

Accounting treatment of Duty Credit Entitlement under the Target Plus Scheme

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

A. Facts of the Case

1. The querist has stated that the Ministry of Commerce and Industry introduced the Target Plus Scheme (TPS) as part of its foreign trade policy 2004-09. The objective of the scheme is to accelerate growth in exports by rewarding Star Export Houses. All high performing Star Export Houses are entitled to a duty credit based on incremental exports substantially higher than the general annual export target fixed. The TPS credit can be subsequently utilised towards payment of customs duty on specified imports under this scheme.
2. The querist has mentioned certain important features of the scheme, which are as follows:
 - (i) All Star Export Houses, which have achieved a minimum export turnover in free foreign exchange of Rs. 10 crore in the previous licensing year, are *eligible* for consideration under the Target Plus Scheme. (Emphasis supplied by the querist.)
 - (ii) An exporter is *eligible* to claim duty credit as a specific percentage of the incremental growth in FOB value of the export in the current licensing year over the previous licensing year, as follows (emphasis supplied by the querist):
 - (iii) A company has to apply for TPS credit on post-export basis on realisation of export proceeds. The TPS credit *can* be subsequently utilised towards payment of customs duty on import of specified inputs and capital goods for either own use or use by supporting manufacturer. (Emphasis supplied by the querist.)
 - (iv) There are some *restrictions* for the utilisation of TPS credit, which are as follows:
 - (a) the duty credit certificate cannot be sold or transferred to a third party; and
 - (b) the duty credit certificate is valid for a period of 24 months from the date of issue.
3. The querist has stated that a company is in the business of manufacturing colour televisions for sale in the domestic and export market, with the turnover of Rs. 1,145 million for the year ended 31st March, 2005. The shares of the company are listed on the Bombay Stock Exchange and the National Stock Exchange. According to the querist, the company was eligible under the scheme for duty credit against exports made in the financial year 2004-05 as it had achieved a minimum export turnover of Rs. 100 million in the previous year, i.e.,

% Incremental growth	Duty credit entitlement as a % of incremental growth
20% & above but less than 25%	5%
25% & above but less than 100%	10%
100% & above	15% (maximum upto 100% growth)

2003-04 and had been awarded a status of 'Star Export House'. The company applied under the scheme to the Director General Foreign Trade (DGFT) on 9th September, 2005. Since the company had achieved a 114% increase in exports for the year 2004-2005 over 2003-2004, the company was given a duty credit entitlement @ 15% and was granted 12 duty credit entitlements worth Rs. 36 million of which Rs. 3 million has been utilised by the company till 31st March, 2006.

4. The company has achieved incremental growth of 26% of exports in the year 2005-2006 as compared to the year 2004-2005 and would be applying for the duty credit on realisation of the foreign exchange from export sales and after completion of the statutory audit for the year ended 31st March, 2006. The duty credit accruing to the company is estimated at Rs. 13 million. As per the querist, as regards recognition of TPS credit, following are the two possible views:

- A. Credit should be recognised on utilisation basis, i.e., in the period when the TPS credit is used to pay duty on imports.
- B. TPS credit should be recognised in the period when relevant exports are made provided recovery is reasonably certain.

5. The querist has advanced the following arguments in favour of the first view, viz., credit should be recognised on utilisation basis, i.e., in the period when the TPS credit is used to pay duty on imports:

- (i) Accounting Standard (AS) 9, 'Revenue Recognition', issued by the Institute of Chartered Accountants of India, lays down the principle that revenue should not be recognised until its realisation is reasonably certain. Even though TPS credit may not strictly fall within the definition of 'revenue', the querist be-

lieves that the above principle would still be applicable. The basic argument for recognising TPS credit only at the time of utilisation is that until its actual utilisation, there may not be a reasonable certainty as to whether or not the company would be able to utilise the aforesaid credit. This is on account of the following factors:

- (a) The Target Plus Scheme does not allow the sale/transfer of the duty credit entitlement.
- (b) TPS credit certificate is valid for a period of 24 months from the date of issue. The certificates remaining unutilised at the end of the 24 month period would lapse.
- (c) The Government reserves the right in public interest, to specify from time to time, the category of exports and export products which shall not be eligible for calculation of incremental growth/entitlement. Similarly, the Government may from time to time also notify the list of goods, which shall not be allowed for import under the duty credit entitlement certificate issued under the scheme. In this regard, the querist has drawn attention of the Committee to the following two recent notifications:

- Notification No. 57 (RE-2005)/2004-2009 dated 31st March, 2006 abolished the Target Plus Scheme for exports from 1st April, 2006 onwards.
- Vide Notification No. 48 (RE-2005)/2004-2009 dated 20.02.2006, the Government has withdrawn the benefit of Target Plus scheme in respect of certain items, like ores and concentrates, sugar, cereals and crude/petroleum products

with retrospective effect from 1st April, 2005.

