WESTERN INDIA REGIONAL COUNCIL OF
THE INSTITUTE OF
CHARTERED ACCOUNTANTS OF INDIA

INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

CA VYOMESH PATHAK

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BACKGROUND OF ICDS

BACKGROUND

ICDS

- 10 ICDS notified by the Government w.e.f. **1 April 2016** i.e. from **FY 2016-17** onwards
- Applicable to all taxpayers following **mercantile system** of accounting for income under **PGBP** and **Other sources**
  - **Exception** – Individuals / HUFs not required to obtain tax audit report
- **No separate books** of account required under ICDS
- Meant only for **normal tax** computation and **not for MAT**

WHY ICDS BY GOVERNMENT

- Availability of **alternative accounting treatments** leading to varying / different **tax** positions
- Taxman's view – **'Early expense' / 'late revenue'** due to accounting choice, in cases where Act does not deal with the situation

ICDS – Government's attempt to bring uniformity and clarity in computation of income

Key Impact Areas of ICDS

KEY IMPACT AREAS OF ICDS

ACCOUNTING POLICY

- **Concept of 'Prudence' diluted** – No expected / MTM losses permitted
- **Substance over Form** – Align treatment to substance, not legal form
- **Mandatory disclosure** – All accounting policies and their impact
- **Disclosure does not remedy wrong tax treatment**

Absence of 'Prudence' to impact expense claims

KEY IMPACT AREAS OF ICDS

REVENUE RECOGNITION

- **Percentage of Completion** (POCM) **mandatory** for services > 90 days
- **Completed Contract Method not permitted** for construction contracts
- **Retention money taxable** under POCM
- **Certainty of collection –** not relevant for interest income, which shall accrue on time basis
- **Interest** on tax refunds taxable on **'receipt' basis**
- **Government Grants** – Taxable as revenue receipts unless given for depreciable asset

Revenue recognition significantly impacted in various cases

KEY IMPACT AREAS OF ICDS

FOREX FLUCTUATION

- **Exchange difference on monetary items** to be recognized as income / expense on settlement / conversion thereof on the last day of FY
  - Subject to section 43A / Rule 115
- **Premium / discount on forward exchange contract** to be amortized over life of the contract
- **Exchange difference on such contracts** to be recognized as income / expense
  - **Contracts to hedge forex risk of firm commitment / highly probable forecast transaction** - recognition on actual settlement

KEY IMPACT AREAS OF ICDS

BORROWING COST

- Borrowing cost **attributable to acquisition / production of 'qualifying asset'** to be capitalized

- **General borrowing cost** – Capitalization = Borrowing costs x $\frac{\text{Cost of Qualifying Asset}}{\text{Total Assets}}$

- **Capitalization to cease** when asset put to use

KEY IMPACT AREAS OF ICDS

PROVISIONS

- **Change in criteria** to recognize provisions
- **'Reasonable certainty'** (ICDS) **vs. 'Probable certainty'** (IGAAP) of outflow
- No recognition of **contingent assets / liabilities**

Deducibility of provisions to impact expense claims

WRIT PETITION- PETITIONER'S CASE

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Petitioner's Case

- Effect of ICDS is to **modify basis of taxation**
- **Basis of taxation can be changed only by Parliament** by amending the Act
  - CG cannot do so through ICDS
- ICDS **contrary to several SC / HC decisions**
- ICDS **not applicable to assessees following cash system of accounting** – violative of A.14 of Constitution
- ICDS cast **additional compliance burden / restrictions on assessees** – violative of A.19(1)(g) of Constitution

DELHI HIGH COURT RULING

DELHI HIGH COURT RULING

Key findings of the Delhi High Court

- Power to **enact validation law** vests with the **Parliament** and not the **Central Government** and such enactment can be made by an **amendment** to the statute
- ICDS has the effect of modifying the basis of COI as recognized by Act / courts
- ICDS cannot overrule the provisions of Act, Rules and judicial precedents
- Section 145(2) should be read down to the extent it is ultra vires the Act and Article 141, 144 and 265 of the constitution

