

Query No. 36

Subject: Preparation of Income and Expenditure Account or Profit and Loss Account for a section 8 company, undertaking commercial activities.¹

A. Facts of the Case

1. A corporation is a company (Public Sector Undertaking) (hereinafter referred to as ‘the company’) originally established under section 26 of the Companies Act 1913 on 31st December 1953 which after enactment of the Companies Act, 1956 became a section 25 company under the Companies Act 1956 and now after enactment of the Companies Act 2013, it is a company under section 8 of the Companies Act 2013.

2. The company operates with a mandate to promote, develop and to commercialise indigenously developed technologies from universities, National Research and Development (R&D) Institutions and individual inventors etc. The company is strengthening the technology resource base by nurturing long-term relationship with R&D Institutions as well as universities, technical organisations, industries as well as individual inventors. Also it specialises in technology transfer, Intellectual Property (IP) portfolio management and project consultancy.

3. Besides the above, the company has undertaken various promotional activities of the Government of India (GoI) by receiving grants-in-aid from the GoI since 1970. Presently, the company carried out the following promotional activities on behalf of the Government of India and received grants-in-aid from the Department of Scientific and Industrial Research (DSIR):

Scheme I: Programme for Inspiring Inventors and Innovators (PIII)

Scheme II: Programme for Development of Technologies for Commercialisation (PDTC)

The company also undertakes the following programmes as consultancy services:

- The company has been integrated with Department of Industrial Policy and Promotion (DIPP) for Start-up India Action Plan.
- Implementing IOCL start-up scheme.
- The company has been designated by DIPP as government facilitator for IP filings for start-ups under Startups Intellectual Property Protection (SIPP) Scheme.
- Various services being offered to Incubators/Start-ups.

4. Presently the company prepares profit and loss account for its commercial activities as per Schedule III of the Companies Act 2013 and for promotional activities, yearly grants-in-aid from the Government of India relating to revenue and expenditure have been recognised in income and expenditure separately *under the Notes to Accounts* (emphasis supplied by the querist). The unspent balances of grants-in-aid are carried forward to subsequent years under the head ‘Current Liabilities and Provisions’ for adjustment against expenses. Excess of expenditure over the amount of grants received after adjusting income, if any, related thereto, has been carried forward to subsequent years under the head ‘Loans and Advances’ as amount receivable from Government of India. Presently the company also paid tax under the Income tax Act, 1961 and filed the return under section 139 thereof.

¹ Opinion finalised by the Committee on 17.10.2018.

5. The querist has mentioned that section 2(40) of the Companies Act, 2013 states as follows:

“financial statement in relation to a company, includes-

- (i) a balance sheet as at the end of the financial year;
- (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year; ...”

B. Query

6. In view of the facts mentioned above, the querist has sought the opinion of the Expert Advisory Committee that being section 8 company and also doing commercial activities whether the company should prepare income and expenditure account or profit and loss account for both promotional and commercial activities and accordingly, whether grants received for promotional activities from the Government of India are required to be shown in the profit and loss account or income and expenditure account or continue to show separately in the notes to accounts.

C. Points considered by the Committee

7. The Committee notes that the basic issue raised by the querist relates to whether the company is required to prepare income and expenditure account or profit and loss account for both promotional and commercial activities and accordingly, whether grants received for promotional activities from the Government of India are required to be shown in the profit and loss account or income and expenditure account or continue to show separately in the notes to accounts. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, whether the company is acting as a principal or as an agent of the Government while carrying out the promotional activities, accounting for individual grants received by the company etc. Further, the Committee has examined the query only from the accounting perspective and not from legal perspective, such as, interpretation of Income-tax Act, 1961, etc.

8. The Committee notes from the Facts of the Case that the company was earlier a section 25 company under the Companies Act, 1956 and now after enactment of the Companies Act, 2013, it is a company under section 8 thereof which provides as follows:

“8. Formation of companies with charitable objects, etc.— (1) Where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company—

(a) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

(b) intends to apply its profits, if any, or other income in promoting its objects; and

(c) intends to prohibit the payment of any dividend to its members,

the Central Government may, by licence issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this section without the addition to its name of the word “Limited”, or as the case may

be, the words “Private Limited”, and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.

...”

9. The Committee further notes section 2(40) of the Companies Act, 2013 which states as below:

“(40) “financial statement” in relation to a company, includes—

- (i) a balance sheet as at the end of the financial year;
- (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;

...”

From the above, the Committee notes that section 2(40) uses the expression ‘carrying on any activity not for profit’, which has not been specifically defined/explained in the Companies Act. The Committee is of the view that the key principle is whether the company is applying its profits to its ‘not for profit’ objective and does not distribute any dividends to its members. The Committee is further of the view that the expression, ‘carrying on any activity not for profit’ does not mean that company need not earn profits. Even a company carrying on activities not-for-profit may earn profits for its sustenance and carry on commercial activities for its intended objectives. However, the objective of the company to earn profits should not be for distribution among its members. In this regard, the Committee notes clause 113 of the Articles of Association (AoA) of the company (separately provided by the querist for the perusal of the Committee) which states as below:

“113. No dividends in any form or shape shall be paid to members so long as the licence granted by the Government of India under Section 25 of the Act remains in force and is not rescinded or withdrawn.”

From the above, the Committee is of the view that the objective of the company is not to earn profits for distribution among its members. The profits earned, if any, will be used for the furtherance of the objectives of the company.

Accordingly, in the extant case, as the company is applying its profits to its ‘not for profit’ objective and does not distribute any profit by way of dividends to its members, it can be construed as a company carrying on activity not for profit and, therefore, is required to prepare only the income and expenditure account (both for promotional and commercial activities) instead of profit and loss account. Incidentally, the Committee notes that AoA of the company requires preparation of both profit and loss account as well as income and expenditure account. In this context, the Committee wishes to point out that considering the views expressed above, the company should consider modification (if any), required to be made in the AoA in this regard.

10. The Committee also notes that ‘General Instructions for Preparation of Statement of Profit and Loss’ of Schedule III to the Companies Act, 2013 states as below:

“1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of clause (40) of section 2 in like manner as they apply to a statement of profit and loss.”

From the above, the Committee notes that for Schedule III purposes, income and expenditure account shall be prepared in a similar manner as the profit and loss account and the General Instructions for Preparation of Statement of Profit and Loss also apply equally on the preparation of an income and expenditure account.

11. Therefore, the Committee is of the view that the income and expenditure account is required to be prepared in place of profit and loss account, as required under section 2(40) of the Companies Act, 2013, and not as a part of notes to accounts as being done by the company in the extant case.

12. As far as accounting (including disclosures) for the grants received for promotional activities from the Government of India is concerned, the same would depend upon the nature of grant received and the capacity in which the funds are received by the company (viz. as a principal or as an agent) and the same would require separate consideration as per the applicable accounting standards and principles on the basis of specific facts and circumstances and conditions under which such grant/amount has been sanctioned/provided to the company.

D. Opinion

13. On the basis of above, the Committee is of the opinion that the company should prepare income and expenditure account for all its activities (both promotional and commercial activities) instead of profit and loss account, as discussed in paragraphs 9 and 10 above. As far as accounting (including disclosures) for the grants received for promotional activities from the Government of India is concerned, refer paragraph 12 above.
