

## Query No. 26

**Subject:** *Accounting treatment for 'Duty Credit Entitlement Certificates' issued under 'Served from India Scheme' (SFIS).<sup>1</sup>*

### A. Facts of the Case

1. This is in reference to an earlier opinion issued by the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) (published as query No. 21 in volume XXXIII of the Compendium of Opinions) on the above subject to a company (hereinafter referred to as the 'company'). The querist has stated that the EAC of the ICAI has opined as follows:

- a) Duty credit entitlement under 'Served from India Scheme' (SFIS) does not fall under 'revenue', as defined in Accounting Standard (AS) 9, 'Revenue Recognition'.
- b) Duty credit entitlement under SFIS is a government grant/subsidy/assistance as defined in Accounting Standard (AS) 12, 'Accounting for Government Grants'.
- c) Duty credit entitlement under SFIS should be treated as a grant related to revenue. Therefore, adjustment against gross value of the assets concerned does not arise.

However, the company still differs with the opinion given by the EAC of the ICAI considering the duty credit entitlement under SFIS as grant related to revenue.

2. The company is of the opinion that:

- A. AS 12 does not specifically refer to grants in the nature of duty credit entitlement scrips but it states the following general propositions which may be noted:
  - a. Two broad approaches may be followed for the accounting treatment of government grants: the 'capital approach', under which a grant is treated as part of shareholders' funds, and the 'income approach', under which a grant is taken to income over one or more periods. (Paragraph 5.1 of AS 12)
  - b. It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants. (Paragraph 5.4 of AS 12)
  - c. Government grants available to an enterprise are recognised in the financial statements at the time:
    - i. when there is reasonable assurance that the enterprise will comply with the conditions attached to them; and
    - ii. when such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made. *Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled and the*

---

<sup>1</sup> Opinion finalised by the Committee on 3.2.2017.

*benefits therefrom are availed or will be availed with certainty.*  
(Paragraph 6.1 of AS 12)

- d. *Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets.* Other conditions may also be attached restricting the type or location of the asset or the periods during which they are to be acquired or held. (Paragraph 8.1 of AS 12)
  - e. Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to specific fixed assets are regarded as acceptable alternatives. (Paragraph 8.2 of AS 12)
    - i. Under one method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value. (Paragraph 8.3 of AS 12)
    - ii. Under the other method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systemic and rational basis over the useful life of the asset. ... (Paragraph 8.4 of AS 12)
- B. In applying the general principles outlined above, according to the querist, the following features of the SFIS scheme should be noted :
- a. The government grant under SFIS is *not a subsidy receivable in cash but is in the form of a duty credit scrip which can be utilised with and in certain conditions.*
  - b. The duty credit entitlement scrip *can only be utilised by the enterprise which has export earnings* through rendering of service or by 'Group companies' who are service providers.
  - c. The duty credit entitlement scrip *can only be used to make payment of import duty on import of capital goods or consumables.*
  - d. The capital goods or consumables whether imported by the exporting enterprise or the 'Group company' *can only be used in the service sector business of the enterprise or the 'Group company'.*
  - e. The duty credit entitlement scrip *cannot be transferred except to a 'Group company'.* It does not therefore have a market value.
  - f. If the duty credit scrip *is not utilised within two years of its issue, it lapses.*
  - g. There is *no grant available for exporters who do not import capital goods or consumables.*
  - h. The usage of duty credit entitlement scrips is for specific assets. For what is specific asset, the following points need to be considered:
    - (i) the term 'specific' as defined in Concise Oxford Dictionary gives the following meaning:
      - clearly defined; definite;

