability's tax base would also be nil because the lease payments would be deductible in future.

As a result, the lease would give rise to two separate temporary differences:

- A temporary difference related to right-of-use asset and
- A temporary difference related to the lease liability.

The asset and liability that arise for accounting purposes under a lease are integrally linked. Accordingly, they should be regarded as a net package for the purpose of recognising deferred tax.

Example: Company A transitions to Ind AS 116 with effect from 1 April 2019, using the modified retrospective method. It measures the right-of-use asset based on option 1 i.e. as though Ind AS 116 was always applied. Based on the given approach, company A records a right-of-use asset of INR5,000 million and a lease liability of INR6,000 million.

Further, in the jurisdiction in which company A operates, expenses are allowed as a deduction from taxable income for tax purposes based on actual payments i.e. depreciation of the right-of-use asset and interest expense on the lease liability are not considered to be allowable expenses. There is a timing difference in terms of the accounting profit and the taxable profit.

In the given case, company A would be required to recognise deferred tax (DTA or Deferred Tax Liability (DTL)) to the extent of difference between the right-of-use asset and lease liability i.e. INR1,000 million (INR6,000-INR5,000 million). Such deferred taxes would be initially recorded through retained earnings on transition and thereafter through the statement of profit and loss.

Rent equalisation/deferred rent

Under Ind AS 17, lease payment under an operating lease is recognised as an expense on a straight-line basis over the lease term. This straight-lining of rent expense may result in recognition of a rent equalisation reserve or an asset (prepaid/deferred rent) in the balance sheet.

Issue: What would be the treatment of such rent equalisation liability and/or deferred rent on transition to Ind AS 116?

A lessee that opts for modified retrospective approach to transition would have two options.

Option 1: To recognise right-of-use asset at the date of initial application at an amount equal to lease liability. In this case, the rent equalisation liability would be regarded as 'accrued lease payments' and the amount of right-of-use asset would be determined by deducting the said liability from the amount of 'lease liability'.

Option 2: To compute the right-of-use asset at its carrying amount as if the standard has always been applied but discounted using the lessee's incremental borrowing rate at the date of initial application. In this case, it would recognise in retained earnings (or other component of equity), the difference, as at the date of initial application of Ind AS 116 (i.e. 1 April 2019), between:

a. The amount at which right of use asset is measured, together with the amount of rent equalisation liability, and
b. The amount at which lease liability is measured.

This could be explained with the help of an example.

Example: Company A transitions to Ind AS 116 with effect from 1 April 2019. For periods up to 31 March 2019, company A has recognised rental expenses under operating lease arrangements on a straight-line basis and recorded a rent equalisation reserve of INR10 million.

In the given case, if company A opts for modified retrospective approach to transition to Ind AS 116 and has elected to compute right-of-use asset:

a. At an amount equal to lease liability: Company A should adjust the amount of lease equalisation reserve (INR10 million) from the right-of-use asset. There will be no impact in retained earnings in the given option.
b. At its carrying amount discounted using incremental borrowing rate at the date of initial application: Company A should adjust the amount of lease equalisation reserve (INR10 million) from retained earnings from the right-of-use asset.

Continuing with the above example, company A, in line with the requirements of Ind AS 109, *Financial Instruments*, had discounted the security deposits given to lessors and accounted for the difference between cash outflows and present value of security deposits, as deferred rent. As at 31 March 2019, company A carried a deferred rent of INR15 million in its balance sheet.

As per the requirements of Ind AS 116, the deferred rent (INR15 million) would be adjusted from the right-of-use asset.

Recognition exemption - Low value assets

Under Ind AS 116, a lessee may elect not to apply lessee accounting model to leases for which the underlying asset is of low value. The election for leases of low-value assets can be made on a lease-by-lease basis.

An underlying asset can be of low value only if:

a. The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee and

b. The underlying asset is not highly dependent on, or highly interrelated with, other assets.