It may be noted that the above mentioned notification does not have any direct impact on the target plus incentive to be received by the company since the company does not fall in the above mentioned categories of exporters. However, it serves to highlight the uncertainty attached to TPS credit.

- (ii) There is already a view taken by the Expert Advisory Committee on the accounting treatment of advance licenses wherein the Committee has stated as follows (Vol. XVI of Compendium of Opinions, p. 53):

“4. With regard to entitlements of advance licenses, the Committee is of the view that the cost of such entitlements is not reliably ascertainable, and their net realisable values may fluctuate considerably since they would also depend on many uncertain factors such as demand for imported goods, change in prices of domestic goods, rate of custom duty prevailing at the relevant point of time etc.”

- (iii) According to Accounting Standard (AS) 1, ‘Disclosure of Accounting Policies’, issued by the Institute of Chartered Accountants of India, ‘prudence’ is one of the major considerations in selection of accounting policies. The Standard explains ‘prudence’ as follows:

“In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.”

In its opinion on treatment of advance licenses referred to above, the Expert

Advisory Committee has explicitly recognised the role of prudence in determining the appropriate accounting treatment of advance licenses.

- (iv) There is a specific provision in the scheme as per which the Government has the power to withdraw the category of export and also the list of goods, which shall not be allowed for import at any point of time. The same is reproduced below:

“3.7.8

Government reserves the right in public interest, to specify from time to time the category of exports and export products, which shall not be eligible for calculation of incremental growth/entitlement.

Similarly, Government may from time to time also notify the list of goods, which shall not be allowed for import under the duty credit entitlement certificate issued under the scheme.”

- (v) There is a difference between Duty Entitlement Pass Book (DEPB) Scheme and the TPS in the sense that whereas the credit under DEPB Scheme can be sold / transferred to a third party, the duty credit under TPS scheme can only be utilised for settling import for own use or for the use of supporting manufacturers which affect the realisability of the entitlement especially in view of the fact that the Government has withdrawn the TPS vide notification No. 48(RE 2005)/2004-2009 dated 20.02.2006 in respect of certain items retrospectively from 1st April, 2005, as mentioned above. The entitlement of DEPB is on shipping bill basis whereas TPS eligibility is decided on annual basis based on the incremental growth in exports. Therefore, both the schemes are entirely different from each other.

Based on the above, it may be ascer-

tained that the TPS and DEPB schemes are designed with different perspectives by the Ministry of Commerce. DEPB is to compensate the tax, infrastructure and other constraints to exporter on regular basis. Whereas TPS is to boost future growth of exports to enable the exporters to survive in global competition.

(vi) Moreover, if the example of a company is taken, which is making local procurement and getting the target plus incentive, since the license is not transferable, the utilisation is impossible for such a company. Therefore, the accounting treatment of Target Plus incentive cannot be the same as that for the DEPB.

6. In addition to the above, the querist has also mentioned the following points for the consideration of the Committee:

(a) Apart from the above mentioned restrictions for the utilisation of TPS, the market is very sensitive in terms of price war, which may force the company to switchover from import component to domestic component. In such cases, the certainty of utilisation of TPS is doubtful as the period during which it can be utilised is 24 months from the date of issue. Further, if there is any change in TPS scheme, the company may opt for 'Advance License', and in that case, TPS cannot be used.

(b) As per the generally accepted accounting principles (GAAP), accounting or recording of transactions is not appropriate on signing a contract or agreement. Since TPS is like a contract under which duty credit is awarded on post-export basis, but the actual realisation is made later, i.e., as and when the entity utilises this benefit, TPS accounting, in the view of the querist, should be on utilisation basis as per the GAAP.

7. The querist has also submitted the

arguments for the other alternative, viz., TPS credit should be recognised in the period when relevant exports are made provided recovery is reasonably certain, which are as follows:

(i) The basic argument in support of recognition of TPS credit in the year in which the exports giving rise to the credit take place is that this treatment results in a proper matching of efforts and accomplishments.

