INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

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EVOLUTION OF ICDS

- 25-1-1996 – CBDT had notified 2 Tax Accounting Standards.
- 2010 - CBDT constituted an Accounting Standard Committee.
- Aug 2012 - Committee submitted its Final Report.
- FA 2014 amended Sec 145(2) and 145(3)
- 31st March, 2015 – First version of ICDS notified (w.e.f. FY 15-16)
- 6-7-2016 – Press Release deferring ICDS
- 29-9-2016 – Earlier version of ICDS rescinded (Notification No. 86/2016)
- 29-9-2016 – Second Version of ICDS notified – Notification No. 87/2016 (w.e.f. FY 16-17)
- 29-9-2016 – Clause 13 of Form 3CD modified
- 23-3-2017 – FAQs issued by CBDT
- 08-11-2017 – Delhi HC judgement [400 ITR 178] striking down ICDS
- FA 2018 – Retrospective amendments to tide over Delhi HC

List of 10 ICDS

ICDS I	Accounting Policies
ICDS II	Inventories
ICDS III	Construction Contracts
ICDS IV	Revenue Recognition
ICDS V	Tangible Fixed Assets
ICDS VI	Effects of Changes in Foreign Exchange Rates
ICDS VII	Government Grants
ICDS VIII	Securities
ICDS IX	Borrowing Costs
ICDS X	Provisions, Contingent Liabilities and Contingent Assets

ICDS applicable to:

- Assesses following mercantile system of accounting (other than Individual and HUF not required to get books of accounts audited u/s 44AB)
- For income computation, not for maintenance of books of account.
- For computation of income chargeable under the head “Profits and gains of business or profession” or “Income from other sources” and not for other heads of incomes

ICDS is not applicable for:

- Computation of MAT u/s 115JB
- Computation of Income where no Books have been maintained

Note: In case of a partnership firm where income is offered to tax under presumptive schemes provisions of ICDS would be applicable

ICDS vs other components of I.T. Law

- **ICDS vs ACT:** The Preamble to every ICDS provides that in the case of conflict between the provisions Act and ICDS the provisions of the Act shall prevail to that extent.
- **ICDS vs Rules:** FAQ by CBDT – specific rules to prevail over general provisions of ICDS. (Eg: Rule 9A)
- **ICDS vs AS (ICAI):** On matters where ICDS is silent, AS would still have a role in income computation Eg: ESOP
- **ICDS vs Judicial precedents** **-**contd…

ICDS vs Judicial Pronouncements

- CBDT:
  - Judicial pronouncements were made in absence of **authoritative guidance on certain issues.** ICDS now provides **certainty on those matters** and therefore override those judicial pronouncements.
- Delhi HC:
  - ICDS **can not override binding judicial precedents**.
  - Section 145 (2), as amended, has to be read down to restrict power of the Central Gov. to notify ICDS that do not seek to override binding judicial precedents or provisions of the Act. The power to enact a **validation law** is an essential legislative power that can be exercised, in the context of the Act, only by the Parliament and not by the executive. If section 145 (2) of the Act as amended is not so read down it would be **ultra vires the Act and article 141 read with articles 144 and 265** of the Constitution.

ACCRUAL BASIS - COMPULSORY FOR COMPANIES?

- In terms of section 128 of the Companies Act, 2013, it is obligatory for companies to follow the accrual system of accounting.
- Sec 145 – Income shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.
- Will provisions of Companies Act override Sec 145 of Income Tax Act?
- No. As held in:
  – Pradip Commercial (P) Ltd Vs CIT (Cal HC)
  – Stup Consultants P. Ltd, Mumbai Vs DIT (Mum)
  – Chennai Finance Co. Ltd. 81 ITD 7 (Hyd.)

Can different methods of accounting be followed for different sources of Income ?

- **Different methods can be adopted for different sources** - - *J.K. Bankers* v. *CIT* [1974] 94 ITR 107 (All.).

- **Different methods can be adopted for different parts of business** - *CIT* v. *E.A.E.T. Sundararaj* [1975] 99 ITR 226 (Mad.).

Income Computation and Disclosure Standard I
Accounting policies

PRUDENCE:

ICDS:

Marked to market loss or **an expected loss shall not be recognised** unless the recognition of such loss is in accordance with the provisions of any other Income Computation and Disclosure Standard.

CBDT:

As per FAQs: M2M Gain will also not be recognized unless in accordance with any provision of any other ICDS

Anticipated losses: Position prior to ICDS

Cases in favour of assessee:

- Mazagon Dock Ltd. v. Jt. CIT [2009] 29 SOT 356 ITAT Mumbai
- Jacobs Engineering India (P.) Ltd. v. Asstt. CIT [2011] 14 taxmann.com 186
- CIT v. Woodward Governor India (P.) Ltd. [2009] 179 TAXMAN 326 (SC)
- CIT v. Indian Overseas Bank [1984] 19 Taxman 542 (Mad.)
- Dy. CIT (International Taxation v. Bank of Bahrain & Kuwait [2010] 41 SOT 290 (Mum.)(SB)

PRUDENCE contd..

DELHI HC [400 ITR 178] :

- ICDS I which does away with concept of 'prudence' is contrary to Act and binding judicial precedents, and, is therefore unsustainable in law

FINANCE ACT 2018: Validating provisions inserted:

- New clause (xviii) inserted in section 36(1) of the Act to provide that marked to market loss or other expected loss as computed in the manner provided in ICDSs shall be allowed deduction.
- New clause (13) inserted in section 40A of the Act to provide that no deduction or allowance in respect of marked to market loss or other expected loss shall be allowed except as allowable under newly inserted clause (xviii) of sub-section(1) of section 36.

List of ICDS where recognition of anticipated losses are permitted.