DELHI HIGH COURT RULING

Key findings of the Delhi High Court

- <u>Provisions of ICDS struck down / watered down</u>
  - × **ICDS I (Accounting Policies)** – **unsustainable in law,** since it has done away with the concept of **'Prudence',** which is contrary to the Act and judicial precedents
  - × **ICDS II (Valuation of Inventories)** – Court annulled the provision, which eliminated distinction between a continuing partnership and discontinued partnership, after dissolution
  - × **ICDS III (Construction Contracts)**
    - – Incidental income not allowed as reduction from borrowing cost, contrary to SC decision in Bokaro Steel and is unsustainable to that extent
    - – Taxing retention money which is uncertain/ conditional is contrary to Judicial precedents; hence impermissible

DELHI HIGH COURT RULING

Key findings of the Delhi High Court

- **ICDS IV (Revenue Recognition)**
  - Impermissibility of completed contract method for revenue recognition held to be ultra vires the Act and struck down
  - Taxation of export incentive upon reasonable certainty of collection contrary to SC decision in Excel Industries; struck down
- **ICDS VI (Effects of changes in foreign exchange rates)** – **Not allowing MTM losses** in case of foreign currency derivatives held for trading/ speculation **and taxation of opening balance of FCTR on monetary items is ultra vires** the judicial decisions
- **ICDS VII (Government Grants)** – Taxation of unaccrued subsidy / grant on the date of actual receipt is ultra vires the tax laws
- **ICDS VIII (Valuation of Securities)** – Part A which prescribes bucket approach for taxpayers not governed by RBI, is ultra vires the tax laws

Interest accrual for NBFC as per ICDS IV held to be valid

Retrospective Amendment by Finance Act, 2018

Snapshot of Amendments by Finance Act, 2018

Sr. No.	Relevant ICDS	Relevant Section	Relevant amendment
1	ICDS I	36(1)(viii)	• Deduction for Marked to Market Loss or other expected loss to be in accordance with ICDS
2	ICDS II and ICDS VIII	145A	• Inventory shall be valued at the lower of cost or net realizable value whichever is lower which is line with the valuation method as provided in ICDS II; • Inventory in nature of securities is to be valued in line with ICDS VIII “ Securities”.
3	ICDS III and ICDS IV	43CB	• Income from a construction as well as service contracts on the basis of percentage completion method; • Contract revenue to include retention money; • Incidental income in nature of interest, dividend or capital gains shall not be reduced from the cost

Snapshot of Amendments by Finance Act, 2018

Sr. No.	Relevant ICDS	Relevant Section	Relevant amendment
4	ICDS IV and ICDS VII	145B	• Interest received on compensation or enhanced compensation – deemed to be the income of the year in which it is received; • Claim for escalation price or export incentives – Year in which a reasonable certainty of realisation is achieved; • Income from a subsidy, grant, cash incentive, duty drawback, waiver, concession – taxable in the year of receipt, if not charged to tax in any earlier previous year.
5	ICDS VI	43AA	• Any foreign exchange gain or loss in respect of specified foreign currency transactions shall be treated as income or loss, if computed according to ICDS VI

Provisions of ICDS legalised in the Finance Act, 2018 (1/2)

Provisions of ICDS [1]	Delhi High Court Ruling [2]	Finance Act, 2018
Revenue Recognition		
• ICDS III (Construction Contract and related services) ICDS IV (service contracts) - Revenues recognition on POCM basis • Contract duration does not exceed 90 days in – Option to follow PCM; • Contract involving indeterminate number of acts over specified period– SLM; • Contract revenue to include retention money; • Incidental income like interest, dividend or capital gains not to be reduced from contact cost;	• To the extent provisions of ICDS IV permit only POCM and do not allow PCM as upheld by judicial precedents, are ultra vires and struck down. • To the extent ICDS III, taxes retention money which is uncertain or conditional are ultra vires and struck down.	• New section 43CB introduced upholding the revenue recognition from construction and service contracts in the manner as provided by ICDS III and IV

Deferring of taxability of retention money based on real income theory relying on judicial precedents no longer available

