Bombay Chartered Accountants’ Society

Practical Issues in Implementation of Income Computation and Disclosure Standards (‘ICDS’)

Presentation by:
Yogesh A. Thar

April 19, 2017
What is ICDS?

- Section 145(1) – Income chargeable under the heads “Profits and Gains from Business or Profession” or “Income from other Sources” – subject to 145(2) - as per method of accounting regularly followed

- Section 145(2) – the Central Government has power to notify “ICDS”

- CBDT vide notification dated March 31, 2015 introduced 10 ICDS to be effective from April 1, 2015 and shall accordingly apply for AY 2016-17 onwards

- However, the said notification was withdrawn by a press release and vide Notification No. S. O. 3079 (E) dated September 29, 2016, the new notification was introduced with effect from AY 2017-18 and onwards
## List of Notified ICDS

<table>
<thead>
<tr>
<th>ICDS</th>
<th>Income Computation and Disclosure Standards</th>
<th>Equivalent AS</th>
<th>Equivalent IND AS</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICDS I</td>
<td>Accounting Policies</td>
<td>AS-1</td>
<td>IND AS-1 and 8</td>
</tr>
<tr>
<td>ICDS II</td>
<td>Valuation of Inventories</td>
<td>AS-2</td>
<td>IND AS-2</td>
</tr>
<tr>
<td>ICDS III</td>
<td>Construction contracts</td>
<td>AS-7</td>
<td>IND AS-11</td>
</tr>
<tr>
<td>ICDS IV</td>
<td>Revenue Recognition</td>
<td>AS-9</td>
<td>IND AS-16</td>
</tr>
<tr>
<td>ICDS V</td>
<td>Tangible Fixed Assets</td>
<td>AS-10</td>
<td>IND AS-16</td>
</tr>
<tr>
<td>ICDS VI</td>
<td>Effects of Changes in Foreign Exchange Rates</td>
<td>AS-11</td>
<td>IND AS-21</td>
</tr>
<tr>
<td>ICDS VII</td>
<td>Government Grants</td>
<td>AS-12</td>
<td>IND AS-20</td>
</tr>
<tr>
<td>ICDS VIII</td>
<td>Securities</td>
<td>AS-13</td>
<td>IND AS-32 and 109</td>
</tr>
<tr>
<td>ICDS IX</td>
<td>Borrowing Costs</td>
<td>AS-16</td>
<td>IND AS-23</td>
</tr>
<tr>
<td>ICDS X</td>
<td>Provisions, Contingent Liabilities and Contingent Assets</td>
<td>AS-29</td>
<td>IND AS-37</td>
</tr>
</tbody>
</table>
Commercial Accounting principles- Basis for Taxable Profits

- Prior to introduction of ICDS, the taxable profits were computed based on the commercial accounting principles subject to express provision of the Act
  - Miss Dhun Dadabhai Kapadia v. CIT (1967) 63 ITR 651(SC)
  - CIT v. U.P. State Industrial Development Corporation (1997) 225 ITR 703 (SC), it was held that -
    
    “for the purposes of ascertaining profits and gains the ordinary principles of commercial accounting should be applied, so long as they do not conflict with any express provision of the relevant statute”

- Going Forward - for taxation purposes - profits to be computed as per commercial accounting principles as modified by provisions of ICDS
Specimen for computing Taxable Income under ICDS framework

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit / loss as per profit and loss statement</td>
<td>XXX</td>
</tr>
<tr>
<td>Add/ Less: Adjustments as per ICDS</td>
<td>xxx</td>
</tr>
<tr>
<td><strong>Adjusted Income as per ICDS</strong></td>
<td>XXX</td>
</tr>
<tr>
<td>Add/ Less: Adjustments as per the provisions of the Act</td>
<td>xxx</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>XXX</td>
</tr>
</tbody>
</table>
## ITR Form for AY 2016-17 – ICDS Disclosure

