

Income Computation And Disclosure Standards (ICDS)

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Background

History

- Section 145 substituted by the Finance Act, 1995.
- Section 145(1) – Use of hybrid method of accounting became impermissible.
- Section 145(2) – Empowered the Government to notify accounting standards.
- Two accounting standards were issued.
- Committee appointed in July 2002 for formulation of Accounting Standards.
 - Recommended notification of AS of ICAI and amendment of IT Act where necessary.

Another Committee in 2010

- Harmonisation of AS issued by ICAI with tax laws & which AS should be adopted v/s
- Method of determination of book profits for MAT under Ind AS accounts.
- Suggest amendments to the Act in view of Ind AS accounts

Interim Report August 2011 – Recommendations

- Separate AS under 145(2) with specific rules to bring about clarity and eliminate alternatives.
- AS (TAS) to be notified only for computation of income and not for maintenance of books of account.
- TAS should apply only to those following mercantile system of accounting
- TAS are meant to be in harmony with the Act, provisions of the Act will prevail.
- Drafts of two ICDS provided.

Final Report August 2012

- Did not deal with impact of Ind AS on book profits
- Drafts of 14 TAS
- Recommended TAS for share based payment Revenue Recognition for Real Estate Developers, Service Concession Agreements, Exploration for Mineral Resources.

Subsequent Events

- Amendment of S.145 – Finance (No 2) Act, 2014
 - Term ‘Income Computation and Disclosure Standards’ introduced
- March 2015 – 10 ICDS notified
- September 2015 – Rescinded original ICDS and notified Revised ICDS

Applicability

- Person following Mercantile system of accounting
- Not applicable to individuals and HUFs are not covered by S.44AB
- No floor limit for applicability for other assessees
- Applicability to Individuals/ HUFs under Presumptive taxation
 - Assessee eligible and opting for
 - Assessee eligible but opting out
- Applicability to other assessees under Presumptive tax
 - S. 44AD, 44ADE, 44BB, 44BBA, 44BBB effectively exclude operation of S. 28 to 43 CA
 - No specific exclusion from application of ICDS
 - Question 3 of clarification dt. 23rd March, 2017

- Applicability to Non- residents
 - Applies to irrespective of residential status
 - Non-residents under presumptive tax
 - Non-residents to whom flat rate of tax applies u/s 115A
 - Non-residents claiming benefit of DTAA
 - Question 14 of clarification dt. 23rd March, 2017

Some Issues

- ICDS not applicable for maintaining books of account
- Reconciliation for the purpose of Tax Audit
- Amendments to Form 3CD – Details of adjustments and disclosures
- ICDS and TDS
 - Allowability of expenditure and obligation to deduct tax may be in different years.

- ICDS and Exemption u/s 11 to 13
 - Computation of exemption u/s 11 is on commercial concept of income.
 - Charitable organization losing exemption
- Turnover for s. 44AB
 - As per books or as per ICDS?
- Amendments to the Act for aligning with ICDS
 - Income s. 2(24) – clause (xviii) inserted – government grants
 - Interest s. 36(1)(iii) – for extension of existing business or profession omitted
 - Bad Debts s. 36(1)(vii) second proviso inserted - ‘deemed written off’ for debts considered as income without entry in books.

Impact of ICDS on judicial rulings

- Courts do not make law but only interpret law
- Judicial decisions based on GAAP or AS
- Judicial decisions – where Act amended
- Rulings laying down basic principles and interpreting tax provisions.
- Question 2 of the classification dated 23rd March, 2017

- ICDS vs Rules
 - ICDS and Rules both notified by the CG
 - ICDS VI is subject to s. 43A and Rule 115
 - Question 4 of the clarification dated 23rd March, 2017
- ICDS vs Circulars, Press Releases
- ICDS and MAT, AMT
 - Question No. 6 of the classification dated 23rd March, 2017
- AS as aid in interpreting ICDS

ICDS-I: Accounting Policies

Scope

- Significant policies applied while computing income under two heads.
- Term 'significant' not defined.