Issue: Whether any quantitative threshold has been prescribed under Ind AS 116 below which assets could be qualified as low value assets?

Ind AS 116 do not specify any threshold for the low-value exemption to exclude assets from lease accounting. However, it provides that a lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.

The standard provide examples of certain assets which can be considered as low value assets such as tablet and personal computers, small items of office furniture and telephones.

Another area of concern for availing low value lease exemption relates to whether the asset need to be of low value on the date of transition to Ind AS 116 or on the initial date when the lease arrangement was entered into.

The standard clearly states that a lessee should assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased. The assessment of whether an underlying asset is of low value is performed on an absolute basis.

Additionally, leases of low-value assets qualify for exemption under the new standard regardless of whether those leases are material to the lessee. The assessment is not affected by the size, nature or circumstances of the lessee. Accordingly, different lessees are expected to reach the same conclusions about whether a particular underlying asset is of low value.

Conclusion

Implementation of the new standard on leases involves significant judgements and critical assessment of the terms of a given lease arrangement. Companies should carefully evaluate the implications of the change in accounting envisaged by Ind AS 116 and ensure that they are equipped with systems and processes to cater such challenges.

CHAPTER 3

Presentation of dividend distribution tax

This article aims to:

Explain the manner of presentation of dividend distribution tax under Ind AS.

Introduction

One of the most common methods of distributing profits to shareholders is by way of declaring dividends (both interim and final). Dividend is an income for shareholders and as per Section 115-O of the Income Tax Act, 1961 (IT Act), a company declaring dividend has to discharge a Dividend Distribution Tax ('DDT') of 15 per cent on the amounts distributed as dividends.

Indian Accounting Standard (Ind AS) 12, *Income Taxes* prescribes the accounting for the income tax consequences of dividends i.e. DDT.

An issue was raised to the International Accounting Standards Board (IASB) whether the income tax consequences of payments on financial instruments classified as equity should be recognised in profit or loss or in equity. To resolve the issue, IASB amended International Accounting Standard (IAS) 12, *Income Taxes* and consequently, the Ministry of Corporate Affairs amended Ind AS 12 and amendments are applicable for accounting periods beginning on or after 1 April 2019.

Accounting guidance

Ind AS 32, *Financial Instruments: Presentation* provides guidance regarding classification of a financial instrument as a financial liability or an equity instrument. This classification determines whether dividend relating to that instrument is recognised as income or expense in the statement of profit and loss.

Thus, dividend relating to a financial liability or a component that is a financial liability would be recognised as an expense in the statement of profit and loss. On the other hand, distributions to holders of an equity instrument should be recognised directly in equity.

The recent Ind AS 12 amendment requires entities to 'recognise the income tax consequences of dividends in profit or loss, Other Comprehensive Income (OCI) or equity according to where the entity originally recognised those past transactions or events'.

Before amendment to Ind AS 12, the requirement regarding income tax consequences of dividends was ambiguous. It was not clear whether the requirements of paragraph 52B of Ind AS 12 before amendment apply only in the circumstances described in paragraph 52A - for example, when there are different tax rates for distributed and undistributed profits or whether those requirements apply as long as payments on financial instruments classified as equity are distributions of profit.

The amendment, therefore, clarifies that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits – i.e. in profit or loss, OCI or equity.

Presentation of DDT

Ind AS 12 (amended) requires companies to recognise DDT in the same place where the underlying transaction or event was recognised. Therefore, as a first step, companies need to analyse the terms and conditions of the financial instruments issued by them to determine if such instruments should be classified as liability or equity in accordance with the guidance provided under Ind AS 32. The classification of financial instruments is likely to involve significant judgement.

On 17 September 2019, the Accounting Standards Board (ASB) of the ICAI also released a Frequently Asked Question (FAQ) and clarified the presentation of DDT as DDT is a unique feature of India tax regime. The ASB referred to paragraph 65A of Ind AS 12 which is reproduced below: ***'when an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends'.*** The term 'withholding tax' is neither defined in the IT Act nor under Ind AS.