<table>
<thead>
<tr>
<th>ITR</th>
<th>Description</th>
<th>Yes / No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>For Individuals having Income from Salary &amp; Interest</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>For Individuals &amp; HUFs not having Income from Business or Profession</td>
<td>No</td>
</tr>
<tr>
<td>2A</td>
<td>For Individuals &amp; HUFs not having Income from Business or Profession and Capital Gains and who do not hold foreign assets</td>
<td>No</td>
</tr>
<tr>
<td>3</td>
<td>For Individuals/HUFs being partners in firms and not carrying out business or profession under any proprietorship</td>
<td>No</td>
</tr>
<tr>
<td>4</td>
<td>For Individuals &amp; HUFs having income from a proprietary business or profession</td>
<td>Yes</td>
</tr>
<tr>
<td>4S</td>
<td>For Individuals/HUF/Partnership Firm having income from presumptive business</td>
<td>No</td>
</tr>
<tr>
<td>5</td>
<td>For persons other than,- (i) individual, (ii) HUF, (iii) company and (iv) person filing ITR-7</td>
<td>Yes</td>
</tr>
<tr>
<td>6</td>
<td>For Companies other than companies claiming exemption under section 11</td>
<td>Yes</td>
</tr>
<tr>
<td>7</td>
<td>For persons including companies required to furnish return under sections 139(4A) or 139(4B) or 139(4C) or 139(4D) or 139(4E) or 139(4F)</td>
<td>No</td>
</tr>
</tbody>
</table>

In the excel utility provided by the Department, impact of ICDS is not considered in computation of total income, a schedule is provided to disclose the monetary impact as per ICDS
## ITR Form for AY 2017-18 – ICDS Disclosure

<table>
<thead>
<tr>
<th>ITR</th>
<th>Description</th>
<th>Yes / No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>For Individuals having Income from Salaries, one house property, other sources (Interest, etc.) and having total income upto Rs. 50 lakh</td>
<td>No</td>
</tr>
<tr>
<td>2</td>
<td>For Individuals &amp; HUFs not carrying out business or profession under any proprietorship</td>
<td>No</td>
</tr>
<tr>
<td>3</td>
<td>For Individuals &amp; HUFs having income from a proprietary business or profession</td>
<td>Yes</td>
</tr>
<tr>
<td>4</td>
<td>For presumptive income from Business &amp; Profession</td>
<td>No</td>
</tr>
<tr>
<td>5</td>
<td>For persons other than (i) individual, (ii) HUF, (iii) company and (iv) person filing Form ITR - 7</td>
<td>Yes</td>
</tr>
</tbody>
</table>

In the excel utility provided by the Department, impact of ICDS is not considered in computation of total income, a schedule is provided to disclose the monetary impact as per ICDS
### Schedule ICDS

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Effect of Income Computation Disclosure Standards on profit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>ICDS</td>
</tr>
<tr>
<td>(i)</td>
<td>(ii)</td>
</tr>
<tr>
<td>(iii)</td>
<td></td>
</tr>
<tr>
<td>I</td>
<td>Accounting Policies</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>II</td>
<td>Valuation of Inventories</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>III</td>
<td>Construction Contracts</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>IV</td>
<td>Revenue Recognition</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>V</td>
<td>Tangible Fixed Assets</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>VI</td>
<td>Changes in Foreign Exchange Rates</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>VII</td>
<td>Government Grants</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>VIII</td>
<td>Securities</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>IX</td>
<td>Borrowing Costs</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>X</td>
<td>Provisions, Contingent Liabilities and Contingent Assets</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
<tr>
<td>XI</td>
<td>Total Net effect (I+II+III+IV+V+VI+VII+VIII+IX+X)</td>
</tr>
<tr>
<td>(i)</td>
<td>XX</td>
</tr>
</tbody>
</table>

April 19, 2017

Bansi S. Mehta & Co

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I TR Disclosure

- The net effect of ICDS on profits is reflected in part A-OI, in column 3 as under:

  Effect on the profit because of deviation, if any, as per Income Computation Disclosure Standards notified under section 145(2) [column 11(iii) of Schedule ICDS]
13. Whether any adjustment is required to be made to the profits or loss for complying with the provisions of ICDS notified u/s 145(2) – effective from April 1, 2017

<table>
<thead>
<tr>
<th>Sr No.</th>
<th>ICDS</th>
<th>Increase in profit (Rs)</th>
<th>Decrease in profit (Rs)</th>
<th>Net Effect (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Accounting Policies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>II</td>
<td>Valuation of Inventories</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>III</td>
<td>Construction Contracts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV</td>
<td>Revenue Recognition</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>V</td>
<td>Tangible Fixed Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VI</td>
<td>Changes in Foreign Exchange Rates</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VII</td>
<td>Government Grants</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VIII</td>
<td>Securities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IX</td>
<td>Borrowing Costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>X</td>
<td>Provisions, Contingent Liabilities and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Contingent Assets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>XI.</td>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NOTIFICATION NO. SO 3080(E) [NO.88/2016 (F.NO.133/) dated 29-06-2016
Insertion of clause in Form 3CD (contd…)