'Accounting Policies' – A misnomer ?

- ICDS do not apply in maintenance of books of account.
- ICDS 1 not merely a disclosure standard.
- Accounting policies should be regarded as 'computation policies'.
- Question 1 of Clarification dt 23rd March, 2017.

ICDS-I: Accounting Policies (contd.)

Fundamental Assumptions

- Going Concern
- Consistency
- Accrual

Accrual

- Revenues and costs accrue as they are earned or incurred.
- Definition in ICDS and accounting definition are on par.
- Section 5 outlines the scope of total income.
 - accrual
 - arisal
 - receipt

ICDS-I: Accounting Policies (contd.)

- Accrual' as judicially defined.
 - Right to receive with corresponding obligation to pay.
- ICDS definition should not alter meaning of accrual u/s 5.
- 145(1) is provision enabling the effectuating the change. 145 is in a sense machinery section.
- DCIT V. Nagarjuna Investment Trust 65 ITD 17 (Hyd SB)

ICDS-I: Accounting Policies (contd.)

Accounting Policies

- Accounting principles and methods of applying these principals.

Considerations in selection of Accounting Policies

- Represent true and fair view
- Substance over legal form
- Marked to market losses not to be recognised unless in accordance with other ICDS.

ICDS-I: Accounting Policies (contd.)

Substance Over Form

- Representing a legal form different from true economic reality of transaction
 - Not acceptable
- Judicial decisions holding 'form' can not be ignored
- Judicial decisions giving importance to substance over form

ICDS-I: Accounting Policies (contd.)

Marked to Market Losses

- TAS committees reasoning – Avoiding differential treatment form income and losses
- Supreme court decision in case of CIT v. Woodward Governor India (P) Ltd. 312 ITR 254
- Marked to Market Gains
- Question 4 of clarification dt 23rd March, 2017

Prudence & Materiality omitted – Significance.

- Prudence – Provision made for all known liabilities and losses through amount can not be determined with certainty.
 - ICDS I silent on liability – covered by ICDS X
 - Concept of prudence is part of section 37 – it allows provisions made for expenditure ‘laid out’.
- Materiality - Income computation was never governed by consideration of quantum

ICDS-I: Accounting Policies (contd.)

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ICDS-I: Accounting Policies (contd.)

- **ICDS vs Rules**

- ICDS and Rules both notified by the CG
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- **ICDS vs Circulars, Press Releases**

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ICDS-I: Accounting Policies (contd.)

- **Change of Accounting Policy**
 - Reasonable cause – not defined
 - Provisions of AS - comparison
 - Statutory, commercial, contractual compulsions
 - Question 9 of clarification dt. 23rd March 2017

ICDS-I: Accounting Policies (contd.)

Disclosure

- Significant policies adopted.
- Change in policies having material effect.
- Amount by which any item is affected
- If impact unascertainable – State the fact
- If material impact is expected in future year, the fact will be disclosed in
 - (I) year of change,
 - (II) year in which change has material impact for the first time.
- Disclosure does not remedy incorrect policy or change in policy.

ICDS-I: Accounting Policies (contd.)

- Fundamental accounting assumption need not be disclosed if followed.
- Question 25 of clarification dt 23rd March 2017

Transitional Provision

- Contracts or transactions existing on 01/04/2016
- Impact on MTM losses provided earlier.

ICDS II – Valuation of Inventories

- Based on AS – 2
- Scope
 - Generally, concept of ‘inventory’ relevant for business

Excludes:

- WIP arising under construction contracts
- Shares, debentures etc. covered by ICDS VIII
- Derivatives ?
- Producers’ inventory of livestock, agricultural and forest produce, mineral oils, ores and gases which are measured at NRV

ICDS II – Valuation of Inventories (contd.)

Excludes (contd.):

- Machinery Spares used in connection with tangible fixed assets
- WIP covered by other ICDS

Inventories

- Held for sale in ordinary course of business
- In the process of production for such sale
- In the form of materials & supplies to be consumed in the production process or in the rendering of services

ICDS II – Valuation of Inventories (contd.)