As per the ASB, withholding tax is only an example of tax collection mechanism envisaged by Ind AS 12. Therefore, ASB concluded that the standard does recognise possibility of other tax collection mechanisms, which have to be interpreted keeping in mind the substance and underlying intent of tax laws of the country. Accordingly, the ASB considered following two indicators to evaluate whether DDT is a portion of tax paid by company on behalf of its shareholders:

1. **Dividend received with an imputed tax credit:** As per the ASB, dividend is received by the shareholders in India with an imputed tax credit i.e. it will not be charged to further tax by the taxation authorities in the hands of shareholders. Therefore, DDT is covered by situation of paragraph 65A as per ASB.

   Further, it is of the view that in India, dividends are not taxable in the hands of shareholders as DDT is paid by the company that paid the dividend. According to ASB, had there been no DDT mechanism, dividend would have been taxable in the hands of recipients (though dividend exceeding specified limit has been made taxable under Section 115BBDA of the IT Act through Finance Act, 2016 with effect from 1 April 2017). In such a situation also, the tax applicable is at a lower rate in view of the fact that tax on dividend has already been collected in the form of DDT.

2. **Receipt of net/full amount of dividend declared and 'grossing up' of DDT:** As per ASB, in India, the amount of dividend is grossed up by the company for computation of DDT and shareholders receive a net amount of the dividend after deducting tax.

   It highlighted that DDT mechanism was introduced to replace the mechanism of Tax Deduction at Source (TDS) (commonly referred to as withholding tax) primarily to reduce the operational difficulties involved in that tax collection structure. Also, the Finance Act, 2014 brought the concept of 'grossing up' of base amount used for computing DDT. As per ASB, the intention behind introduction of grossing up was to bring the tax base equivalent to the tax base on which tax would have been collected if the dividends were taxable in the hands of shareholders.

   Based on the above, the ASB concluded that DDT is a portion of the dividends paid to taxation authorities on behalf of its shareholders. Therefore, DDT in substance is payment by the company on behalf of the shareholders and thus, will be covered under paragraph 65A of the IT Act.

With respect to presentation of the DDT, the ASB is of the view that the relevant guidance is in paragraph 61A of Ind AS 12. Para 61A states that 'current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss.