<table>
<thead>
<tr>
<th>Clause</th>
<th>Disclosure as per ICDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>ICDS I- Accounting Policies</td>
</tr>
<tr>
<td>II</td>
<td>ICDS II- Valuation of Inventories</td>
</tr>
<tr>
<td>III</td>
<td>ICDS III-Construction Contracts</td>
</tr>
<tr>
<td>IV</td>
<td>ICDS IV- Revenue Recognition</td>
</tr>
<tr>
<td>V</td>
<td>ICDS V-Tangible Fixed Assets</td>
</tr>
<tr>
<td>VII</td>
<td>ICDS VII-Government Grants</td>
</tr>
<tr>
<td>IX</td>
<td>ICDS IX- Borrowing Costs</td>
</tr>
<tr>
<td>X</td>
<td>ICDS X- Provisions, Contingent Liabilities and Contingent Assets</td>
</tr>
</tbody>
</table>
Scope of delegated Legislation

- Settled law that a notification cannot override the statute:
  - CIT v. Taj Mahal Hotels [(1971) 82 ITR 44 (SC)]

- Preamble to every ICDS clearly states that in case of conflict between the provisions of the Act and the ICDS:
  - The provisions of the Act shall prevail

Can ICDS bring to charge any item which is not “income”?
Basic Issues

- Whether the decisions of the Supreme Court or a High Court interpreting the provisions of the Act would prevail over the ICDS, in case of any conflict?

Refer Q.2 of FAQ

The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head “Profits and gains of business or profession” or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years.
Basic Issues (contd...) 

- Will ICDS be applicable for computing the Minimum Alternate Tax liability?
  - Not applicable - Preamble of each ICDS clearly states that ICDS is not for the purpose of maintenance of books of accounts – Q. 6 of the FAQs
  - However, applicable to AMT, since it is computed by making adjustments to adjusted total income as per the regular provisions of the Act

- Whether ICDS would have any impact on the financial statements of the assessee?
  - Preamble of each ICDS states that ICDS is not for the purpose of maintenance of books of accounts
  - However, deferred tax asset or liability under AS 22 would be affected due to the timing differences between the income or expense is recognised in the books and when they are considered while computing total income Q.1 of the FAQs
Basic Issues (contd…)

- Whether ICDS will apply in case of presumptive taxation?
  - Refer Q. 3 of FAQ

  ICDS is applicable to specified persons having income chargeable under the head Profits and gains of business or profession or ‘Income from other sources’. Therefore, the relevant provisions of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. For example, for computing presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the ease may be.
### Basic Issues-Comments (contd…)

<table>
<thead>
<tr>
<th>Section</th>
<th>Particulars</th>
</tr>
</thead>
<tbody>
<tr>
<td>44AD and 44ADA</td>
<td>• Turnover relevant</td>
</tr>
<tr>
<td></td>
<td>• 44AA requirement to maintain accounts if income is &gt;Rs. 1.2 lakhs or turnover</td>
</tr>
<tr>
<td></td>
<td>is greater than Rs. 10 lakhs</td>
</tr>
<tr>
<td></td>
<td>• No specific provision to exempt maintenance of books</td>
</tr>
<tr>
<td>44AF</td>
<td>• Sub-section (4) – s. 44A is Not applicable</td>
</tr>
<tr>
<td></td>
<td>• Hence, contradiction in FAQ</td>
</tr>
<tr>
<td>44B</td>
<td>• Non-resident shipping company</td>
</tr>
<tr>
<td></td>
<td>• 7.5% of the freight</td>
</tr>
<tr>
<td></td>
<td>• Turnover not relevant</td>
</tr>
<tr>
<td></td>
<td>• Under Companies Act, no accounts are required to be maintained</td>
</tr>
<tr>
<td></td>
<td>• Hence contradiction in FAQ</td>
</tr>
<tr>
<td>44BBA</td>
<td>• Non-resident aircraft company</td>
</tr>
<tr>
<td></td>
<td>• Similar to 44B</td>
</tr>
<tr>
<td>44BB</td>
<td>Sub-section 3 requires accounts only if lower profits are claimed</td>
</tr>
</tbody>
</table>
ICDS I - Accounting Policies
ICDS I - Accounting Policies – Analysis

- Whether prudence is no more relevant?
  - Accounting Standard –
    - Recognises the concept of prudence hence, expected losses are provided and expected gains are ignored
  - Committee Report –
    - To avoid differential treatment of recognition of loss and income, concept of prudence has been removed
  - ICDS –
    - Mark to market and expected loss should not be provided unless permitted by other ICDS
ICDS I - Accounting Policies – Analysis (contd…) 

- Whether mark to market loss on interest rate swaps will be allowed?
  - As the concept of prudence has been removed from ICDS – I, *prima facie*, mark to market loss on interest rate swaps may not be allowed
  - If it is cross currency interest rate swap it will be governed by ICDS-VI
  - In case of Banks, it will be governed by RBI norms for accounting IRS
ICDS I - Accounting Policies – Analysis (contd…)