(ii) It is the activity of export which results into entitlement of duty credit and accordingly, this credit can not be related to duty payable at the time of subsequent imports. At the time of subsequent imports, the full duty payable on such imports should form part of the cost which is met partly or fully by way of adjustment of TPS credit depending on the policy of the Government of India at that time.

(iii) The utilisation of duty credit is a mode of payment of duty. In other words, it is not an exemption from duty in the year of import but is a benefit/right arising out of the earlier export performance. Thus, the duty earned represents an asset in the nature of advance payment of duty to be utilised towards subsequent payment of customs duty on specified imports.

(iv) The decision as to when the credit under the TPS should be recognised as income should broadly be based on the principles similar to those applicable to recognition of revenue. Performance related to TPS credit should be considered to be complete when the exports which give rise to the credit have been made, provided the other criteria for recognition of revenue are fulfilled, viz., those laid down in AS 9. However, according to the querist, AS 9 provides that revenue should be recognised

only when there is no significant uncertainty regarding the amount of the consideration that will be derived and when there is no significant uncertainty as to its ultimate collection. Where such uncertainties exist, the recognition of revenue should be postponed.

- (v) There is also an opinion of the Expert Advisory Committee on the accounting treatment of DEPB benefit, wherein it has been opined that the credit under DEPB Scheme should be recognised as income when the exports (against which the credit has been granted) are made provided the criteria for recognition of revenue under AS 9 have been fulfilled (query No. 28 of Vol. XX of Compendium of Opinions, page 96). In the said opinion, the Committee has stated, inter alia, the following:

“Under the facts and circumstances of the query, the DEPB credit should be recognised in the books of account when no significant uncertainties as to the amount of consideration that would be derived and as to its ultimate collection exist. In the case of DEPB credit on post-export basis when the company applies for the credit on realisation of export proceeds and the credit is to be utilised for imports by the company, there seems to be no such significant uncertainty and, therefore, the DEPB credit should be recognised in the year in which the export was made in accordance with paragraph 6 above.”

According to the querist, the incentive under TPS is similar to that under the Duty Entitlement Pass Book (DEPB) Scheme except that the credit under DEPB can be sold/transferred to a third party. This difference only affects the assessment as to the realisation of the entitlement. Due to transferability, there may be greater assurance of realisation of DEPB credit than that of

TPS credit. Thus, if there is a reasonable assurance of utilisation of TPS credit, it should be treated at par with DEPB credit and, accordingly, recognised in the year in which the exports giving rise to the credit take place.

- (vi) The opinion of the Committee on treatment of DEPB credit is later in time than its opinion on treatment of advance license. Accordingly, it is only logical to conclude that in formulating its opinion on treatment of DEPB credit, the Committee would have considered non-recognition of credit on account of advance licenses, viz., cost of the entitlement being not reliably ascertainable and uncertainty as to realisation and realisable value of the entitlement, etc.
- (vii) It is also noteworthy that as per the Update on Compendium of Opinions Volumes I – XX, the Committee’s opinion on advance license needs to be viewed in the light of subsequent issuance of AS 26. However, there is no such mention in respect of the opinion on DEPB credit.
8. Based on the above, the querist has argued that if there is reasonable certainty that the company has satisfied all the stipulated conditions and it will be entitled to credit of duty if it imports raw material, spares or capital goods as per the scheme, duty credit under the TPS should be accounted for in the year of relevant exports to the extent there is reasonable certainty that the company would be able to utilise it in accordance with the terms of the scheme. In assessing whether there exists a reasonable certainty of utilisation of the duty credit, all relevant factors should be taken into consideration including the documented plans of the company showing the likely imports of the relevant items. In case of capital goods, the detailed plans of the company should be considered.

9. The querist has further provided the following facts:

- (i) The amount of incentive for the financial year 2004-2005 of Rs. 36 million has already been received in the form of duty credit entitlement in the month of January 2006, out of which Rs. 3 million has been utilised. Thus, there is no uncertainty to the extent of only Rs. 3 million.
- (ii) The incentive for the financial year 2005-2006 can be derived based on the incremental exports made during the year 2005-2006, which is Rs. 13 million.
- (iii) As mentioned earlier, the company is yet to make application to DGFT for grant of TPS credit for the financial year 2005-06. The application will be made after the statutory audit for the year is over and the export proceeds have been realised.
- (iv) The company imported major raw material items for the production of colour TV in the year 2005-2006. The import duty expense of the company is approximately Rs. 10-15 million per month.
- (v) It may also be mentioned that the company has been receiving DEPB benefit and recognising it as income when the exports (against which the credit has been granted) are made.