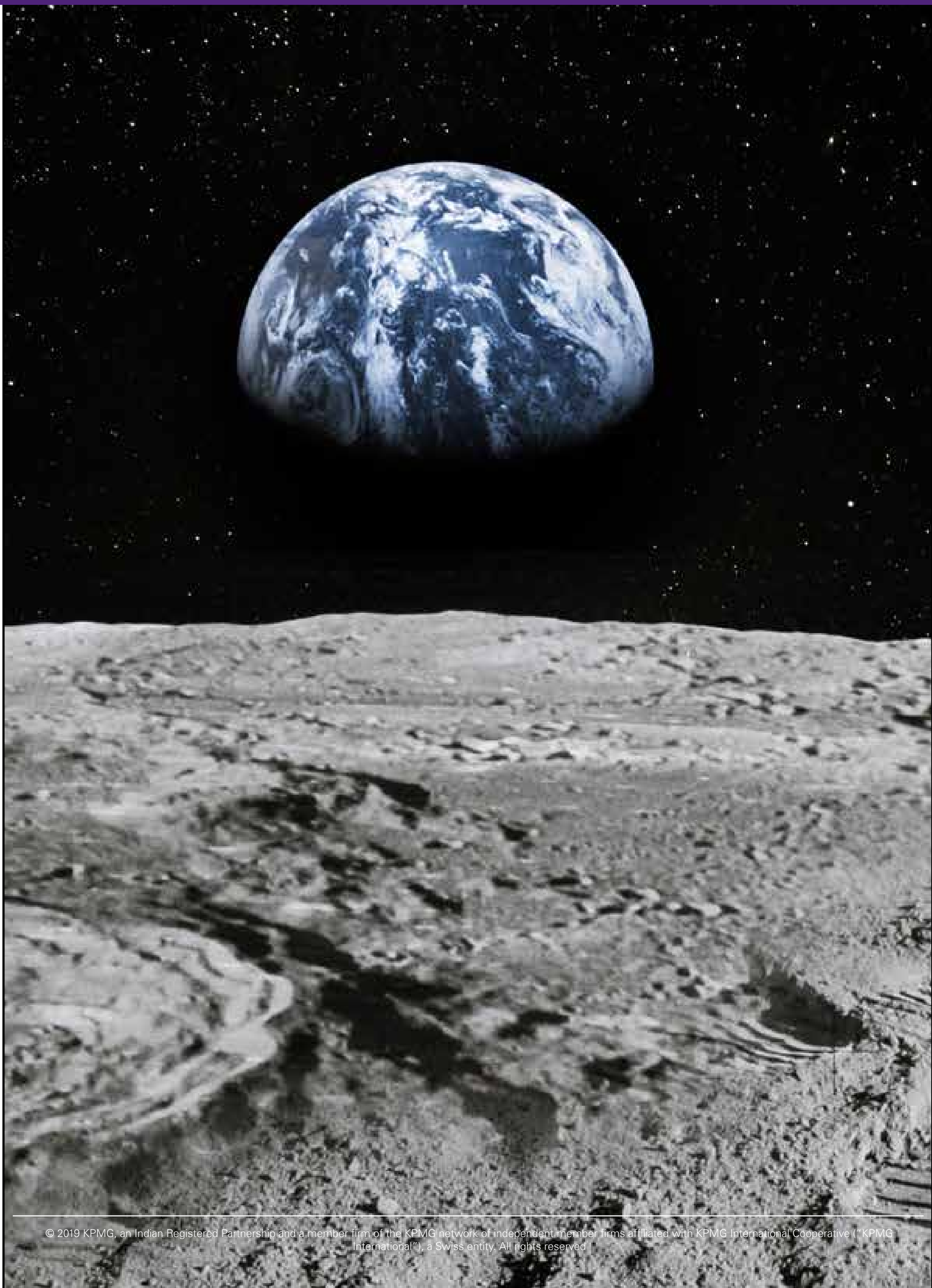
Accordingly, the ASB clarified that the presentation of DDT paid on dividends should be consistent with the presentation of the transaction that creates those income tax consequences, as follows:

a. **Dividend charged to statement of profit and loss:** Charge DDT to the statement of profit and loss.

b. **Dividend recognised in statement of changes in equity:** Recognise DDT in the statement of changes in equity.

CHAPTER 4

Regulatory updates



ITFG clarifications' bulletin 21

The Ind AS Technical Facilitation Group (ITFG) of the Institute of Chartered Accountants of India (ICAI) issued its clarifications' bulletin 21 on 17 September 2019. The bulletin provides clarifications on five issues relating to application of Ind AS 116, *Leases* as follows:

- Eligibility for short-term lease exemption under Ind AS 116
- Accounting treatment of rent equalisation liability
- Treatment of a lease classified as finance lease under Ind AS 17, *Leases* upon transition to Ind AS 116
- Application of Ind AS 116 for leases acquired in a business combination by a first-time adopter of Ind AS
- Treatment of foreign exchange differences relating to lease liability.

(Source: ICAI-ITFG clarification bulletin 21 dated 17 September 2019)

The Code on Wages, 2019

On 8 August 2019, the Code on Wages, 2019 (the code) received the assent of the President of India. The code amends and consolidate the laws relating to wages and bonus and the related matters. Accordingly, the code subsumes the following acts:

a. The Payment of Wages Act, 1936

b. The Minimum Wages Act, 1948

c. The Payment of Bonus Act, 1965 and

d. The Equal Remuneration Act, 1976.