- Whether mark to market loss on interest rate swaps recognised in earlier year needs to reversed in AY 2016-17?
  - Transitional Provision of ICDS – I states as under:
    
    “All contract or transaction existing on the 1st day of April, 2015 or entered into on or after the 1st day of April, 2015 shall be dealt with in accordance with the provisions of this standard after taking into account the income, expense or loss, if any, recognised in respect of the said contract or transaction for the previous year ending on or before the 31st March, 2015.”
ICDS I - Accounting Policies – Analysis (contd…)

- MAT implications if mark to market gain recognised in earlier year needs to reversed in AY 2017-18? (Refer Q 8 of FAQ)
  - Example - MTM gain recognised in earlier year was Rs. 300

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Book Profit</th>
<th>Profit as per Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before ICDS adjustment</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>ICDS Adjustment</td>
<td>-</td>
<td>(300)</td>
</tr>
<tr>
<td>Profit after ICDS adjustment</td>
<td>100</td>
<td>(200)</td>
</tr>
</tbody>
</table>

- MAT paid in earlier year on Rs. 300;
- No deduction from MAT in this year;
- May have to pay normal tax in the subsequent year
ICDS I - Accounting Policies – Analysis (contd…)

- Concept of materiality has been done away by ICDS?
  - Accounting Standard –
    - Recognises the concept of materiality
  - Committee Report –
    - As the concept of materiality not recognised by the Income Tax Act
  - ICDS –
    - No specific provision on materiality
  - Possible view –
    - ICDS deals with ‘significant’ accounting policy (Para 1)
    - Selection of accounting policy should be such that discloses ‘true and fair view’ not ‘true and correct’ (Para 4)
    - Change in accounting policy having material effect are to be disclosed (Para 7)
    - Hence, even though the concept of materiality has not been expressly stated, it is impliedly still relevant
ICDS II - Valuation of Inventories
ICDS II - Valuation of Inventories–Analysis

- Whether ICDS – II will be applicable to service providers?
  - Accounting Standard –
    - Scope excludes WIP of service provider
  - Committee Report -
    - Incorporate the method of valuation of inventories of a service provider based on the international best practices
  - Cost of services – Para 6
    - *The costs of services in the case of a service provider shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.*
  - ICDS - Para 2(1) - Inventories are assets:
    - 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 process or in the rendering of services
ICDS II - Valuation of Inventories–Analysis (contd…)

- Whether ICDS – II will be applicable to service providers?
  - Possible view –
    - The definition of inventories has not been modified to cover WIP of service providers
    - However, service provider need to follow percentage completion method, hence, valuation of WIP is implicit therein, ICDS-II is not applicable
ICDS II - Valuation of Inventories–Analysis (contd…) 

- Whether inventory has to be valued at NRV in case of dissolution of a firm even though the business is continued, as required by ICDS?
  - Accounting Standards – Silent on the issue
  - Committee Report – To give certainty to the tax treatment
  - Judicial Pronouncement
    - Sakthi Trading (250 ITR 871) (SC) – Regular method of accounting to be followed, hence inventory to be valued at cost or NRV, which ever is lower
  - Possible view –
    - Prima facie, Sakthi Trading is overruled, but whether ICDS can bring to tax something which is not income, just based on valuation ?
    - Cost of acquisition to acquirer – not clear ?
ICDS II - Valuation of Inventories—Analysis (contd…)

- Whether ICDS on inventory has any relevance?
  - Section 145A of the Act –
    
    "Notwithstanding anything to the contrary contained in section 145,—
    
    (a) the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be—
    
    (i) in accordance with the method of accounting regularly employed by the assessee; and…"
  
  - Following points may be noted -
    - Section 145A starts with a non-obstante clause
    - Requires inventory of goods to be valued in accordance with the method of accounting regularly employed by the assessee
    - Even the preamble of ICDS states that in case of conflict between the Act and ICDS, Act will prevail
  - Possible view – ICDS on Inventories has no relevance for goods
ICDS III – Construction Contracts
ICDS III - Construction contracts – Retention Money

- Judicial View –
  - More than 6 High Courts have held that retention money doesn’t accrue during the performance of contract based on the principle of ‘accrual’
    - CIT v. Simplex Concrete Piles India Pvt. Ltd. (179 ITR 8) (Cal HC);
    - CIT v. East Coast Constructions & Industries Ltd. (283 ITR 297)(Mad HC);
    - CIT v. Associated Cables Pvt. Ltd. (286 ITR 596)(Bom HC);