- **ICDS 2 :** Closing inventory is to be valued at cost or NRV whichever is lower
- **ICDS 6:** Exchange differences arising out of forward exchange contract held for hedging (other than hedging of firm commitment or a highly probable forecast transaction) to be recognised in the year in which exchange rates change
- **ICDS 8 :** Closing inventory of listed securities is to be valued at cost or NRV whichever is lower

Cases where anticipated loss is not permitted / concept of prudence is violated

- **ICDS 3 :** As per Para 35 of AS 7 "When it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately." Similar enabling provision is absent in ICDS 3 and therefore by implication anticipated losses in construction contract should not be recognised and only loss to the extent incurred should be considered
- **ICDS 3:** As per AS 7 When the outcome of a construction contract **cannot** be **estimated reliably**, no revenue to be recognised. However ICDS 3 does not recognize that the possibility that outcome of a construction contract cannot estimated reliably except during early stages of contract
- **ICDS 4:** Interest income should be accounted on time basis. Paragraph pertaining to reasonable certainty of ultimate collection conspicuously absent.
- **ICDS 6:** Premium and exchange difference in relation to foreign exchange contracts which are held for trading / speculation / Hedging of firm commitment or a highly probable forecast transaction to be recognised at the time of settlement only.
- **ICDS 7:** Recognition of Government grant shall not be postponed beyond the date of actual receipt
- **ICDS 8 :** In respect of unlisted securities and securities listed but not regularly traded ICDS 8 mandates closing inventory to be valued at cost ignoring market value
- **ICDS 10:** Contingent assets are assessed continually and when it becomes **reasonably certain (**as against virtual certainty prescribed by AS 29) that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs.

Change in accounting policy

- Para 5 of ICDS 1:

  An accounting policy shall not be changed without **reasonable cause**.

- As to what is "reasonable cause" is not defined.
- CBDT FAQs: - Concept of reasonable clause has evolved well over a period of time conferring desired flexibility to the tax-payer in deserving cases.

Disclosure of change in accounting policy

Any change in an accounting policy is required to be disclosed as under:

- Any change in an accounting policy which has a material effect shall be disclosed.
- The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable.
- Where such amount is not ascertainable, wholly or in part, the fact shall be indicated.
- If a change is made in the accounting policies which has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted and also in the previous year in which such change has material effect for the first time.

Sample disclosures

1. Basis for preparation of financial statements

a) The financial statements are prepared under the historical cost convention, in accordance with the Generally Accepted Accounting Principles (GAAP) as adopted consistently.

b) Expenses and incomes are accounted on accrual basis.

2. Disclosure pertaining to change in accounting policy

a) The entity has switched the method of valuation of inventory from FIFO method to Weighted Average Method

b) The change in such accounting policy was on account of ….(some reasonable cause)

c) Had the entity continued with its earlier method of valuation the closing inventory and profits for the year would have been lower by ……Rs.

3. Specific Disclosure of fundamental accounting policy is not followed:

The assessee has incurred huge losses and the net of the assessee has been completely eroded. The going concern presumption in the case of the assessee does not hold good any longer. The accounts are therefore prepared on liquidation basis.

Income Computation and Disclosure Standard II
Valuation of Inventories

Inclusive Vs Exclusive System of accounting

ICDS:

- The costs of purchase shall consist of purchase price *including duties and taxes*, freight inwards and other expenditure directly attributable to the acquisition i.e. inclusive system of accounting to be followed

Exclusive method of stock valuation is revenue neutral:

- Berger Paints India Ltd Vs. CIT 187 CTR 193 (SC)
- Lakhanpal National Ltd Vs CIT 162 ITR 240 (Guj)
- CIT vs Indo Nippon Chemicals Ltd. 261 ITR 275 (SC)

Inclusive Vs Exclusive System

Eg:

- Purchased five units of product at a price of 100/- each plus GST @ 10%
- Sold four unit at a price of 150/- plus GST
- Paid GST to Govt Rs. 10/- [60-50]

Inclusive System			
To Purchases (100*5 + 10*5)	550	By Sales (150*4 + 15*4)	660
Less: GST Credit avalied on cost of goods sold	(50)	By Closing Stock (100 + 10)	110
To GST paid on sales	10		
To Gross Profit	200		
	710		**770**

Exclusive System			
To Purchases (100*5)	500	By Sales (150*4)	600
To Gross Profit	200	By Closing Stock (100)	100
	700		**700**

Treatment of Machinery Spares

- **ICDS :** Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets.
- **Revised AS 2**: Inventories do not include spare parts, servicing equipment and Standby equipment which meet the definition of property, plant and equipment as per AS 10, *Property, Plant and Equipment.*
- **AS 10:** Spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory. [para 8]
- **AS 10:** Property, plant and equipment are tangible items that:

  (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

  (b) are expected to be used during more than a period of twelve months.

Inventory valuation upon dissolution of firm / AOP / BOI

- ***Sakthi Trading Co. v. CIT* [2001] 118 Taxman 301 (SC):**

Where firm got dissolved due to death of a partner and business was reconstituted with the remaining partners, and **business continued without any interruption**, **the closing stock was to be valued at the cost or market price, whichever was lower**, and not at market value

- ***A.L.A. Firm* [1989] 189 ITR 285 (SC):**

In the case of dissolution of a partnership firm, if the **business is discontinued** then stock-in-trade has to be valued at market price only

Contd..

Inventory valuation upon dissolution of firm / AOP / BOI contd..

ICDS*:*

- In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value. [Para 24 of ICDS-II]

Delhi HC 400 ITR 178:

- ICDS II pertaining to valuation of inventories which eliminates distinction between a continuing partnership business after dissolution from one which is discontinued upon dissolution, is contrary to decision of Supreme Court in Shakti Trading Co. v. CIT [2001] 250 ITR 871/118 Taxman 301 and, thus, being ultra vires Act, has to be struck down as such

Contd..