10. The querist has stated that the Bank Realisation Certificate not having been obtained by 31st March, 2006 and the application not being made to DGFT by that date are not significant enough to conclude that inflow of TPS benefit is not probable. Due to the time factor, the aforesaid certificate cannot be obtained, and application to DGFT cannot be made, before the close of financial year. The issuance of these licenses depends on the policy of the Government of India at the time when these are actually issued, which is uncertain

based on the above facts. The querist has also mentioned that the Government notification regarding withdrawal of the scheme is effective prospectively from 1st April, 2006 but the Government has the power to withdraw the scheme as mentioned above retrospectively.

11. The querist has also brought to the notice of the Committee that vide DGFT notification No. 8(RE2006)/2004-2009 dated 12.06.2006, the Central Government has recently made an amendment to the Target Plus Scheme for the period April 1, 2005 to March 31, 2006 which states as follows:

“The entitlement under this scheme would be contingent on the minimum percentage incremental growth of 20% in the FOB value of exports in the current licensing year over the previous licensing year, and the rate of entitlement shall be 5% of the incremental growth”.

“This will take effect from 01.04.2005”.

With this notification (a copy of which has been separately provided by the querist for the perusal of the Committee), the Central Government has restricted the benefit of Target Plus Scheme to a maximum of 5% of incremental growth which was earlier at 15% of the incremental growth and this has been effected retrospectively from April 1, 2005. This has resulted in the loss of revenue in the case of the companies which had recognised revenue at 15% earlier. These companies would now have to adjust their accounts for entitlement of 5% and this will affect the revenues of the current year or they will have to reopen the accounts for the earlier years to provide for this situation.

B. Query

12. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether TPS credit should be recog-

nised in the period when the exports which give rise to the credit have been made or whether it should be recognised on utilisation, i.e., in the period when the TPS credit is used to pay duty on imports.

- (ii) In case credit is required to be recognised in the period of exports, whether it would make any difference, if the target has been achieved but the application is still to be filed with the DGFT.

C. Points considered by the Committee

13. The Committee, while giving its opinion, has answered only the issues raised in paragraph 12 above, and has not touched upon any other issue arising from the Facts of the Case, such as, accounting treatment of DEPB credit being availed by the company, valuation of subsequent imports, etc.
14. The Committee notes that the basic issue raised in the query relates to recognition of the benefit of duty credit under Target Plus Scheme, i.e., when should this benefit be recognised in books of account – whether at the time when relevant exports are made or at the time TPS credit is utilised to pay duty on subsequent imports.
15. Keeping in view the recognition principles laid down in AS 9, the Committee is of the view that the TPS credit should be recognised at the time when and to the extent there is no significant uncertainty as to its measurability and ultimate realisation, i.e., utilisation of the TPS credit. The assessment of the level of uncertainty is a matter of judgement based on the facts and circumstances of each case on considering

factors, such as, utilisation of duty credit within the specified period as evidenced by the existence of a binding contract for purchase of inputs within the specified period against which the duty credit can be utilised, the expected cost of purchase of the imported inputs vis-à-vis the cost of the inputs available within the domestic market, expectation of future amendments in the scheme, realisability of export proceeds in convertible foreign exchange, etc. Events occurring after the balance sheet date may remove the uncertainty about the utilisation of the duty credit. For example, imports are made after the balance sheet date but before the approval of accounts by the governing authority, against which the duty credit has been utilised. The Committee is, therefore, of the view that it is not necessary that uncertainty regarding measurement and utilisation of duty credit is removed only on actual utilisation of the credit, i.e., at the time when the import of specified goods is made.

D. Opinion

16. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 12 above:
- (i) TPS credit should be recognised in the period when there is no significant uncertainty about the measurability and ultimate realisation of TPS credit, i.e., utilisation of the duty credit, after considering the factors, such as those indicated in paragraph 15 above.
- (ii) The basis for recognition of TPS credit is indicated at (i) above.

Notes:

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 Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 24 volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.