Accounting Treatment of Expenditure Incurred on Stamp Duty and Registration Fees for Increase in Authorised Capital

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A company was incorporated under the Companies Act, 1956 as a private limited company. The company is registered as a non-banking financial company ('NBFC') (non-deposit accepting) as defined under section 45-1A of the Reserve Bank of India ('RBI') Act, 1934. The company is primarily engaged in the business of lending for purchase of equipments.

2. The details of share capital of the company as at 31st March, 2013 are as follows:
   Authorised share capital (70,00,000 equity shares of ₹10/- each) ₹7,00,00,000
   Issued, subscribed and paid-up capital ₹6,48,00,000
   (64,80,000 equity shares of ₹10/- each)
   The company has not issued shares or other securities at premium and hence, does not have securities premium account.
   The company has received share application money of ₹55,62,55,000. To be able to allot further equity shares, the shareholders of the company, have approved increase in authorised share capital to ₹75,00,00,000/-. The company has incurred an expenditure of ₹47,60,000 (₹34,00,000 towards stamp duty and ₹13,60,000 towards registration fees paid to the Registrar of Companies) for the said increase in authorised share capital.
   Post increase in authorised capital, the Board of Directors of the company has passed a resolution for allotment of 5,56,25,500 equity shares of the company of ₹10/- each at par amounting to ₹55,62,55,000.
3. The issue relates to accounting treatment of the expenditure of ₹47,60,000 incurred by the company for increase in authorised capital.

Relevant legal/accounting requirements

4. The querist has stated that the following technical literature merits consideration to determine the appropriate accounting treatment for stamp duty and registration fee incurred by the company for increase in authorised share capital:

- Section 78 of the Companies Act, 1956 permits the use of securities premium account, inter alia,
  (a) in writing off the preliminary expenses of the company, and
  (b) in writing off the expenses of any issue of shares or debentures of the company.
- As per Accounting Standard (AS) 26, 'Intangible Assets',
  "6.1 An <u>intangible asset</u> is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes."
  "5. Exclusions from the scope of an Accounting Standard may occur if certain activities or transactions are so specialised that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the expenditure on the exploration for, or development and extraction of, oil, gas and mineral deposits in extractive industries and in the case of contracts between insurance enterprises and their policyholders. Therefore, this Standard does not apply to expenditure on such activities. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure (such as start-up costs), in extractive industries or by insurance enterprises. Accounting issues of specialised nature also arise in respect of accounting for discount or premium relating to borrowings and ancillary costs incurred in connection with the arrangement of borrowings, *share issue expenses* and discount allowed on the issue of shares. Accordingly, this Standard does not apply to such items also." (Emphasis supplied by the querist.)
- As per the Guidance Note on Terms Used in Financial Statements:
  "15.08 Share Issue Expenses
  Costs incurred in connection with the issue and allotment of shares. These include legal and professional fees, advertising expenses, printing costs, underwriting commission, brokerage, and also expenses in connection with the issue of prospectus and allotment of shares."

- As per the Guidance Note on Audit of Miscellaneous Expenditure:
  "14. Preliminary expenses are the expenses relating to the formation of an enterprise. For example, in the case of a company, preliminary expenses would normally include the following:
  (a) Legal cost in drafting the memorandum and articles of association.
  (b) Fees for registration of the company.
  (c) Cost of printing of the memorandum and articles of association and statutory books of the company
  (d) Any other expenses incurred to bring into existence the corporate structure of the company."

"Expenses Related to Subscription or Issue of Shares
20. Expenses related to subscription or issue of share include commission or brokerage on underwriting or subscription of shares or debentures, discount allowed on issue of shares or debentures. ..."
"24. Other expenses on issue of shares or debentures, such as fees of the managers to the issue, fees of the registrars to the issue including mailing and handling charges, fees of the advisors to the issue, advertisement expenses, expenses on printing and supply of prospectus and application forms, expenses on printing of share/debenture certificates, etc., should be verified with reference to supporting documents such as invoices, agreements, etc. ..."
(Emphasis supplied by the querist)