Provisions of ICDS legalised in the Finance Act, 2018 (2/2)

Provisions of ICDS [1]	Delhi High Court Ruling [2]	Finance Act, 2018
Mark to market loss on forward exchange contract ('FEC')		
• Premium or discount and exchange difference on FEC for trading and speculation purposes and FEC to hedge firm commitments – to be recognised on only on settlement • Premium or discount on other FEC to be amortised over the period of FEC and MTM loss to be recognised on year end basis	• Since disallowance of MTM gain/ loss on FEC for trading and speculation purposes is not in consonance of Supreme Court decisions, such provision is struck down	• Introduction of sub-section (xviii) to section 36 permitting deduction of MTM loss in accordance with ICDS; • Thus no MTM loss shall be allowed based on accounting principles and judicial precedents;
Valuation of Inventory		
At cost or NRV whichever is lower	• No observation for valuation of inventory in normal course of business	Cost or NRV whichever is lower – Possibly no impact

- **Escalation in price in contract shall be taxable in the year of reasonable certainty of its realisation**
- **Compensation or enchased compensation shall be taxable in the year of receipt**

1 Notified by CBDT vide notification dated 29 September 2016 under Section 145(2) of the Act
2 The Chamber of Tax Consultants v Union of India W.P.(C) 5595/2017 & CM APL 23467/2017
3 Sutlej Cotton Mills Limited v. CIT [1979] 116 ITR 1 (SC)

NOTIFIED ICDS

Notified ICDS

ICDS	Income Computation and Disclosure Standards	Equivalent AS	Equivalent IND AS
ICDS I	Accounting Policies	AS-1	IND AS-1 and 8
ICDS II	Valuation of Inventories	AS-2	IND AS-2
ICDS III	Construction contracts	AS-7	IND AS-115
ICDS IV	Revenue Recognition	AS-9	IND AS-115
ICDS V	Tangible Fixed Assets	AS-10	IND AS-16
ICDS VI	Effects of Changes in Foreign Exchange Rates	AS-11	IND AS-21
ICDS VII	Government Grants	AS-12	IND AS-20
ICDS VIII	Securities	AS-13	IND AS-32
ICDS IX	Borrowing Costs	AS-16	IND AS-23
ICDS X	Provisions, Contingent Liabilities and Contingent Assets	AS-29	IND AS-37

ICDS- An Overview

- ✓ **Applicable to 'All' assesses following mercantile basis of accounting – Except individuals and HUFs not liable to Tax Audit u/s 44AB of the Act**
- ✓ **Applicable for computation of income chargeable to income-tax under the head 'Profits and gains from business or profession' or 'Income from other sources'**
- ✓ **Applicable from AY 2017-18 – quarterly tax provision and advance tax as per ICDS to avoid interest**
- ✓ **Lay down certain rules to ensure certainty and clarity - eliminate alternatives to the extent possible**
- ✓ **Current Accounting Standards are taken as a base - however the objective was to provide an independent framework for tax computation**
- ✓ **Separate books of account not required to be maintained**
- ✓ **Various disclosure requirements – silent about the placement of various disclosures e.g. financial statements (separately), computation of income or return of income, etc.**

In case of conflict between the provisions of the Act and ICDS, the provisions of the Act shall prevail to that extent

ICDS - Key Impact Areas

Can ICDS go beyond the meaning of 'income', as defined and understood?

- ✓ In the scheme of the Act, income is identified or recognized or determined as per the provisions of S. 4, 5, 14 and Chapter IV as well as definition of 'income'

- ✓ The recording of income and the method to be adopted in the books of account are provided in S. 145, a procedural provision
  - The method of accounting, inter-alia, involves quantification
  - ICDS deals only with quantification and disclosure
  - Its scope and ambit is limited and not as wide as AS & GAAP
  - ICDS recognize the above in its nomenclature, preamble and otherwise

- ✓ Revenue authorities may contend that ICDS being in relation to 'income computation', it is framed to give effect to the provisions of S. 29
  - Possible to contend that ICDS is a child of S. 145 and not Chapter IV

- ✓ ICDS can be said to override at least quantification of income or expenditure, where a specific provision is made for determination of amount thereof

Identification & recognition as income ought to be decided by the provisions of the Act and not ICDS

ICDS - Key Impact Areas

Whether SC decisions are affected by ICDS?