Inventory valuation upon dissolution of firm / AOP / BOI contd..

FA 2018*:*

- Section 145A has been substituted with effect from AY 2017-18. In terms of new Section 145A, the valuation of inventory shall be made at lower of actual cost or net realisable value computed in accordance with the ICDSs;

Impact of amendment:

- In view of section 145A(*i*), para 24 of ICDS will no longer apply. On dissolution of partnership firm or AOP, whether business is discontinued or not, the inventory will have be valued at lower of actual cost and NRV.

Value of opening inventory

- The value of the inventory as on the beginning of the previous year shall be :
  - ✓ the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and
  - ✓ the value of the inventory as on the close of the immediately preceding previous year, in any other case. [Para 22 of ICDS-II]

Sample Disclosure

a) Inventories are valued at the lower of the cost or the market value.

b) Cost of inventories is ascertained on the 'weighted average' basis.

c) Exclusive method of stock valuation is followed. It has been held in following cases that the exclusive method of stock valuation is revenue neutral

- Berger Paints India Ltd Vs. CIT 187 CTR 193 (SC)
- Lakhanpal National Ltd Vs CIT 162 ITR 240 (Guj)
- CIT vs Indo Nippon Chemicals Ltd. 261 ITR 275 (SC)

d) Total carrying amount of inventories:

– held for sale in the ordinary course of business

– in the process of production for such sale;

– in the form of materials or supplies to be consumed in the production

Possible Income adjustments under ICDS II

Particulars	Addition	Deduction
Adjustments in respect of Machinery spares	XXXX	XXXX
Adjustments under inclusive system of accounting	XXXX	XXXX
Valuation adjustments in case of dissolution of firms	XXXX	
Transitional adjustments (only in I Year)	XXXX	XXXX

CONSTRUCTION CONTRACTS ICDS III

ISSUE: RETENTION MONEY

ICDS:

- Contract Revenue shall comprise of retention money [Para 10]

FAQ No. 11 of CBDT's Circular No. 10/2017:

- Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition contained in para 9 of ICDS-III on Construction contracts.

Delhi HC:

- Contd…

ISSUE: RETENTION MONEY contd…

Delhi HC:

- The treatment to retention money under Paragraph 10(a) in ICDS-III will have to be **determined on a case to case basis** by applying settled principles of accrual of income. By deploying ICDS-III in a manner that seeks to bring to tax the retention money, the receipt of which is uncertain/conditional, at the earliest possible stage, irrespective of the facts, the Respondents would be acting contrary to the settled position in law as explained in the decisions CIT v. Simplex Concrete Piles India (P.) Ltd. (1988) 179 ITR 8 (ii) CIT v. P & C Constructions (P.) Ltd. (2009) 318 ITR 113 (iii) Amarshiv Construction (P.) Ltd. v. DCIT (2014) 367 ITR 659 and (iv) DIT v. Ballast Nedam International (2013) 355 ITR 300 which followed the decision in Anup Engineering Limited v. CIT (2000) 247 ITR 114 and to that extent para **10(a) of ICDS III would be rendered ultra vires**.

ISSUE: RETENTION MONEY contd…

FA 2018:

- New section 43CB inserted in the Act to provide that the contract revenue **shall include** retention money.

ISSUE: Anticipated losses

ICDS:

- ICDS 1 provides that anticipated losses shall not be claimed unless permitted by any other ICDS
- ICDS 3 does not provide for claiming of anticipated losses of construction contracts

FA 2018:

- New clause (13) inserted in section 40A of the Act to provide that no deduction or allowance in respect of marked to market loss or other expected loss shall be allowed except as allowable under newly inserted clause (xviii) of sub-section(1) of section 36.

ISSUE: Netting of costs by incidental income

ICDS:

- These costs shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in contract revenue. [Para12]

Delhi HC:

- Para 12 of ICDS III read with para 5 of ICDS IX, dealing with borrowing costs, makes it clear that no incidental income can be reduced from borrowing cost. This is contrary to the decision of the Supreme Court in CIT v. Bokaro Steel Limited [1999] 236 ITR 315 and is therefore struck down.

FA 2018:

- New section 43CB inserted in the Act to provide that contract cost shall not be reduced by incidental interest, dividend and capital gains.

ISSUE: Recognition of contract revenue and expenses

Accounting standards:

- When the outcome of a construction contract **cannot** be **estimated reliably**, no revenue to be recognised
- During **the early stages of a contract**, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred. However, no definition as to upto what % of completion it can be considered that contract is at early stage.

ICDS:

- Does not recognize that the possibility that outcome of a construction contract cannot estimated reliably except during early stages of contract.
- The early stage of a contract shall not extend beyond **25**% of the stage of completion

Disclosure

- A person shall disclose :
  - (a) the amount of contract revenue recognised as revenue in the period; and
  - (b) the methods used to determine the stage of completion of contracts in progress. [Para 23 of ICDS-III]

- A person shall disclose the following for contracts in progress at the reporting date, namely:
  - (a) amount of costs incurred and recognised profits less recognised losses upto the reporting date;
  - (b) the amount of advances received; and
  - (c) the amount of retentions. [Para 24 of ICDS-III]

Transition

- Contract revenue and contract costs associated with the construction contract, which commenced on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.
- Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2016 but not completed by the said date, shall be recognised based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016.