- As per paragraph 8.7.4 of the Guidance Note on the Revised Schedule VI to the Companies Act, 1956, dealing with 'Other non-current assets':
  "The Revised Schedule VI does not contain any specific disclosure requirement for the unamortized portion of expense items such as share issue expenses, ancillary borrowing costs and discount or premium relating to borrowings. The Old Schedule VI required these items to be included under the head "Miscellaneous Expenditure".
  As per AS 16 *Borrowing Costs* ancillary borrowing costs and discount or premium relating to borrowings could be amortized over the loan period. Further, share issue expenses, discount on shares, ancillary costs-discount-premium on borrowing, etc., being special nature items are excluded from the scope of AS 26 *Intangible Assets* (Para 5). Keeping this in view, certain companies have taken a view that it is an acceptable practice to amortize these expenses over the period of benefit, i.e., normally 3 to 5 years. The Revised Schedule VI does not deal with any accounting treatment and the same continues to be governed by the respective Accounting Standards/practices. Further, the Revised Schedule VI is clear that additional line items can be added on the face or in the notes. Keeping this in view, entity can disclose the unamortized portion of such expenses as "Unamortized expenses", under the head "other current/non-current assets", depending on whether the amount will be amortized in the next 12 months or thereafter."

- As per an EAC opinion (Volume XI, Query No. 3.1) regarding classification of share issue expenses:
  "3. The Committee is of the view that, in general, all expenses incurred directly in relation to a public issue should be considered as public issue expenses. In other words, public issue expenses are those expenses which would not have been incurred had the public issue not been made, e.g., Registrar's Processing Charges, expenses on printing and distributing of a application forms, prospectus, etc. Further, in the view of the Committee, public issue expenses would be those which are incurred between the decision to make the public issue and completion of all necessary formalities with regard to the issue." (Emphasis supplied by the querist.)

Querist's analysis

5. As per the literature quoted above, it is permissible to amortise share issue expenses over a period of 3 to 5 years. A company has also an option to write off expenses on issue of shares against the securities premium account. However, none of the aforesaid literature makes specific reference to expenditure incurred on increase in authorised share capital and whether such expenditure is a part of share issue expenses. The querist's analysis is as follows:

- One argument is that the increase in authorised capital happens before issuance of shares and should not be regarded as share issue expenses. However, the purpose of increasing authorised share capital of a company is solely to enable the company to issue shares to that extent. There is no other reason why any company would increase its authorised share capital. Thus, the benefit from incurring expenditure on increase in authorised capital arises when the company

issues shares. To properly reflect this cost-benefit relationship, expenditure on increase in authorised share capital should be regarded as part of share issue expenses.

- In the given case, the nexus of increase in authorised capital with issue of shares is even clearer than is the case generally. The test (laid down in the EAC opinion referred to above) for determining whether an expenditure is a part of share issue expenses is whether it would have been avoided if the share issue had not been made. This test is satisfied in the present case:
    - Further equity shares could not have been allotted without increasing the authorised share capital as the company's issued capital was nearly equal to its authorised share capital.
    - Share application money was received first and the increase in authorised share capital was effected later.
    - The expenditure was incurred after the company had firmed up its decision to issue shares.

Thus, it is clear that the company would not have incurred this expenditure had the share issue not been made.

6. On the basis of the above analysis, the querist believes that the expenditure incurred by the company for increase in authorised share capital should be treated as part of share issue expenses.

- If expenditure on increase in authorised capital is treated as part of share issue expenses, it would be a logical corollary that pending issue of shares, the same should be regarded as an asset. What are the future economic benefits from this asset - can capacity to issue shares be regarded as a future economic benefit?
- If shares are issued only for a part of the increase in authorised capital, should a proportionate part of the relevant expenditure for such increase be carried as an asset? The current accounting practice does not seem to support an affirmative answer to the above.

B. Query

7. On the basis of the above, opinion of the Expect Advisory Committee is sought by the querist on whether the company can treat the whole of the expenditure incurred on increase in authorised capital as 'share issue expenses'.