- ✓ Article 141 of the Constitution of India provides that the law declared by SC shall be binding on all Courts in India
  - The SC explains the provision of the Act
- ✓ All SC decisions dealing with identification, recognition, determining the nature of receipt, etc. in some cases should continue to govern the computation of total income
  - ICDS may apply in respect of quantification of income
- ✓ ICDS may have impact on those decisions which relied on commercial principles and accounting practices then followed e.g.:
  - Woodward Governor India Private Limited [(2009)(312 ITR 254)(SC)]

ICDS should not affect the principles laid down by SC decisions unless impacted by the retrospective amendment– except those decisions which relied on commercial principles and accounting practices then followed

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 2 : Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?**

- 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.

ICDS - Key Impact Areas

What if the provisions of ICDS are not complied with?

✓ **Section 145(3)-**

If income has not been computed in accordance with the ICDS , then the Assessing Officer may make an assessment in the manner provided in section 144 i.e. **Best Judgment Assessment**.

Specimen for computing income under ICDS regime

Particulars	Amt	Amt
Profits and Gains from Business or Profession	XXX	
Add/ Less: Adjustments as per ICDS	xxx	
Add/ Less: Adjustments as per the provisions of the Act	xxx	
Net PGBP		XXX
Income from Other Sources	XXX	
Add/ Less: Adjustments as per ICDS	xxx	
Add/ Less: Adjustments as per the provisions of the Act	xxx	
Net IFOS		XXX
Total		**XXX**

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 3 : Does ICDS apply to non-corporate taxpayers who are not required to maintain books of account and/or those who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc. of the Act?**

- 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 case may be.

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 4 : If there is conflict between ICDS and other specific provisions of the Income-tax rules, 1962 (‘the Rules’) governing taxation of income like rules 9A, 9B etc. of the Rules, which provisions shall prevail?**

- ICDS provides general principles for computation of income. In case of conflict, if any, between the provisions of Rules and ICDS, the provisions of Rules, which deal with specific circumstances, shall prevail.

ICDS – FAQs issued by CBDT on 23 March 2017

- ✓ **Question 5 : ICDS is framed on the basis of accounting standards notified by Ministry of Corporate Affairs (MCA) vide Notification No. GSR 739(E) dated 7 December, 2006 under section 211(3C), of erstwhile Companies Act, 1956. However, MCA has notified in February, 2015 a new set of standards called 'Indian Accounting Standards' (Ind-AS). How will ICDS apply to companies which adopted Ind-AS?**

  - ICDS shall apply for computation of taxable income under the head " Profit and gains of business or profession" or "Income from other sources" under the Income-tax Act. This is irrespective of the accounting standards adopted by companies i.e. either Accounting Standards or Ind-AS.

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 6 : Whether ICDS shall apply to computation of Minimum Alternate Tax (MAT) under section 115JB of the Act or Alternate Minimum Tax (AMT) under section 115JC of the Act?**

- MAT under section 115JB of the Act is computed on 'book profit' that is net profit as shown in the Profit and Loss Account prepared under the Companies Act subject to certain specified adjustments. Since, the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, the provisions of ICDS shall not apply for computation of MAT.
- AMT under section 115JC of the Act is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act. Hence, the provisions of ICDS shall apply for computation of AMT.

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 7 : Whether the provisions of ICDS shall apply to Banks, Non-banking financial institutions, Insurance companies, Power sector, etc.?**

- The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. For example, ICDS VIII contains specific provisions for banks and certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business.

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 14 : Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents under section 115A of the Act.?**

- Yes, the provisions of ICDS shall also apply for computation of these incomes on gross basis for arriving at the amount chargeable to tax.