Possible Income adjustments under ICDS III

Particulars	Addition	Deduction
Adjustments in respect of Retention moneys	XXXX	
Early stage income not accounted in books	XXXX	
Anticipated losses accounted in books not allowable under I.T	XXXX	
Incidental income netted off under books taxable under I.T.	XXXX	

Note each of the timing differences in year 1 would have to be reversed in subsequent years where the income that has already been offered to tax is accounted in the books of accounts. Maintenance of parallel books in addition to normal books would be advisable.

ICDS-IV - REVENUE RECOGNITION

ISSUE: Revenue from escalation of price and export incentives – point of taxation:

ICDS:

- income from export incentive to be recognised in the year of making of the claim if there is 'reasonable certainty' of its ultimate collection. Can be postponed only if there is inability to assess the ultimate collection [Para 5]

Delhi HC:

- Para 5 of ICDS-IV is contrary to the decision of the Supreme Court in CIT v. Excel Industries Limited [2015] 358 ITR 295 (SC) and is, therefore, ultra vires the Act and struck down as such

FA 2018:

- New Section 145B inserted to provide that the claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

ISSUE: Income from services

ICDS:

General Rule:

- Revenue has to be offered to tax under percentage completion method only.

Exceptions:

- Revenue from service contracts with duration of not more than ninety days **may be** recognised when the rendering of services under that contract is completed or substantially completed.
- When services are provided by an indeterminate number of acts over a specific period of time, revenue **may be** recognised on a straight line basis over the specific period. Eg: AMC

Delhi HC:

- The proportionate completion method as well as the contract completion method have been recognized as valid method of accounting under the mercantile system of accounting by the Supreme Court in *CIT* v. *Bilhari Investment Pvt. Ltd.* [2008] 299 ITR 1 (SC). *CIT* v. *Manish Buildwell Pvt. Ltd.* [2011] 245 CTR 397 (Delhi) and *Paras Buildtech India Pvt. Ltd.* v. *CIT* [2016] 382 ITR 630 (Delhi). Therefore, to the extent that para 6 of ICDS-IV permits only one of the methods, *i.e.,* proportionate completion method, it is contrary to the above decisions, held to be *ultra vires* the Act and struck down as such

ISSUE: Income from services contd..

FA 2018:

- New section 43CB inserted in the Act to provide that the profits and gains arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method.
- **Provided** that profits and gains arising from a contract for providing services,—

  (i) with duration of not more than ninety days **shall** be determined on the basis of project completion method;

  (ii) involving indeterminate number of acts over a specific period of time **shall** be determined on the basis of straight line method.

Note:

- Note for AMC contracts and short duration contracts there is an option in ICDS to not follow percentage completion method but under Act there is a mandate to not follow percentage completion method.
- In case of conflict between the provisions of Act and ICDS provisions of Act will prevail

ICDS-IV vs. I.T. Act

- Section 145B(1) of the Act provides that **interest** received by an assessee **on compensation or on enhanced compensation**, as the case may be, shall be deemed to be the income of the year in which it is received. No corresponding provision in ICDS.
- ICDS: Interest on refund of taxes to be recognised as income in the year of receipt. No corresponding provision in Act.

Interest

ICDS:

- Interest shall accrue on the **time basis** determined by the amount outstanding and the rate applicable.

Issues:

- Should income be offered to tax on time basis even if it is not due?
- Paragraph pertaining to reasonable certainty of ultimate collection conspicuously absent

FAQ No. 15 of CBDT's Circular No. 10/2017:

- As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non-recovery in either cases can be claimed as deduction in view of amendment to section 36(1)(*vii*). Further, the provision of the Act (*e.g.* section 43D) shall prevail over the provisions of ICDS

Dividend

AS 9:

- Dividends are recognized when owner's right to receive payment is established.

ICDS:

- Dividends are recognised in accordance with the provisions of the Act.

Sec 8 of IT Act:

- (a) any dividend **declared** by a company or **distributed** or **paid** by it within the meaning of Sec 2(22) (a) /(b) /(c) /(d) / (e) shall be deemed to be the income of the previous year in which it is so **declared**, **distributed** or **paid**, as the case may be;
- (b) any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is **unconditionally made available** by the company to the member who is entitled to it.

Sample Disclosures

- Revenue is accounted as & when it is accrued.
- Income from service contracts is determined under percentage completion method
- The amount of revenue from service transactions recognised as revenue during the previous year is Rs....
- Revenue not recognised due to lack of reasonable certainity in collection (delete if not applicable)
- For service transactions in progress:
  - Cost incurred and revenue recognised
  - Amount of advances received
  - Amount of retentions

Possible Adjustments under ICDS IV

Particulars	Addition	Deduction
Revenue not recognized in books (on account of **revenue not being measurable**)	XXXX	
Additional revenue from services under **% completion method** (where books follow project completion method)	XXXX	
Dividend Income not recognized in books but to be recognized in under Section 8	XXXX	
Royalty Income (if not offered to tax as per contract terms)	XXXX	XXX
Doubtful interest income not accounted in books	XXXX	XXX*
Transitional adjustments (if any)	XXXX	XXX

* Deduction to be claimed u/s 36(1)(vii)

Note each of the timing differences in year 1 would have to be reversed in subsequent years where the income that has already been offered to tax is accounted in the books of accounts.

Income Computation and Disclosure Standard V
Tangible Fixed Assets

NEED FOR ICDS V?

- ICDS V does not deal with depreciation computation as it is governed by Sec 32 of the Act.
- ICDS V defines components of Actual Cost
- Section 43(1) of the Act defines actual cost. There are 15 existing Explanations in section 43(1) which specify how actual cost is to be worked out in various situations
- For all practical purposes actual cost as defined u/s 43(1) would have to be followed as Act overrides ICDS.
- ICDS-V Tangible Fixed Assets was not challenged before the Delhi HC.