Key features of the code are as follows:

a. Coverage: The code will apply to all employees. The Central Government (CG) will make wage-related decisions for employments such as railways, mines, oil fields, air transport service and others. State governments will make decisions for all other employments.

b. Minimum wage: The code prohibits employers from paying wages less than the minimum wages. Minimum wages will be notified by the central or state governments. This will be based on time, or number of pieces produced. The minimum wages will be revised and reviewed by the central or state governments at an interval of not more than five years.

c. Floor wage: As per the code, the CG will fix a floor wage, taking into account living standards of workers. Further, it may set different floor wages for different geographical areas. Before fixing the floor wage, the CG may obtain the advice of the Central Advisory Board and may consult with state governments.

The minimum wages decided by the central or state governments must be higher than the floor wage. In case the existing minimum wages fixed by the central or state governments are higher than the floor wage, they cannot reduce the minimum wages.

d. Determination of bonus: All employees whose wages do not exceed a specific monthly amount, notified by the central or state government, will be entitled to an annual bonus. The bonus will be at least: (i) 8.33 per cent of an employee's wages, or (ii) INR100, whichever is higher. Additionally, the employer will distribute a part of the gross profits amongst the employees. This will be distributed in proportion to the annual wages of an employee. An employee can receive a maximum bonus of 20 per cent of his/her annual wages.

e. Gender discrimination: The code prohibits gender discrimination in matters related to wages and recruitment of employees for the same work or work of similar nature. Work of similar nature is defined as work for which the skill, effort, experience, and responsibility required are the same.

Effective date: The code will come into force on such date as the CG may, by notification in the official gazette appoint. Different dates may be appointed for different provisions of the code.

(Source: The Code on Wages, 2019 issued by the Ministry of Law and Justice dated 8 August 2019)

Extension of the due date of Goods and Services Tax (GST) annual return and reconciliation statement

Background

On 21 June 2019, Central Board of Indirect Taxes and Customs (CBIC) through its press release, extended the due date for filing annual return in the FORM GSTR-9/ FORM GSTR-9A and reconciliation statement in the FORM GSTR-9C for the financial year 2017-18 till 31 August 2019.

New development

The CBIC through its press release dated 26 August 2019 further extended the due date for furnishing above returns/reconciliation statement by three months till 30 November 2019.

(Source: CBIC-press release dated 26 August 2019)

Advisory on auditor's reporting on Section 197(16) of the Companies Act, 2013

Section 197(16) of the Companies Act, 2013 (2013 Act), requires an auditor of a public company to state in his/her auditor's report (under Section 143(3) of the 2013 Act) whether the remuneration paid by the company to its directors is in accordance with the provisions of Section 197 or whether remuneration paid to any director is in excess of the limit laid down and give such other details as may be prescribed.

On 9 September 2019, ICAI issued an advisory and clarified that the reporting requirement under Section 197(16) should be covered under 'Report on Other Legal and Regulatory Requirements' section of the auditor's report.

The advisory comes into force with immediate effect.

(Source: ICAI announcement dated 9 September 2019)

National Financial Reporting Authority (Amendment) Rules, 2019

The Ministry of Corporate Affairs (MCA) through its notification dated 5 September 2019, amended the National Financial Reporting Authority (NFRA) Rules, 2018. The amendment to the NFRA Rules, 2018 has extended the due date of submission of annual return in FORM NFRA-2 by an auditor of a company and a body corporate covered under NFRA Rules by six months i.e. 30 November every year (earlier it was required to be filed by 30 April every year).

The amendment to the NFRA Rules, 2018 also prescribes the format of the FORM NFRA-2.

The notification comes into effect from 5 September 2019.