ICDS II – Valuation of Inventories

Scope of ICDS II – Valuation of Inventories

Inventories defined as assets

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

Exclusions

- WIP under construction contract / other ICDS,
- Shares, debentures and Financial instrument held as stock-in-trade
- Producer’s Inventories of livestock, agriculture, etc to the extent measured at NRV
- Machinery spares which can be used in connection with Tangible Assets – irregular in use

Permitted valuation methods

- FIFO, weighted average, retail method or specific identification method
- Re-introduction of standard costing method

Scope of ICDS II – Valuation of Inventories

Other key points

- Lower of cost or NRV – goods as well as services
- Method of valuation once adopted cannot be changed without reasonable cause
- Distribution cost excluded
- Cost of services in case of service provider to include cost of labour, supervision, personnel and attributable overheads
- In case of newly commenced business, cost of inventory on the date of commencement of business shall be the opening inventory
- Value of Opening inventory to be same as the value of closing inventory of the immediate preceding year

Prospective from the date of transition
Transition provision only to the extent of borrowing cost

Position Pre and Post ICDS

Pre ICDS

- No concept of valuation for services
- Judicial precedents – both sides - opening stock could / could not be adjusted in case of change in method of valuation of closing stock
- Judicial precedents permitted *bonafide* change of method if it is as per AS and regularly followed

Post ICDS

- Services to be valued at lower of Cost or NRV
- Distribution cost excluded
- Value of Opening stock to be same as the value of closing stock of the immediate preceding year - *Tax impact in the year of change of inventory valuation*
- No change permitted without reasonable cause –

  Reasonable cause not defined - could create ambiguity

Issues

Issue 1

- Valuation of inventory for service industry – No clarity?

Issue 2

- Section 145A of the Act overrides Section 145 (ICDS) of the Act
- Section 145A states that stock valuation to be done as per method of accounting regularly followed
- Taxpayers regularly following any other method for valuation of inventory – Can this be continued post ICDS relying on Section 145A?

Section 145A

Method of accounting in certain cases.

145A. 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

  (ii) further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

- Explanation.—For the purposes of this section*, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment;
- (b) 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.

Valuation of Inventories in case of service providers

AS- 2	ICDS
• AS-2 does not include Work in Progress ('WIP') arising in the ordinary course of business ***of service providers.***	• Specifies that it does not apply to WIP which is dealt with by other ICDS.

- Valuation of service inventory to be the lower of cost or NRV.
- Cost to include labour and other costs of personnel directly engaged in providing services including supervisory personnel and attributable overheads.
- Difficulty would arise in case of services whose chargeability depends on the success of the service.

Valuation of Inventories in case of Dissolution of Firm/AOP/BOI

- According to ICDS II, 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 Realizable Value***.

- This is unfair particularly as there is no specific provision for allowing such NRV as the cost to the successor of the business.

- Also this is contrary to law settled by Apex court in the case of ***Sakthi Trading Co. v. CIT***

Case Laws discussed

A.L.A. Firm v. CIT [1991] 55 Taxman 497 (SC) / 189 ITR 285

- In cases of dissolution of firm, the stock-in-trade will have to be valued at the prevailing market price while preparing the accounts if the business of the firm is discontinued.

Sakthi Trading Co. v. CIT [2001] 118 Taxman 301 (SC) / 250 ITR 871

- If on dissolution of the firm the business is not discontinued, then, the ordinary principle of commercial accounting permitting valuation of stock-in-trade at Cost or Net Realizable value whichever is lower will apply.

Disclosure Requirements

- Accounting Policies adopted in measuring inventories including the cost formulae used;
- Where Standard Costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost; and
- The total carrying amount of inventories and its classifications appropriate to a person.