Sample Disclosures:

- Fixed Assets are stated at the W.D.V,plus additions , Less deletions and less depreciation charged for the year.
- Depreciation on fixed assets is provided according to the method and rates prescribed in Income-tax Rules
- For written down value of assets and depreciation claimed and other disclosures under Para 19 of ICDS V, refer Annexure to clause 18 of Form 3CD

Income Computation and Disclosure Standard VI
The Effects of Changes in Foreign Exchange Rates

Issue: Forward Exchange Contracts

ICDS:

Item of expense / loss	For trading / speculation	Hedging of firm commitment or a highly probable forecast transaction	Other hedging contracts
Premium or **discount** arising at inception of contract	Shall be recognised at the time of settlement		Amortised as expense or income over the life of the contract
Exchange differences	Shall be recognised at the time of settlement		Recognised as income / expense in the previous year in which the exchange rates change

Issue: Forward Exchange Contracts contd…

Delhi HC:

- ICDS-VI which states that marked to market loss/gain in case of foreign currency derivatives held for trading or speculation purposes are not to be allowed, is not in consonance with the ratio laid down by the Supreme Court in Sutlej Cotton Mills Limited v. CIT [1979] 116 ITR 1 (SC), insofar as it relates to marked to market loss arising out of forward exchange contracts held for trading or speculation purposes. It is, therefore, held to be ultra vires the Act and struck down as such.

FA 2018:

- A new section 43AA inserted in the Act to provide that, any gain or loss arising on account of effects of changes in foreign exchange rates in respect of specified foreign currency transactions shall be treated as income or loss, which shall be computed in the manner provided in ICDS.

Issue: Foreign Operations

Accounting standard:

- Translation differences from Non integral foreign operations should be accumulated in a foreign currency translation reserve (FCTR) and on the disposal of the net investment in foreign operation; it should be recognised as income or as expenses.

ICDS:

- There is no bifurcation like Integral or non-integral foreign operation.
- Paras 3 to 6 of ICDS VI will be applicable for translation of financial statement of all foreign operations.
- All resulting exchange differences are recognised as income or expense in that previous year..

Issue: Foreign Operations **contd…**

FAQ No. 16 of CBDT's Circular No. 10/2017:

- FCTR balance as on 1 April 2016 pertaining to exchange differences on monetary items for non-integral operations, shall be recognised in the previous year relevant for assessment year 2017-18 to the extent not recognised in the income computation in the past.

Delhi HC:

- Losses/gains arising by valuation of monetary assets and liabilities of the foreign operations as at the end of the year cannot be treated as real income. It is only in the nature of notional or hypothetical income which cannot be even otherwise subject to tax

FA 2018: **contd…**

Issue: Foreign Operations contd...

FA 2018: inserted new section 43AA:

- Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be,
- Such gain or loss shall be computed in accordance with the ICDSs
- Above provisions apply to gain or loss arising on account of the effects of change in foreign exchange rates in respect of all foreign currency transactions, including those relating to—

  (i) monetary items and non-monetary items;

  (ii) translation of financial statements of foreign operations;

  (iii) forward exchange contracts;

  (iv) foreign currency translation reserves.

Disclosure requirements:

There are no disclosure requirements under ICDS VI ☺

Income Computation and Disclosure Standard VII
Government Grants

Issue: Timing for recognition of Govt Grant

ICDS:

- Recognition of Government grant shall not be postponed beyond the date of actual receipt.

Delhi HC:

- ICDS VII which provides that recognition of government grants cannot be postponed beyond the date of accrual receipt, is in conflict with the accrual system of accounting. To that extent it is held to be ultra vires the Act and struck down as such.

FA 2018:

- New section 145B inserted in the Act to provide that income referred to in sub-clause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

Disclosure requirements:

(a) nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year

(b) nature and extent of Government grants recognised during the previous year as income;

(c) nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons thereof; and

(d) nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

ICDS-VIII - SECURITIES

Scope

Part A

- Applies to all assessees other than (assessees engaged in insurance business, venture capital funds, mutual funds, banks and public financial instituitions
- Income recognition as per ICDS VIII

Part B

- Applies to Scheduled Banks and Public Financials institutions
- ICDS VIII not applicable; Follow guidelines issued by RBI

Key Provisions of Part A:

- Where unpaid interest has accrued before the acquisition of an interest-bearing security and is included in the price paid for the security, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; **the pre-acquisition portion of the interest is deducted from the actual cost**. [Para 8 of ICDS-VIII]
- Subsequent measurement of inventory:
  - Inventory of securities to be valued at cost or NRV which ever is lower
  - The comparison of actual cost initially recognised and net realisable value shall be done category-wise and not for each individual security. For this purpose, securities shall be classified into the following categories, namely:—
  - (a) shares;
  - (b) debt securities;
  - (c) convertible securities; and
  - (d) any other securities not covered above. [Para 10 of ICDS-VIII]

Key Provisions of Part A: contd..

- Securities not listed on a recognised stock exchange or listed but not quoted on a recognised stock exchange with regularity from time to time, **shall be valued at actual cost initially recognised**. [Para 12 of ICDS-VIII]
- For the purposes of paras 9, 10 and 11 where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of **first-in-first-out method** or weighted average method[Para 13 of ICDS-VIII]

Security	*Category*	*Cost*	*NRV*	*Lower of cost or NRV*	*ICDS Value*
A	Share	100	**75**	**75**	
B	Share	120	150	120	
C	Share	140	120	120	
D	Share	200	190	190	
	Total	560	**535**	505	**535**
E	Debt Security	150	160	150	
F	Debt Security	105	**90**	**90**	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
	Total	**600**	615	585	**600**
Securities Total		1160	1150	1090	**1135**

Part A Struck down by Delhi HC:

- For those entities not governed by the RBI to whom Part A of ICDS VIII is applicable, the accounting prescribed by the AS has to be followed which is different from the ICDS. In effect, such entities will be required to maintain separate records for income tax purposes for every year since the closing value of the securities would be valued separately for income tax purposes and for accounting purposes. To this extent Part A of ICDS VIII is held to be *ultra vires* the Act and is struck down as such. [Para 102]

Ratification by FA 2018

Section 145A of the Act has been substituted by the Finance Act, 2018 with retrospective effect from 2017-18 to provide that :

- inventory being securities not listed, or listed but not quoted, on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised in the manner provided in ICDS
- inventory being listed securities, shall be valued at lower of actual cost or net realisable value in the manner provided in ICDS and for this purpose the comparison of actual cost and net realisable value shall be done category-wise.