(Source: MCA Notification no. G.S.R. 636 (E) dated 5 September 2019)

Report on unpaid dues by listed entities before filing a draft scheme of arrangement

On 12 September 2019, the Securities and Exchange Board of India (SEBI) ssued a circular (no. SEBI/HO/CFD/DIL1/CIR/P/2019/192) (the circular) regarding unpaid dues. This circular requires all listed entities to ensure that all dues, fines and penalties imposed by SEBI, stock exchanges and depositories have been paid/settled by them before filing a draft scheme of arrangement with the stock exchange.

In case of unpaid dues, fines and penalties, the listed entity should submit a 'Report on the unpaid dues' to the stock exchanges along with the draft scheme in the format specified by SEBI in Annexure B to the circular.

For a detailed read, please refer to KPMG in India's Notes on 'SEBI issues directions for settlement of outstanding dues prior to filing a scheme of arrangement' dated 24 September 2019.

(Source: SEBI circular no. SEBI/HO/CFD/DIL1/CIR/P/2019/192 dated 12 September 2019)

Loan exposure limit to a single NBFC enhanced by RBI

Background

Currently, bank's exposure to a single Non-Banking Financial Company (NBFC) is restricted to 15 per cent of its tier-I capital. For entities in the other sectors the exposure limit is 20 per cent of tier-I capital of the bank, which can be extended to 25 per cent by a bank's board under exceptional circumstances.

New development

In order to harmonise the exposure limit to a single NBFC with that of the general limit, the Reserve Bank of India (RBI) through its notification dated 12 September 2019, has enhanced bank's exposure limit to a single NBFC (excluding gold loan companies) to 20 per cent of its eligible capital base.

A bank's finance to NBFCs that are predominantly engaged in lending against gold will continue to be governed by limits prescribed in relevant circular.

(Source: RBI notification no. RBI/2019-20/60 dated 12 September 2019)

Revised FAQ on presentation of dividend and dividend distribution tax

On 17 September 2019, the ICAI issued a revised Frequently Asked Question (FAQ) on presentation of dividend and Dividend Distribution Tax (DDT). The FAQ clarified that if a financial instrument is classified as debt, the dividend or interest paid thereon is in the nature of interest which should be recognised in the statement of profit and loss. Dividend or interest paid on a financial instrument which is classified as equity, should be recognised in the statement of changes in equity.

With respect to presentation of DDT, it clarified that the presentation of DDT paid on the dividends should be consistent with the presentation of the transaction that creates those income tax consequences. Therefore, DDT should be recognised in the statement of profit and loss if the dividend itself is recognised in the statement of profit and loss. If the dividend is recognised in equity, then DDT should be recognised in equity.

For a detailed read, please refer to our article on 'Presentation of dividend distribution tax' in the current month's edition of AAU (Issue no. 38 - September 2019).

(Source: ICAI announcement dated 17 September 2019)

The Taxation Laws (Amendment) Ordinance, 2019

On 20 September 2019, the Ministry of Law and Justice issued the Taxation Laws (Amendment) Ordinance, 2019 (ordinance) and made certain amendments to the provisions of Income-tax Act, 1961 (IT Act) and the Finance (No. 2) Act, 2019 with effect from financial year 2019-20.

The key amendments made by the ordinance are as follows:

Particulars	Amendments
Reduction in tax rates for domestic companies	An option has been given to domestic companies to pay tax at the rate of 22 per cent (effective tax rate is 25.17 per cent including surcharge and cess) subject to the condition that no exemption/incentive under the IT Act has been taken by them. Also, such companies are not required to pay Minimum Alternate Tax (MAT).
Tax rate for newly incorporated domestic companies	Any domestic company which has been incorporated on or after 1 October 2019 and makes fresh investment in manufacturing can choose to pay income tax at the rate of 15 per cent (effective tax rate is 17.01 per cent including surcharge and cess). The benefit is subject to the condition that such companies will not claim any exemption/ incentive and should commence their production on or before 31 March 2023. Also, such companies are not required to pay Minimum Alternate Tax (MAT).
Option to companies which continue to avail tax exemptions	A company which does not opt for the concessional tax regime and avails the tax exemption/incentive should continue to pay tax at the pre-amended rate (25 or 30 per cent as the case may be[1]). However, such companies can opt to pay tax at the concessional rate of 22 per cent after the tax holiday/exemption period is over. The option once exercised cannot be subsequently withdrawn. The rate of MAT for companies which continue to avail exemptions/incentives has also been reduced from 18.5 per cent to 15 per cent.
Buy-back of shares by listed companies	Listed companies which have announced buy-back of shares before 5 July 2019 are not required to pay tax on buy-back of shares.
Minimum Alternate Tax (MAT)	With effect from 1 April 2020 (financial year 2019-20): • MAT rate has been reduced to 15 per cent from 18 per cent. • MAT provisions will not apply to a person who has exercised the option to avail the concessional tax rate of 22 per cent or concessional tax rate of 15 per cent to new manufacturing companies.

For a detailed read, please refer to KPMG in India's Tax Flash News on 'Government introduces tax measures to provide stimulus to boost the economy' dated 21 September 2019.

(Source: The Taxation Laws (Amendment) Ordinance, 2019 issued by the Ministry of Law and Justice dated 20 September 2019)

1. Domestic companies with a total turnover or gross receipt (in previous year 2017-18) of less than INR400 crore are required to pay corporate tax at the rate of 25 per cent of the total income and domestic companies with a total turnover or gross receipt of INR400 crore or more are required to pay corporate tax at the rate of 30 per cent of the total income.

Constitution of the Company Law Committee

The MCA through its order dated 18 September 2019, constituted a Company Law Committee (the committee) for examining and making recommendations to the government on various provisions and issues pertaining to implementation of the 2013 Act and the Limited Liability Partnership Act, 2008.

Accordingly, the objectives of the committee, *inter alia*, include the following:

- Analyse the nature of offences (compoundable and non-compoundable) and submit its recommendations as to whether any of the offences could be re-categorised as 'civil wrongs' along with measures to optimise the compliance requirements under the 2013 Act
- Examine the feasibility of introducing settlement mechanism and deferred prosecution agreement under the 2013 Act and
- Propose measures to further de-clog and improve functioning of the National Company Law Tribunal (NCLT).

The committee is required to submit its recommendations to the government from time to time as may be decided by the chairperson of the committee.

(Source: MCA order dated 18 September 2019)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First Notes

SEBI issues directions for settlement of outstanding dues prior to filing a scheme of arrangement

24 September 2019

Background

The Securities and Exchange Board of India (SEBI) through its circulars[1] provides regulations to be followed for the schemes of arrangements.

New development

In order to streamline the processing of draft schemes of arrangements, SEBI on 12 September 2019 has issued directions to listed entities in relation to payment of outstanding dues to SEBI, stock exchanges and depositories. The SEBI has amended its circular dated 10 March 2017 and a new paragraph no. 11 on ' Unpaid Dues Report' has now been inserted. The circular requires all listed entities to ensure that all dues to, and/or fines/penalties imposed by SEBI, stock exchanges, depositories, etc. have been paid/settled before filing the draft scheme with the designated stock exchange.

In case there are unpaid dues/fines/penalties, then a listed entity, prior to obtaining observation letter from the stock exchanges on the draft scheme should submit a 'Report on the Unpaid Dues' to the stock exchanges in the manner prescribed.

This issue of First Notes provides an overview of the SEBI circular.

([1]SEBI Circular No. CIR/CFD/CMD/16/2015 dated 30 November 2015 and SEBI Circular No. CFD/DIL3/CIR/2017/21 dated 10 March 2017.)

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Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) - a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 22 August 2019, KPMG in India organised a special session of VOR webinar to discuss the significant areas relating to lease accounting and also highlighted some of the key implementation areas that could be challenging for the companies in the technology sector with the help of practical examples.

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