ICDS IX – Borrowing Cost

Scope of ICDS IX– Borrowing Cost

- **Borrowing Cost defined Interest and Other Costs incurred in connection with borrowing of funds and**

Includes

- Commitment Charges;
- Amortised amount of discounts or premiums;
- Amortised amount of ancillary costs; and
- Finance charges in respect of assets acquired under finance lease

Excludes

- Actual or imputed cost of owners' equity and preference share capital

Position pre-ICDS

- Provisions of Section 36(1)(iii)
  - Core Health Care Ltd (SC)
- Amendment to section 36(1)(iii) by Finance Act 2015
  - Words "for extension of existing business or profession" in the first proviso deleted
- Discount / upfront interest paid on issue of debentures
  - Madras Industrial Investment Corporation Ltd (SC)
  - Taparia Tools Limited (SC)
- Ancillary borrowing costs – stamp duty, registration fee, legal fee, etc.
  - India Cements Ltd (SC)

Provisions of ICDS IX

Recognition

- Borrowing costs directly attributable to acquisition, construction or production of a ”qualifying asset” to be capitalized
- **Qualifying asset -**
  - Land, building, machinery, plant or furniture, being tangible assets;
  - Know-how, patents copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets;
  - Inventories that require a period of 12 months or more to bring them to a saleable condition

Criteria of twelve months or more for its acquisition, construction or production for other than inventories applicable only in the case of General Borrowings

Provisions of ICDS IX

- Borrowing costs eligible for capitalization
  - Specific borrowing – actual borrowing costs incurred
  - General borrowing – amount to be determined as per prescribed formula
- Commencement of capitalization
  - Specific borrowing – from the date on which funds were borrowed
  - General borrowing – from the date on which funds were utilised
- Cessation of capitalization
  - Tangible / intangible assets – when the asset is first put to use
  - Inventory – when substantially all activities necessary to prepare it for intended sale are complete

Comparison of ICDS IX with AS 16

AS - 16	ICDS
<u>Commencement of Capitalisation:</u>	
The date of fulfilment of three conditions viz. incurrence of capex, incurrence of borrowing costs and preparatory activities are in progress	a) Specific borrowings – Date on which funds were borrowed b) General borrowings – Date on which funds were utilised

<u>Capitalisation period starts early under the ICDS as compared to AS 16</u>

Comparison of ICDS IX with AS 16

AS - 16	ICDS
<u>Method of Capitalisation- Specific Borrowing</u>	
Actual borrowing costs incurred on the borrowing during the period less any income from temporary investment of those borrowings	Actual borrowing costs incurred during the period on the funds borrowed

<u>Income from temporary deployment of unutilised funds from specific loans shall be taxable as Income from Other Sources under the ICDS</u>

Comparison of ICDS IX with AS 16

AS - 16	ICDS
Suspension of Capitalisation	
During extended periods in which active development of the asset is interrupted	ICDS IX does not contain any provision for suspension of capitalisation of borrowing cost

Borrowing cost incurred during the periods in which active development of the asset is interrupted also to be capitalised under the ICDS

Comparison of ICDS IX with AS 16

AS - 16	ICDS
<u>Cessation of Capitalisation</u>	
When substantially all activities necessary to prepare the qualifying asset for its intended use or sale are complete	• Qualifying Asset – when such asset is first put to use. • Inventory – when substantially all activities necessary to prepare it for its intended sale are complete