Disclosure requirements:

There are no disclosure requirements under ICDS VIII ☺

Possible Income adjustments under ICDS VIII

Particulars	Addition	Deduction
Adjustments in valuation where there is exchange of assets	XXXX	XXXX
Adjustments in respect of closing valuation of inventories	XXXX	XXXX
Adjustments in respect of opening valuation of inventories	XXXX	XXXX

Income Computation and Disclosure Standard IX
Borrowing Costs

SCOPE

(1) This Income Computation and Disclosure Standard deals with treatment of borrowing costs.

(2) This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.

ICDS IX is therefore not applicable to interest on partner’s capital

Definition of Borrowing costs

- *"**Borrowing costs**" are **interest** and **other costs** incurred by a person in connection with the borrowing of funds and **include**:*
  - *(i) <u>commitment charges</u> on borrowings;*
  - *(ii) amortised amount of <u>discounts or premiums</u> relating to borrowings;*
  - *(iii) amortised amount of <u>ancillary costs</u> incurred in connection with the arrangement of borrowings;*
  - *(iv) <u>finance charges</u> in respect of assets acquired under finance leases or under other similar arrangements."*

FAQ 21: Borrowing costs

- As per FAQs – **Bill discounting charges** also would fall within the definition of borrowing costs
- Contrary to judgement of Delhi High Court in the case of *CIT v Cargill Global Trading Pvt Ltd [2011]335 ITR 94(Delhi)* (SLP rejected by the Supreme Court)
  - discounting is not a borrowing,
  - but a sale of the bill

Definition of Qualifying Asset

"Qualifying asset" means:

- *(i) land, building, machinery, plant or furniture, being **tangible assets**;*
- *(ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being **intangible assets**;*
- *(iii) inventories that require a period of twelve months or more to bring them to a saleable condition*

Sec 36(1)(iii) of I.T. Act

- The amount of the interest paid in respect of capital borrowed for the purposes of the business or profession - *shall be allowable as deduction*
- **Provided** that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset - *shall not be allowed as deduction.*
- The term "asset" used in this proviso, has to be construed as "capital asset", given similar usage of the term in section 43(1), as well as section 43A.

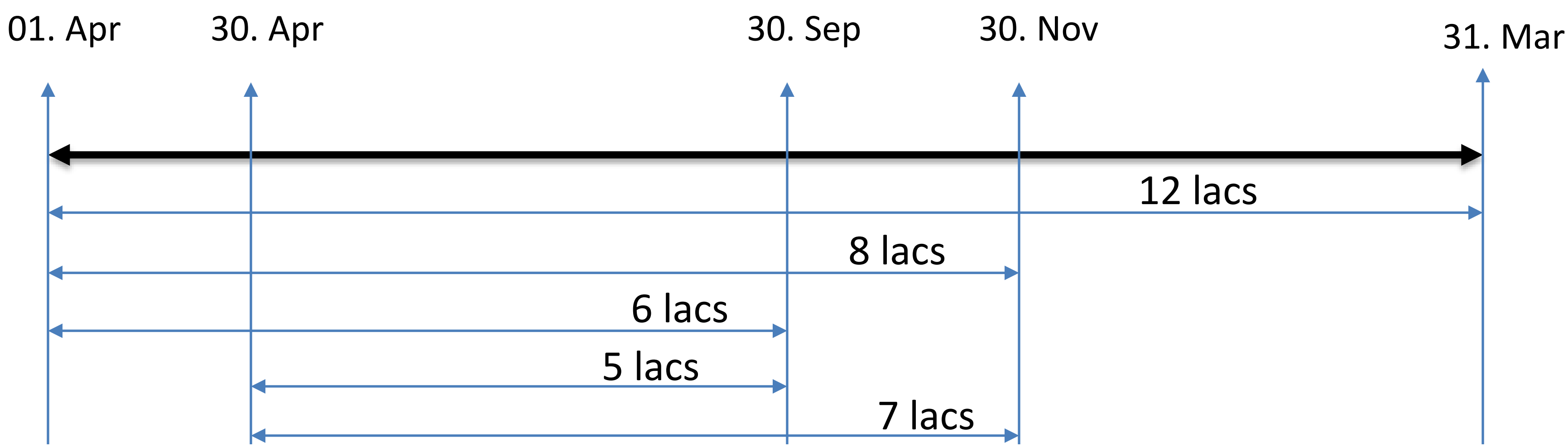
- CIT v Lokhandwala Construction Industries (2003) 260 ITR 579 (Bom)

Understanding capitalisation

Issue	***Specific Borrowings***	***General Borrowings***
When should Borrowing costs be capitalized?	**Any** borrowing costs in relation to qualifying asset	Only if borrowing costs relate to qualifying assets which require 12 months or more for construction / acquisition / production.
Commencement of capitalisation (*from when to capitalise*)	From the date borrowing costs are incurred	From the date funds are utilised for qualifying asset
Cessation of capitalisation (*upto when to capitalise*)	Inventories: when inventory is ready for intended sales Others: When the asset is first **put to use**	
How much to capitalise	Actual borrowing cost	Proportionate borrowing cost –i.e. A X B / C