C. Points considered by the Committee

8. The Committee notes from the Facts of the Case that the company has received share application money in excess of the authorised share capital and subsequently increased its authorised share capital and made allotment of shares. The Committee notes that the query raised is in relation to expenses (stamp duty and registration fee) incurred for increase in authorised share capital of the company. Accordingly, the Committee has examined only that issue and has not examined any other issue arising from the Facts of the Case, such as, accounting for expenses incurred on allotment and other share issue expenses, etc. Further, the opinion of the Committee expressed, hereinafter, is only from accounting point of view and not from legal viewpoint.
9. The Committee notes that the querist has argued that the expenses incurred on increase in authorised share capital can be considered as share issue expenses as in the extant case, the shares against the excess share application money received can be issued only after increasing the authorised share capital. Accordingly, the Committee has first analysed whether these expenses can be termed as 'share issue expenses'. In this respect, the Committee notes paragraph 5 of Accounting Standard (AS) 26, 'Intangible Assets', notified under the Companies (Accounting Standards) Rules, 2006 (as reproduced in paragraph 4 above), which states that this Standard does not apply to accounting for share issue expenses. The term 'share issue expenses', however, has not been defined in AS 26. The Committee further notes that the term has been defined in the Guidance Note on Terms Used in Financial Statements which provides as under:

   "Costs incurred in connection with the issue and allotment of shares. These include legal and professional fees, advertising expenses, printing costs, underwriting commission, brokerage, and also expenses in connection with the issue of prospectus and allotment of shares."

   From the above, the Committee notes that share issue expenses are costs incurred *in connection with the issue and allotment of shares.*
10. The Committee also notes that the querist has cited the view expressed by the Committee in one of its opinion (refer paragraph 4 above), wherein the Committee had expressed the view that public issue expenses are those expenses which would not have been incurred had the public issue not been made, e.g., Registrar's processing charges, expenses on printing and distributing of application forms, prospectus,

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Chairman
Committee for Members in Industry
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Mobile: 09821345687

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Committee for Members in Industry
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)

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etc. Further, the Committee had expressed the view that, public issue expenses would be those which are incurred between the decision to make the public issue and completion of all necessary formalities with regard to the issue. The Committee wishes to point out that in the cited query, the issue of enhancing the authorised capital was not raised. The Committee is of the view that increase in authorised share capital is an independent process which does not necessarily lead to issue of shares. The need to increase the authorised capital and to incur expenses for increasing the same would not have arisen had the additional allotment of shares was within the limits of existing authorised capital. Accordingly, the Committee is of the view that the expenses incurred on increase in authorised share capital are distinct and separate from the expenses incurred on share issue. Additionally, the Committee is of the view that accounting depends on the nature of expense and the fact that the share application money was received before increase in authorised share capital will not change the nature of expense. Further, increase in authorised share capital does not represent issue of additional share capital and only sets a limit for the paid up capital of a company at any given point of time. Accordingly, the Committee is of the view that the expenses incurred on increasing the authorised share capital cannot be termed as 'share issue expenses'.

11. As regards the issue relating to accounting for the expenses incurred on increase in authorised capital, the Committee notes the following paragraphs of AS 26:

    "6.2 An asset is a resource:
    (a) controlled by an enterprise as a result of past events; and
    (b) from which future economic benefits are expected to flow to the enterprise."

    "56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. …"

    From the above paragraph of AS 26, the Committee notes that if an expenditure does not result into acquisition of an asset, it should be recognised as an expense as and when incurred. The Committee also notes that the amount spent towards increase in authorised share capital does not give rise to any *resource controlled* by the enterprise. In fact, such expenses are only permitting the company to enhance the limit for the paid-up capital of the company which does not ensure any flow of funds to the company. Accordingly, it does not meet the definition of an asset, as reproduced above. Thus, the amount aggregating to ₹47,60,000 incurred towards stamp duty and fees paid to the Registrar of Companies should be recognised as expense in the statement of profit and loss as per the requirements of paragraph 56 of AS 26.

D.Opinion

12. On the basis of the above, the Committee is of the opinion that the expenditure incurred by the company towards increase in authorised share capital (stamp duty and registration fee paid to the Registrar of Companies) cannot be considered as share issue expenses and should be treated as expense and charged off in the statement of profit and loss, as discussed in paragraphs 10 and 11 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on January 22-23, 2014. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty two volumes. A CD of Compendium of Opinions containing thirty two volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in.