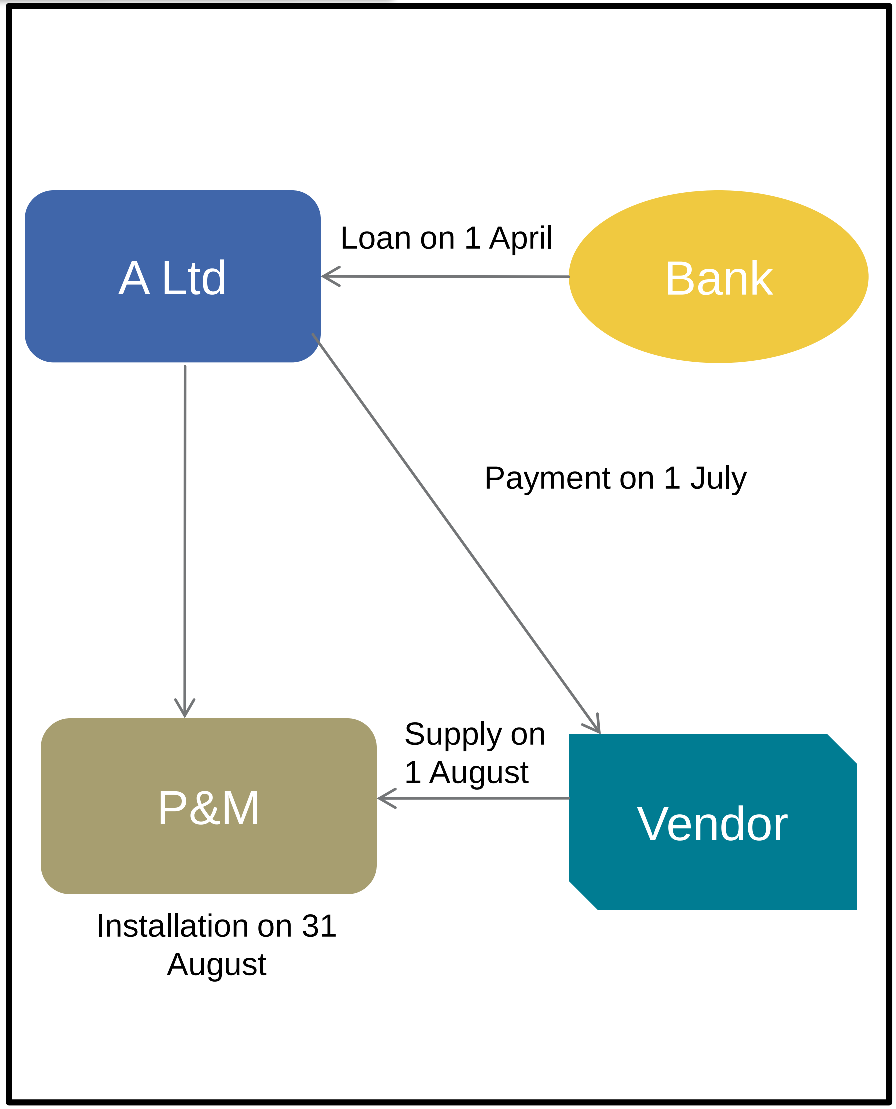
Potential issues

- Provisio to Section 36(1)(iii) refers only to "acquisition" of asset whereas ICDS refers to "acquisition, construction or production" of qualifying asset
- "Inventories" as per ICDS v/s. "inventories" as per the Act
- Supreme Court decisions v/s. provisions of ICDS
  - Discount / upfront interest on issue of debentures
  - Ancillary costs in relation to borrowing
  - Capitalisation of amortised amount??
- General borrowings
  - Availability of sufficient own funds - potential controversy similar to Rule 8D
  - Commencement of capitalisation not as per provisio to Section 36(1)(iii)
- Income from temporary investment of borrowed funds
  - Tuticorin Alkali Chemicals (SC)

Case Study

Facts

- A ltd is engaged in business of manufacturing of certain consumer products
- It desires to replace its P&M at its factory with a new one at total cost of INR 10 crs
- It borrows funds from the bank for this purpose on 1 April @ 12% p.a. interest
- Full payment is made to the vendor on 1 July
- For the period from 1 April to 30 June, funds invested in short term deposits @ 8% interest
- The machinery is supplied by vendor to the factory of A ltd on 1 August
- The machinery is installed on 31 August



Case Study

Tax treatment pre ICDS and pre amendment to 36(1)(iii)

- A ltd can claim full deduction for interest u/s 36(1)(iii)
- Interest not required to be capitalised in absence of 'extension of existing business'
- Interest on short term deposits taxable as 'income from other sources'

Tax treatment post ICDS and amendment to 36(1)(iii)

- All fixed assets considered as 'qualifying assets' warranting capitalisation of interest, irrespective of whether or not it is for 'extension of existing business'
- Therefore, A ltd required to capitalise interest from the date of specific borrowing (i.e. 1 April) till the asset is put to use, i.e (31 August), irrespective of the date of utilization being 1 July.
- Interest on short term deposits taxable as 'income from other sources'

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 20 : There arc specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a)(1), 40(a)(ia), 40A(2)(b), etc of the Act. Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under such specific provisions?**

- Since specific provisions of the Act override the provisions of ICDS, it is clarified that borrowing costs to be considered for capitalization under ICDS-IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act.