Specific Borrowing cost

Particulars	
Q	Loan taken from HDFC Bank for purchase of plant – 100 Lacs • Date of borrowing loan – 01/04/2016 • Date of repayment – 31/03/2017 • Rate of interest - 12% • Money paid for purchase of plant on 30/04/2016 • Plant installed on 30-09-2016 • Plant put to use on 30-11-2016



Computing proportionate borrowing costs

Borrowing costs to capitalise = A * B / C

where:

- A = General borrowing costs
- B = Average costs of qualifying assets
- C = Average of total amount of assets

Note: As per FAQ Calculation has to be done on asset to asset basis

A - General borrowing costs

- Total borrowing cost for the year XXX
- Less: Specific Borrowing costs

  capitalized under para 5 (ICDS) (xxx)
- Less: Interest disallowed u/s 14A,

  40(a)(i), 40(a)(ia) etc (as per FAQ) (xxx)
- Less: Specific borrowing costs (even if not capitalised) (ICAI) (xxx)

A - General borrowing costs *contd.....*

#	**Particulars**
1	Loan from HDFC Bank for purchase of plant – 100 Lacs • Refer previous example on specific borrowing. • Total interest paid 12 lacs • Interest capitalized to plant in terms of Para 5 of ICDS – 8 lacs
2	Interest paid to Mr. A for general borrowings – 100 lacs • About 50 lacs utilized towards payments to trade creditors • Balance utilized for purchase of plant. • Plant was purchased, setup and put to use within 6 months • Total interest paid 12 lacs
3	Interest paid to Mr. B for general borrowings – 100 lacs • About 50 lacs utilized towards payments to trade creditors • Balance utilized for construction of factory shed. • Construction of factory shed commenced on 01-04-2016 and the work was under progress as on 31-03-2017 • Total interest paid 12 lacs

Computing general borrowing costs *contd…..*

Particulars	**Amount Rs.**	**Remarks**
Total interest paid	36,00,000	
Less: Interest on Loan from HDFC Bank for purchase of plant	(12,00,000)	As per ICDS 8 lacs As per ICAI 12 lacs
Interest paid to Mr. A for general borrowings	(12,00,000)	Plant has taken less than 12 months for being setup
Interest paid to Mr. B for general borrowings	-	
Total general borrowing cost	12,00,000	To be considered in formula A * B / C

Issues in computing:

- Determining whether a borrowing is a specific borrowing or general borrowing is going to be a challenge.

- In following cases it has been held, in the context of interest free loans given to sister concerns, that where an assessee is having own funds more than interest free loans it should be presumed that interest free loans have been given out of own funds:
  - Munjal Sales Corpn. v. CIT [2008] 168 Taxman 43 (SC).
  - CIT v. Reliance Utilities & Power Ltd. [2009] 178 Taxman 135 (Bom.).
  - CIT v. Tin Box Co. [2004] 135 Taxman 145 (Delhi)
  - CIT v. Motor Sales Ltd. [2008] 304 ITR 123 (All.)
  - CIT v. Bharti Televenture Ltd. [2011] 200 Taxman 39 (Mag.)
  - J.K. Industries Ltd. v. CIT [2011] 11 taxmann.com 72 (Cal.)
  - CIT v. Indian Sugar Exim Corpn. Ltd. [2012] 206 Taxman 242

Issues contd..

- Asset proved to be acquired out of own funds – No interest has to be capitalized.

- In computing average cost of qualifying asset, borrowing cost already capitalized in books should be excluded – else it will lead to capitalisation of interest on interest.

- For computing average Gross assets to be considered not net assets – compare like with like.

- Computation of interest to be capitalized in a case where both specific and general borrowings are used.

- For general borrowing interest has to be capitalized from the date of utilization of funds and not from the date of borrowing. But the formula A * B / C does not make a provision for this.

Sr. No.	*Points of comparison*	*ICDS IX (New) : Borrowing Costs*	*(AS) 16 Borrowing Costs*
1.	**Exchange differences arising from foreign currency borrowings** to the extent regarded as interest costs	These are not treated as borrowing costs under ICDS	These are regarded as borrowing costs
2.	Qualifying assets - whether in-tangible assets are qualifying assets	Term expressly includes Know-how, patents, copy- rights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;	Term not defined to cover intangible assets

Sr. No.	*Points of comparison*	*ICDS IX (New) : Borrowing Costs*	*(AS) 16 Borrowing Costs*
3.	Period of time necessarily taken for acquisition, construction or production of asset so that asset qualifies as 'qualifying asset'	However, ICDS-IX (New) allows capitalization of only actual borrowing costs incurred on funds specifically borrowed for acquisition, construction or production of the asset in such cases. Capitalisation of borrowing costs other than those incurred on funds specifically borrowed as aforesaid as per specified formula is allowed under ICDS-IX(new) **only where the qualifying asset necessarily requires a period of 12 months or more** for its acquisition, construction or production. Where acquisition, construction or production necessarily requires less than 12 months, capitalization of borrowing costs other than those borrowings which were specifically borrowed for the asset are not allowed.	Assets can be regarded as qualifying assets even if they take less than 12 months only if in facts and circumstances of the case it is justified to do so