- Committee Report –
  - To overcome unintended meaning given by judicial pronouncements
ICDS III - Construction contracts – Retention Money (contd…)

- ICDS –
  - Contract revenue defined to include the initial amount of revenue agreed in the contract, including retentions
  - Further, contract revenue has to be recognised by reference to the stage of completion of contract activity

- Q. 11 of FAQ -
  - Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition
Expected Loss

- Expected Loss - Total contract costs exceed total contract revenue

- AS/Ind AS–
  - Expected loss is allowed – Prudence

- Committee Report –
  - To remove differential treatment between income and losses

- ICDS III - Silent on treatment of Expected Loss
Expected Loss (contd…)

- ICDS I -
  - Principle of ‘prudence’ not regarded as one of the principles for selecting accounting policy
  - Expected loss shall not be recognised unless such recognition is in accordance with any other ICDS

- ICDS X-
  - Unlike AS 29, ICDS X does not deal with the provision for ‘onerous contracts’
  - However, provision for expenses permissible in computing contract costs
Transitional provisions of ICDS III

- Contract revenue and contract costs associated with uncompleted construction contract as on March 31, 2016 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

- Hence, ICDS would not affect the tax treatment of contracts which are already in progress as on March 31, 2016

- Applicable even to transition provisions of ICDS IV relating to service contracts
ICDS IV – Revenue Recognition
ICDS IV - Revenue Recognition – Analysis

- Whether ICDS – IV would impact treatment of finance lease?
  - Accounting Standard –
    - Specific AS 19 deals with leases
  - Committee Report –
    - Had recommended ICDS on leases, which has not been notified
  - ICDS –
    - Excludes revenue recognition of items specifically dealt by other ICDS
  - Possible view –
    - Scope of ICDS-IV is limited to sales of goods, rendering of services and use of resources by others yielding interest, royalties or dividends
    - Hence, possible view - Lease rentals are outside the purview of ICDS – IV - Refer circular dated March 23, 2017 No. 10 of 2017 (Refer Q.12 of FAQ)
Whether ICDS will have any impact on revenue recognition of export incentive?

- **Accounting Standard** –
  - Export incentive cannot be construed to be received from sale of goods or rendering of services and hence AS 9 is not strictly applicable - EAC Opinion

- **Judicial Pronouncement** –
  - Recognise income when there is corresponding third party liability to pay [CIT v. Excel Industries Ltd. (SC) (358 ITR 295)]

- **ICDS IV- para 5**

  Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved.
ICDS IV - Revenue Recognition – Analysis (contd…)

- IND – AS v. ICDS on treatment of Interest free Deposits

- IND – AS
  - Valuing interest free deposits at amortised cost (i.e., present value) and corresponding debit to opening balance of retained earnings/profit and loss
  - Every year, notional interest income would be credited to profit and loss account

- ICDS
  - Interest shall accrue on the time basis determined by the amount outstanding and the rate applicable
  - Is the notional interest recognised in profit and loss account under Ind AS = “Interest” u/s. 2(28A)?
  - MAT Impact?
ICDS IV - Revenue Recognition – Analysis (contd…)

- Under Ind AS, long-term bonds (investments) have to be recognised at amortised cost using effective interest rate
- Now, effective interest rate is arrived at after considering actual interest and discount/premium
- Accordingly, for ICDS, following adjustments to be made:

```
<table>
<thead>
<tr>
<th>Effective Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Interest</td>
</tr>
<tr>
<td>Discount/Premium</td>
</tr>
<tr>
<td>Actual Interest</td>
</tr>
<tr>
<td>Market Interest – Actual Interest</td>
</tr>
<tr>
<td>Apply ICDS IV and tax on accrual</td>
</tr>
<tr>
<td>Reverse the effect</td>
</tr>
<tr>
<td>Whether capital/revenue?</td>
</tr>
</tbody>
</table>
```
ICDS IV - Revenue Recognition – Analysis (contd…)

- A Ltd engaged in providing services related to initial public offering, the fee structure normally has two components (i) Fixed Amount (ii) Variable amount – dependent on price at which shares are subscribed or any other benchmark related to subscription or listing of securities.

- How the receipts should be considered for COI under the Act?

- Contract revenue shall comprise of:
  
  (a) the initial amount of revenue agreed in the contract, including retentions; and

  (b) variations in contract work, claims and incentive payments:

  (i) to the extent that it is probable that they will result in revenue; and

  (ii) they are capable of being reliably measured
Build-Operate-Transfer projects–Ind AS–ICDS Impact

Q. 12 of FAQ - Presently, no specific ICDS notified, hence, relevant provisions of the Act and ICDS shall apply to these transactions, as may be applicable

Ind AS –

- Do not recognise the cost of construction as “asset” in its books. Instead, such costs will be treated like cost of construction incurred by a contractor rendering construction service.