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **Question 21 : Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost?**

- The definition of borrowing cost is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing cost.

✓ **Question 22 : 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 capitalization of general borrowing cost under ICDS-IX shall be done on asset-by-asset basis.

Disclosure Requirements

- The accounting policy adopted for borrowing costs; and
- The amount of borrowing costs capitalised during the previous year.

Any Questions?

Questions

&

Answers

THANK YOU

CA VYOMESH PATHAK

MOBILE: +91 98202 53945

Disclosure in RoI for AY 2017-18

Part A- OI	Other Information (optional in a case not liable for audit under section 44AB)			
1		Method of accounting employed in the previous year	1	Mercantile
2		Is there any change in method of accounting	2	No
3		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]	3	0
4		Method of valuation of closing stock employed in the previous year		
	a	Raw Material (if at cost or market rates whichever is less write 1, if at cost write 2, if at market rate write 3)	4a	(Select)
	b	Finished goods (if at cost or market rates whichever is less write 1, if at cost write 2, if at market rate write 3)	4b	(Select)
	c	Is there any change in stock valuation method (Select)	4c	No
	d	Effect on the profit or loss because of deviation, if any, from the method of valuation prescribed under section 145A	4d	

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- Relevant changes in ITR Form – Form No. 3,5 (made available till date)
  - ✓ Part A-OI – Effect on the profit because of deviation as per ICDS
  - ✓ Separate sheet on ICDS – Effect of ICDS on profit (one item for each ICDS)

- However, no effect of such figure in Schedule of BP and OS? How to make the adjustment to the total income? In 'other adjustment' row
- Consolidated figure is required
- One should prepare a statement of ICDS disclosure in accordance with the disclosure requirements of each ICDS, which cannot be submitted with the ROI, but should be kept ready or should be made an annexure to the Form 3CD.
- Refer Q. 25 of the FAQs issued by CBDT

Schedule ICDS in RoI for AY 2017-18

Schedule ICDS	Effect of Income Computation Disclosure Standards on profit	
Sl. No.	ICDS	Amount
(i)	(ii)	(iii)
I	Accounting Policies	
II	Valuation of Inventories	
III	Construction Contracts	
IV	Revenue Recognition	
V	Tangible Fixed Assets	
VI	Changes in Foreign Exchange Rates	
VII	Government Grants	
VIII	Securities	
IX	Borrowing Costs	
X	Provisions, Contingent Liabilities and Contingent Assets	
XI	Total Net effect (I+II+III+IV+V+VI+VII+VIII+IX+X)	0

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Disclosure

Notification No. 88/2016 – Income-tax (23rd Amendment) Rules, 2016

- ✓ W.e.f 1.4.2017
- ✓ In Form 3CD, in part B, in clause 13, for sub-clause (d), the following clause shall be substituted.

(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)

Disclosure in Form No. 3CD for AY 2017-18

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

		Increase in profit (Rs.)	Decrease in profit (Rs.)	Net Effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
	Total			

Disclosure in Form No. 3CD for AY 2017-18

(f) Disclosure as per ICDS:

(i)	ICDS I-Accounting Policies
(ii)	ICDS II-Valuation of Inventories
(iii)	ICDS III-Construction Contracts
(iv)	ICDS IV-Revenue Recognition
(v)	ICDS V-Tangible Fixed Assets
(vi)	ICDS VII-Governments Grants
(vii)	ICDS IX Borrowing Costs
(viii)	ICDS X-Provisions, Contingent Liabilities and Contingent Assets".

Section 36(1)(iii)

***36.** (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—*

(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 for extension of existing business or profession (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.*

Formula for capitalization of general borrowing cost

A X B / C

Where,

A = borrowing costs incurred during the previous year except on borrowings directly relatable to specific purposes;

B =

(i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;

(ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day or both on the first day and the last day of previous year, half of the cost of qualifying asset;

(iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion,

Excluding the extent to which the qualifying assets are directly funded out of specific borrowings;

C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than those assets which are directly funded out of specific borrowings