- relating to a particular subject; peculiar;
  - (a) of or concerning a species;
    - (b) possessing or concerned with the properties that characterise a species;
  - (of a duty or a tax) assessed by quantity or amount, not by value of goods.
- (ii) when the literal meaning of the term ‘specific’ is applied to the words, ‘specific asset’, it means an individual asset, an individual asset forming part of a group or class of assets or a group or classes of assets.
- C. Having regard to the general considerations and the specific features noted in paragraph above, the following conclusions emerge:
- a. The availability of the grant is dependent upon *two independent criteria*, both of which must be satisfied namely, (i) *a qualifying criteria that the service provider should have foreign exchange earnings and (ii) a utilisation criteria that the duty credit entitlement scrip must be utilised only for payment of import duty on import of a capital asset or consumables to be used in the service sector business of the exporter*. It is not sufficient if only one condition is satisfied; but it is necessary that both conditions must be satisfied. The nature of grant therefore is different from a normal grant for the promotion of exports. Thus, no grant is available to an exporter in the services sector, who does not, or does not need to, import capital goods or consumables.
  - b. It is also important to note that the duty credit entitlement scrip is not transferrable other than to group company and has no market value. Further, it lapses if it is not utilised through import within two years.
  - c. For the capital goods to be imported and to qualify for the utilisation of the duty credit entitlement scrip, its use is restricted in the service sector business of the enterprise or of the enterprise’s ‘Group company’.
    - i. Thus the duty credit entitlement *scrips can be used only for payment of customs duty on such capital goods which are imported for use in the service sector. These capital goods are therefore, clearly specific assets.*
    - ii. The duty credit entitlement scrips if utilised for such specific assets are therefore the grants related to specific assets within the meaning of paragraph 8.1 of AS 12.
  - d. *The company has utilised the duty credit entitlement scrips only for payment of customs duty on identifiable and specific capital goods imported for use in its service sector business. It has therefore availed of a grant related to specific fixed assets in terms of paragraph 8.1 of AS 12.*

Secondly, the EAC has stated that “the Committee notes that such duty credit entitlement under SFIS can be utilised not only for the payment of duty on import of capital goods but also for their spare parts or consumables which can be revenue in nature. Moreover, it is not necessary under the Scheme that its recipient should utilise the scrip for importing goods only. The recipient may transfer them to another company within the same group or managed hotels as per conditions of the Scheme resulting into an income for it. Thus, the amount of duty credit entitlement under SFIS should be considered to be generating income to the company.”

- e. The above view of the Committee also needs to be supplemented with the following:
- i. The duty credit entitlement scrip is not transferable except to a 'Group Company' and that too only for use in the service sector businesses. Therefore, if the exporting company is not part of a 'Group' or the 'Group' does not have an entity in the service sector, the scrip is completely non-transferable.
  - ii. The duty credit scrip cannot be used for any type of import. *It must be used only for import of capital goods and consumables in the service sector.*
  - iii. The capital goods and consumables for which the duty credit entitlement scrip is used cannot be transferred except to a 'Group company' for use in the service sector.
  - iv. No income is generated when a duty credit scrip is awarded. *Income would be generated only if the duty credit scrip is transferred to a Group Company for consideration.*

D. It is also pertinent to note that in terms of the Foreign Trade Policy for 2015-2020 announced by the Government of India, SFIS has been replaced with the 'Service Export from India Scheme (SEIS)'. Under SEIS, the duty credit entitlement scrip "would no longer be with actual user condition and will no longer restrict the usage for specified types of goods but be freely transferrable and usable for all types of goods and services for debits on procurement of services/ goods. Debits would be eligible for CENVAT credit or drawback."

E. The above brings out the essential difference between the two Schemes and highlights the reasons why duty credit entitlement scrip under SEIS can be considered as income whereas duty credit entitlement scrip under SFIS being subject to actual user conditions cannot be considered as income.

(Emphasis supplied by the querist.)

Hence, according to the company, the grant becomes effective when two independent conditions, viz. (i) the earning of export income and (ii) the utilisation of the SFIS scrip for import of capital goods and consumables in the service sector are both satisfied. When it is used for payment of customs duty on import of capital goods it becomes a capital grant. Since the company has used SFIS scrip for payment of customs duty on import of capital goods, it is rightful to treat it as capital grant and not the grant in the nature of revenue.

3. The company has, therefore, submitted that:
- (a) Mere issuance of duty credit entitlement scrips without their utilisation does not create any benefit in the hands of exporter; and
  - (b) If utilised in accordance with the conditions of issuance of scrips, the nature of grant, i.e. revenue grant or capital grant will be determined and accordingly accounted for the benefit.