- The Annuity Charge, to the extent it is determinable and recoverable under the Agreement, is apportioned into:
  - Charge towards construction service;
  - Charges towards O&M service; and
  - Finance income

- The Charges towards construction service are recognized as revenues based on percentage completion method during the period of construction
Build-Operate-Transfer projects–Ind AS–ICDS Impact (contd…)

- ICDS
  - Provision of service on percentage completion method
  - Interest on time basis
  - Principles of accrual would apply – Impact of Ind AS to be reversed and income to be offered as per Act/ICDS
Impact of ICDS IV on treatment of Finance Lease

Q. 12 of FAQ:
- Presently, no specific ICDS notified for leases
- Therefore, relevant provisions of the Act and ICDS shall apply to these transactions, as may be applicable

Possible view –
- Scope of ICDS–IV is limited to sales of goods, rendering of services and use of resources by others yielding interest, royalties or dividends
- Hence, a view may be taken that lease rentals are outside the purview of ICDS–IV
Recognition of interest income from NPAs

Q. 13 of FAQ –

“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 the amendment to section 36(1)(vii). Further, the provision of the Act (eg. Section 43D) shall prevail over the provisions of the ICDS.”

Section 43D –

- Interest income from NPAs of Scheduled Banks, Cooperative Banks, etc. is taxable in the year in which it is credited to the Profit and Loss A/c or the year of receipt, whichever is earlier
- Provision not applicable to NBFCs

Where interest is taxed as IFOS, bad debts not allowable - concept of real income – Whether nullified by ICDS?
Applicability to income taxable on gross basis

- Q. 14 of FAQ -
  - The provisions of ICDS shall apply for computation of income which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s. 115A for arriving at the amount chargeable to tax

- Section 115A provides for rate of taxation for non-resident assessees- for interest income no ROI is to be filed (section 115A(5)). Question of maintaining books of account does not arise. Therefore, 145(2) not applicable.

- Royalty/FTS chargeable under the treaty when “paid”. Hence, ICDS not applicable.
Applicability of ICDS to Real Estate Developers

- Committee Report –
  
  “the Committee recommends that TAS covering the following areas may also be considered for notification under the Act:...

  (iii) Revenue recognition by real estate developers”

- Q. 12 of FAQ -
  
  “At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.”(Q 12)

- ICDS III/IV not applicable to real estate developers
ICDS V – Tangible Fixed Assets
Changes in revised ICDS V

- What are the major difference between AS and ICDS?
  - Spares that can be used only in connection with an item of fixed asset and their use is expected to be irregular
    - AS provides that the total cost of such spares should be allocated on a systematic basis over a period not exceeding the useful life of the principal asset
    - As against this, the ICDS requires such spares to be capitalized
  - Significant delay between the period when the plant is ready for commercial production and the actual commencement of commercial production,
    - AS - Expenditure during such period can also be treated as revenue in nature
    - ICDS - In the absence of such specific clause, expenditure would have to be capitalised
ICDS V – Tangible Fixed Assets – Analysis

Definition of “actual cost”

- Section 43(1) – not an exhaustive definition
- Challapali Sugar Case (98 ITR 167)(SC)- commercial accounting principles;
- AS-10- principles well settled ;
- IND AS- Different methods of recording actual cost;
- ICDS- Nullifies the effect of IND AS
ICDS VI – Effects of changes in foreign exchange rates
ICDS VI – Effects of changes in foreign exchange rates – Overview

- Scope –
  - Transaction in foreign currency
  - Foreign operation
  - Forward exchange contracts

- “Monetary items” are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Examples –
  - Cash,
  - Receivables, and
  - Payables, etc.
ICDS VI – Effects of changes in foreign exchange rates – Overview (contd…)

- Foreign currency transactions
  - Initial Recognition
  - Conversion on last day of previous year
    - Incomes and Expenses – Exchange rate on date of transaction or average rate
    - Monetary item – Exchange rate on last day of previous year
    - Non - Monetary item - Exchange rate on date of transaction
ICDS VI – Effects of changes in foreign exchange rates – Overview (contd…)

- Forward Exchange contract -
  “An agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature”

- Interest rate swap for cross currency loans – covered by above definition;

- In case of Banks, IRS to be governed by RBI norms
ICDS VI – Effects of changes in foreign exchange rates – Analysis