Sr. No.	*Points of comparison*	*ICDS IX (New) : Borrowing Costs*	*(AS) 16 Borrowing Costs*
4.	Whether 'investment properties' are qualifying assets	No	Yes.
5.	Commencement of Capitalisation	The capitalisation of borrowing costs shall commence: (a) in a case referred to in paragraph 5 (funds specifically borrowed for obtaining a qualifying asset), from the date on which funds were borrowed; (b) in a case referred to in paragraph 6, from the date on which funds were utilised.	The capitalisation of borrowing costs shall commence from the date all the following conditions are satisfied (i) expenditure for a acquisition, construction or production of a qualifying asset is being incurred; (ii) borrowing costs are being incurred; and (iii) activities that are necessary to prepare the asset for its intended use are in progress

Sr. No.	*Points of comparison*	*ICDS IX (New) : Borrowing Costs*	*(AS) 16 Borrowing Costs*
6.	Income on temporary investment of borrowed funds which are specifically borrowed for obtaining a qualifying asset	**No netting off** from cost of asset. Will be taxed as income	To be netted off from borrowing costs and capitalized

Delhi HC: Para 12 of ICDS III read with para 5 of ICDS IX, dealing with borrowing costs, makes it clear that no incidental income can be reduced from borrowing cost. This is contrary to the decision of the Supreme Court in CIT v. Bokaro Steel Limited [1999] 236 ITR 315 and is therefore struck down.

FA 2018: New section 43CB inserted in the Act to provide that profits arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method except for certain service contracts, and that the contract revenue shall include retention money, and contract cost shall not be reduced by incidental interest, dividend and capital gains.

Sr. No.	*Points of comparison*	*ICDS IX (New) : Borrowing Costs*	*(AS) 16 Borrowing Costs*
7.	Suspension of capitalisation	No suspension of capitalization under any circumstances	Capitalization suspended during extended periods in which **active development is interrupted**
8.	Cessation of capitalization	Capitalization of borrowing costs shall cease when asset is first **put to use** in case of qualifying asset other than inventory	Capitalisation of borrowing costs shall cease when substantially all the activities necessary to prepare such inventory for its intended sale are complete.

Sample Disclosures:

- **Accounting Policy**: Borrowing costs that are attributable to the acquisitions, construction or production of qualifying assets are capitalized as part of such assets. A qualifying asset is an asset that necessarily requires a substantial period of time to get ready for its intended use or sale. All other borrowing costs are recognized as an expense in the period in which they are incurred.
- Details of borrowing costs capitalised during the year: …..

Income Computation and Disclosure Standard X Provisions, Contingent Liabilities and Contingent Assets

Sr. No.	*Points of comparison*	*ICDS-X (New) Provisions, Contingent Liabilities and Contingent Assets*	*(AS) 29 Provisions, Contingent Liabilities and Contingent Assets*
1.	Applicability	This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" **and not for the purpose of maintenance of books of account**	(AS) 29 applies for the purpose of preparation of financial statements.
2.	Recognition of provision	Provision to be recognised when outflow of resources to settle the obligation is **reasonably certain**	Provision to be recognised when outflow of resources is **probable**
3.	Recognition of Contingent Asset	A person shall not recognise a contingent asset. Contingent assets are assessed continually and when it becomes **reasonably certain** that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs.	Contingent asset shall not be recognized. Contingent assets are assessed continually and when it becomes **virtually certain** that inflow of economic benefit will arise, the asset and related income are recognised in the previous year in which the change occurs

Sr. No.	*Points of comparison*	*ICDS-X (New) Provisions, Contingent Liabilities and Contingent Assets*	*(AS) 29 Provisions, Contingent Liabilities and Contingent Assets*
4.	Recognition of reimbursement in respect of a provision	Where some or all of the ex- penditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is **reasonably certain** that reimbursement will be received if the person settles the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision.	Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is **virtually certain** that reimbursement will be received if the person settles the obligation. The amount recognised for the reimbursement shall not exceed the amount of the provision.

Disclosures:

<u>Provisions:</u>

For each class of provision:

a) Brief description of nature of obligation
b) Carrying amount at the beginning of the year
c) Provisions made during the year
d) Amounts incurred / charged against the provision
e) Unused provisions reversed during the year
f) Amount of any expected reimbursement

<u>Contingent Assets:</u>

For each class of contingent asset

a) Brief description of nature of asset
b) Carrying amount at the beginning of the year
c) Additional amount of asset and related income recognised
d) Amount of asset and related income reversed.

Disclosures: Issues

Q. Where is the taxpayer required to make disclosures specified in ICDS

A. The disclosures required under ICDS shall be made in the tax audit report in Form 3CD.

Q. Cases where the assessee is not liable to tax audit where and how should the disclosures be made?

A. There shall not be any separate disclosure requirements for persons who are not liable to tax audit.

- **CIRCULAR NO.10/2017 [F.NO.133/23/2016-TPL]**, **DATED 23-3-2017**

3CD: Relevant clauses

Clause 13(d): Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2) - Yes / No

Clause 13(3): If answer to (d) above is in the affirmative, give details of such adjustments:

(e) If answer to (d) above is in the affirmative, give details of such adjustments:

S.No.		ICDS	Increase in profit (Rs.)	Decrease in profit (Rs.)	Net effect (Rs.)
1		Select			0
Total			0	0	0

Add Delete

Clause 13(f):

(f) Disclosure as per ICDS:

S.No.		ICDS	Disclosure
1		ICDS I-Accounting Policies	As per annexure
2		ICDS II-Valuation of Inventories	As per Annexure
3		ICDS III-Construction Contracts	As per Annexure
4		ICDS IV-Revenue Recognition	As per Annexure
5		ICDS V-Tangible Fixed Assets	As per Annexure
6		ICDS VII-Governments Grants	As per Annexure
7		ICDS IX Borrowing Costs	As per Annexure
8		ICDS X-Provisions, Contingent Liabilitie	As per Annexure

Add Delete

Character restriction of about 1995 letters. If not possible to provide disclosure on account of space restrictions, disclosures may be separately attached as annexure.