## **B. Query**

4. In view of the above, the querist has requested to the EAC of the ICAI to review its earlier opinion and issue necessary clarification / revision of its opinion on the basis of utilisation of SFIS scrips as mentioned above.

### C. Points considered by the Committee

5. At the outset, the Committee wishes to point out that normally the Committee does not accept the request for review of its earlier opinion, except in certain situations, such as submission of certain additional facts which materially affect the opinion earlier issued by the Committee or omission of certain material facts while providing the opinion, etc. However, the Committee notes that in the extant case, although the querist has requested for review of its earlier opinion, the issue raised in the extant query relating to recognition of duty credit entitlement certificates (scrips) issued under the 'Served from India Scheme' based on their utilisation was not specifically raised in the earlier query and is, therefore, considered as a separate issue raised by the querist.

6. The Committee notes that the basic issue raised in the query relates to the nature of the grant related to duty credit entitlement certificates (scrips) issued under the 'Served from India Scheme', viz., whether the scrips utilised for payment of import duty on import of a capital asset should be treated as grant related to specific fixed asset and those utilised for payment of import duty on consumables as grant related to revenue, instead of treating the entire grant as grant related to revenue as opined in the earlier EAC Opinion to the querist. Therefore, the Committee has considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, presentation and disclosure of duty credit entitlement under SFIS in the financial statements, timing of recognition of the duty credit entitlement under SFIS, accounting for transfer of the duty credit entitlement to the group companies, etc.

7. With regard to the issue raised as to whether the duty credit entitlement can be treated as grant related to specific fixed asset in case it is utilised for payment of import duty on capital goods, the Committee notes paragraphs 5.4 and 8.1 of AS 12, notified under the Companies (Accounting Standards) Rules, 2006, which provide as below:

"5.4 It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants."

"8.1 Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held."

From the above, the Committee notes that accounting for grant should be based on the nature of relevant grant (based on the eligibility condition for availing the grant) rather than its actual utilisation, as being argued by the querist. Further, the Committee notes that grants related to specific fixed asset are the grants whose *primary condition* is that an enterprise qualifying for them should purchase, construct or otherwise acquire such specific assets. Thus, Committee is of the view that in case of such grants, specific fixed asset(s) is identified for which the grant is to be used. The Committee notes that in the extant case, the Scheme is applicable to various kind of service providers. To avail the benefit under SFIS

the main eligibility condition is exports. Thus, the company would not be entitled to receive the duty credit unless this condition of exports is met. While the scheme entitles the scrips to be utilised for payment of import duty on the capital goods pertaining to the service sector in which those service providers deal (apart from other permitted forms of utilisation), it is only representative of one of the possible ways of the utilisation of the duty credit. In other words, the import of capital goods is not essential (or the primary condition) to be entitled to the benefit. The nexus of the entitlement to duty credit is with export of services. The substantive position is that once the export occurs, the entitlement to duty credit arises. The real trigger is the exports; the entitlement does not arise as a result of import of a specific fixed asset/specific type of fixed asset. If there is no such exports during the period, there would be no duty credit accruing to the company. Thus, this situation can be distinguished from those where an entity is entitled to a government grant if it purchases a specific type of asset, e.g. certain pollution control equipments or energy saving derives. In these cases, the nexus of the grant is with the purchase of the asset. However, in the extant case of duty credit entitlement, the nexus of entitlement is with exports, though the grant is not paid in cash and is instead usable for payment of customs duty on most types of imports (capital goods and consumables) relevant to the exporter in the normal course of business. Accordingly, the Committee is of the view that since the primary condition is neither related to any fixed asset nor are the benefits based on capital investment, in terms of the classification of government grants under AS 12, the scrips are in the nature of grant related to revenue. The actual utilisation of scrips for a purpose, say for import of capital goods does not change the nature of the grant.

#### **D. Opinion**

8. On the basis of above, the Committee is of the opinion that the duty credit entitlement under SFIS should be treated as a grant related to revenue, as discussed in paragraph 7 above. The actual utilisation of scrips for a purpose, say for import of capital goods does not change the nature of the grant.

\*\*\*\*\*