- Whether exchange gain on conversion of foreign currency loan, used for purpose of acquiring asset in India, will be taxable, as it is not covered by section 43A?
  - Accounting Standard –
    - Para 46A specifically deals with such situation
  - Judicial Pronouncement –
    - If foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature [Sutlej Cotton Mills Ltd. v. CIT (116 ITR 1)(SC)]
  - ICDS –
    - Exchange difference on translation of monetary item at closing rate to be treated as income or expense
ICDS VI – Effects of changes in foreign exchange rates – Analysis (contd…)  

<table>
<thead>
<tr>
<th>Intention of Forward Contract</th>
<th>Treatment as per AS - 11</th>
<th>ICDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm commitment having underlying Asset on last day of the year (Hedge)</td>
<td>Premium or Discount to be amortised over the period of contract. Exchange difference to recognised on the last day of previous year.</td>
<td>Premium or Discount to be amortised over the period of contract. Exchange difference to recognised on the last day of previous year.</td>
</tr>
<tr>
<td>Firm commitment <strong>not</strong> having underlying Asset on last day of year</td>
<td>Not dealt by AS – 11</td>
<td>Premium or Discount and exchange difference to be recognised at the time of settlement</td>
</tr>
<tr>
<td>Highly Probably Transaction</td>
<td>Not dealt by AS – 11</td>
<td></td>
</tr>
<tr>
<td>Trading or Speculative Transaction</td>
<td>Marked to Market gain or loss to be recognised on Balance Sheet date</td>
<td></td>
</tr>
</tbody>
</table>

April 19, 2017  

Bansi S. Mehta & Co
ICDS VI – Effects of changes in foreign exchange rates – Analysis (contd…)

Q. 16 of FAQ - What is the taxability of opening balance as on 1st day of April 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognised as per Accounting Standards (AS) 11?

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.
ICDS VII – Government Grants
ICDS VII – Government Grants – Analysis

- Whether recognition of government grant cannot be postponed beyond the date of actual receipt?
  - Accounting Standard –
    - Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled (AS-12, para 6.1)
  - Committee Report –
    - To reduce litigation and to provide certainty
  - ICDS
    - Para 4(2)- Recognition of Government grant shall not be postponed beyond the date of actual receipt.
  - Judicial Pronouncement –
    - Real income concept – whether given a go-by?
ICDS VII – Government Grants – Analysis (contd…)

- Definition of income amended in section 2(24)(xviii) - inserted w.e.f 1.4.2016
- Cases of Carbon credits and discount of pre-payment of sales tax subsidy – not affected
- Subsidy received prior to 1 April 2016, but not recognized in books pending satisfaction of related conditions and achieving reasonable certainty of receipt, how shall the same be recognized under ICDS on or after April 1, 2016?
  - Q. 17 of FAQ - Grants to continue to be governed by the provisions of law applicable prior to 1 April, 2016
ICDS VIII – Securities
ICDS VIII – Securities – Part A – Overview

- What would be the major impact of ICDS on securities, will it apply to NBFC?
  - NBFC has not been specifically excluded, hence ICDS will apply
  - Comparison of cost or NRV has to be done category wise not individual asset wise

<table>
<thead>
<tr>
<th>Individual Security</th>
<th>Cost</th>
<th>NRV</th>
<th>Lower</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company P</td>
<td>150</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Company Q</td>
<td>150</td>
<td>45</td>
<td>45</td>
</tr>
<tr>
<td>Company R</td>
<td>150</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Company S</td>
<td>150</td>
<td>300</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td><strong>600</strong></td>
<td><strong>380</strong></td>
<td><strong>230</strong></td>
</tr>
<tr>
<td>Valuation (A.S.)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Valuation (under ICDS)</td>
<td></td>
<td></td>
<td>230</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>380</td>
</tr>
</tbody>
</table>
ICDS VIII – Securities – Part A – Overview (contd…)

What would be the major impact of ICDS on securities, will it apply to NBFC?

- Possible view 1 –
  - As discussed in ICDS-II, section 145A of the Act will override ICDS, hence normal accounting principle may be followed

- Possible view 2 –
  - Income of Rs.150 (380-230) has to be offered to tax in AY 2017-18
ICDS VIII – Securities – Part B – Overview (contd…)

- **Scope** -
  - Scheduled Bank
  - Public Financial Institution formed under Central or a State Act or so declared under the Companies Act, 1956/2013

- **Definition** -
  - Scheduled Bank shall have the meaning assigned to it in clause (ii) of the Explanation to section 36(1)(viia)
  - Securities shall have the meaning assigned to it in Section 2(h) of the Securities Contract (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested
ICDS VIII – Securities – Part B – Overview (contd…)