Measurement

- Inventories shall be valued at cost, or NRV, whichever is lower
- Cost of Inventories
 - Costs of purchases
 - Costs of services
 - Costs of conversion and
 - Other costs incurred in bringing the inventories to their present location and condition.

ICDS II – Valuation of Inventories (contd.)

- Costs of Purchases
 - Recoverable taxes and duties to form part of cost. (Section 145A)
 - Freight inward and other directly attributable expenditure
 - Impact of para 25 of Revised AS 2, para 8 of Ind AS 2
- Costs of Services (Absent in AS - 2)
- Costs of Conversion & Other Costs: As per AS – 2
 - Actual level of production when approximates to normal capacity

ICDS II – Valuation of Inventories

Cost of Services

- Includes:
 - Labour and other costs of personnel directly engaged in providing services
 - Supervisory personnel
 - Attributable overheads
- **Other Costs**
 - Incurred in bringing the inventories to their present location and condition.
 - Interest
- **Joint products, by-products, scrap**

ICDS II – Valuation of Inventories

Exclusions

- Abnormal waste of material, labour and other costs
 - Storage costs
 - Administrative overheads
 - Selling costs
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- Considering ICDS on Revenue Recognition, this ICDS will not cover WIP of service providers

ICDS II – Valuation of Inventories

Cost Formulae

- Specific identification
- Permits FIFO and Weighted Average Cost Method
- “Fairest Possible Approximation” – Concept of `Materiality’ built-in

ICDS II – Valuation of Inventories

Techniques for measurement

- Standard Costing
 - Takes into account normal levels of consumption, efficiency and capacity utilisation
 - Results approximate the actual cost
 - Nature of variance analysis & adjustments made
- Retail Method

ICDS II – Valuation of Inventories

Net Realisable Value

- Estimated selling price in the ordinary course of business less estimated cost of completion and estimated costs necessary to make the sale

Measurement

- On item by item basis
- Evidence available at the time of valuation
- Materials & supplies held for production

ICDS II – Valuation of Inventories

Value of Opening Inventory

- Para 22 of ICDS II deems cost of inventory available on the commencement of business as Opening Inventory
- Conversion of a Capital Asset into Stock in Trade
 - Provisions of section 45(2) of the Act.
 - Difference in original cost & FMV on conversion date taken as consideration for capital gains

ICDS II – Valuation of Inventories

Value of Opening Inventory

- Conversion of a Capital Asset into Stock in Trade (Contd.)
 - Ratio of decision of SC in Bai Shirinbai K. Kooka (1962) 46 ITR 86
 - Cost to business
 - Double taxation not possible
- Specific provisions of the Act – S. 43C
- Property in respect of which tax has been paid u/s 56(2)

ICDS II – Valuation of Inventories

- Change in Method of Valuation
 - “Reasonable Cause” for the purpose of change in method of valuation of inventories.
- Dissolution of Partnership, AOP & BOI
 - Valuation to be done only at Net Realisable Value
 - Impact.
 - A. L. A. Firm v. CIT 189 ITR 285(SC)
 - Sakthi Trading Co. v. CIT 250 ITR 871 (SC)

ICDS II – Valuation of Inventories

- Transitional Provision
 - Interest & other borrowing costs included in cost of inventory as on 1st day of April, 2015 will continue to remain included on 31st March, 2016 if inventory items remain in stock.

ICDS II – Valuation of Inventories

Disclosure

- Accounting Policy adopted
 - If standard costing used – confirmation that cost approximates actual cost
 - Total amount and classification

ICDS II – Valuation of Inventories

- Other issues:
 - ICDS II is in sync with section 145A
 - Care should be taken to compare & reconcile reporting in clause 14(b) of form 3CD with valuation under ICDS II

Audit Considerations

- Disclosure in ITR forms 3, 5 and 6
- Disclosure in form 3CD - Clause 13(d), (e) and (f)
 - Notification No.88 /2016, F.No.133/23/2015-TPL, dated 29.9.16 has modified Form 3CD

Thank You