- Classification, Recognition and Measurement – Para 3
  - Securities shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account. To this extent, the provisions of Income Computation and Disclosure Standard VI on the effect of changes in foreign exchange rates relating to forward exchange contracts shall not apply.”
ICDS IX – Borrowing Costs
ICDS IX – Borrowing Costs – Analysis

- Would there be any timing difference between AS and ICDS for cessation of capitalization of borrowing cost?
  - Accounting Standard –
    - When asset is ready to use
  - Committee Report –
    - Wordings have been changed to align with the provisions of the Act
  - ICDS –
    - When asset is put to use
  - Possible view –
    - Though in common parlance both the words have different meaning, but courts have consistently taken a view that ready to use, means put to use for Income Tax purposes
ICDS IX – Borrowing Costs – Analysis (contd…) 

- Whether general borrowing costs should be attributed to cost of inventory of real estate?
  - Accounting Standard –
    - Borrowing cost on inventory taking at least 12 months needs to be added to cost.
  - ICDS –
    - Same as accounting standard
  - Section 36(1)(iii) -

  “the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession:

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.”
ICDS IX – Borrowing Costs – Analysis (contd…)

- Possible view –
  - Express provision of the Act shall override ICDS
  - Interest is a period cost u/s 36(1)(iii) and unless specific borrowing for capital asset, expense has to be allowed.
  - Lokhandwala Construction Inds. Ltd. 260 ITR 579 (Bombay HC) – will still hold good.
    - Note:- special bench in case of Wall Street Construction Ltd. (5 SOT 103) had held against the aforesaid proposition in case of stock in trade. Reliance was placed on Bombay High Court decision Taparia Tools. However the aforesaid decision has been reversed by Supreme Court (372 ITR 605)
  - Calcutta High Court in Cellice Developers Pvt Ltd in (231 Taxman 255) has followed the Bombay High Court decision as held in 260 ITR 579
ICDS IX – Borrowing Costs – Analysis (contd…) 

- Cost disallowed under specific provisions of the Act, to be excluded from borrowing costs covered to be capitalized under ICDS-IX?
  - Since specific provisions of the Act override the provisions of ICDS, borrowing cost capitalized under ICDS-IX shall exclude those borrowing costs which are disallowed under specific provisions under the Act (Q No 21 of FAQ)

- Bill discounting charges and other similar charges are covered as borrowing cost (Q No 21 of FAQ)

- How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS-IX to different qualifying assets?
  - The capitalisation of general harrowing cost under ICDS-IX shall he done on asset-by-asset basis. (Q No 22 of FAQ)
ICDS X – Provisions, Contingent Liabilities and Contingent Assets
ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Overview

- Scope:
  This ICDS deals with provisions, contingent liabilities and contingent assets, except:
  (a) financial instruments;
  (b) executory contracts;
  (c) insurance business;
  (d) provision for doubtful debts

- A provision shall be recognised when:
  - present obligation arising out past event;
  - it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle obligation; and
  - a reliable estimate of the obligation could be made.
ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Analysis

- Whether ICDS will have any impact on Provision on Warranty?
  - Accounting Standard –
    - Provision of warranty can be recognised.
  - Judicial Pronouncement –
    - Supreme Court has upheld the allowance of provision for warranty in case of Rotork Controls v CIT 314 ITR 62 (SC)
  - ICDS –
    - Requires recognition of provision when it is reasonably certain that an outflow of resources embodying economic benefits would be required to settle the obligation.
ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Analysis (contd…)

Will ICDS impact current treatment of contingent asset?

- Accounting Standard –
  - Requires recognition when there is virtual certainty of inflow of economic benefits.

- Committee Report –
  - To remove differential treatment between recognition of income and expense.

- Judicial Pronouncements –
  - Basic concept of accrual & real income theory

- ICDS –
  - Requires recognition of contingent asset if it becomes ‘reasonably certain’ that inflow of economic benefit will arise.
Under Ind AS, long-term provisions have to be recognized at amortised cost (i.e., at their present value);

ICDS - Para 12 – Amount of a provision cannot be discounted to its present value. Hence, adjustment made in Ind AS has to be reversed while computing tax under ICDS
Clarifications issued by CBDT

- Expenditure on most post-retirement benefits like provident fund, gratuity, etc. are covered by specific provisions. There are other post-retirement benefits offered by companies like medical benefits. Such benefits are covered by AS-15 for which no parallel ICDS has been notified. Whether provision for these liabilities are excluded from scope of ICDS X?

  It is clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with By ICDS-X. (Q No. 24 of FAQ)
THANK YOU