

Income Computation and Disclosure Standards

ICDS-VI ,VII and VIII

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Discussion Points

- Basic Principles
- ICDS VI – The Effects Of Changes In Foreign Exchange Rates
- ICDS VII – Government Grants
- ICDS VIII - Securities

Basic Principles

- Applicable for computation of income chargeable under the head “profits and gains from business and profession” and “income from other sources”
- Revised ICDS notified on 29 September 2016 and the same are effective from FY 2016-17.
- Changes in the relevant ICDS vis a vis old ICDS
 - No classification of foreign operations into integral and non-integral
 - Definition of securities
 - Introduction of provisions for securities held by a scheduled bank

Introduction to ICDS

- CBDT has issued a circular number 10/2017 in March 2017 to clarify certain issues in relation to ICDS e.g.
 - overriding of judicial precedents,
 - applicability to presumptive scheme of taxation- Section 44 AD, Section 44AB
 - Treatment for MTM gains
 - Applicability of ICDS on Derivatives
 - ICDS is applicable only for computation of income under the normal provisions of the Act and not for computing MAT liability.

Constitutional validity of ICDS challenged

Disclosures on the impact of ICDS

- Disclosure of ICDS impact is to be made in the Tax Audit Report and the Income Tax Return Form.



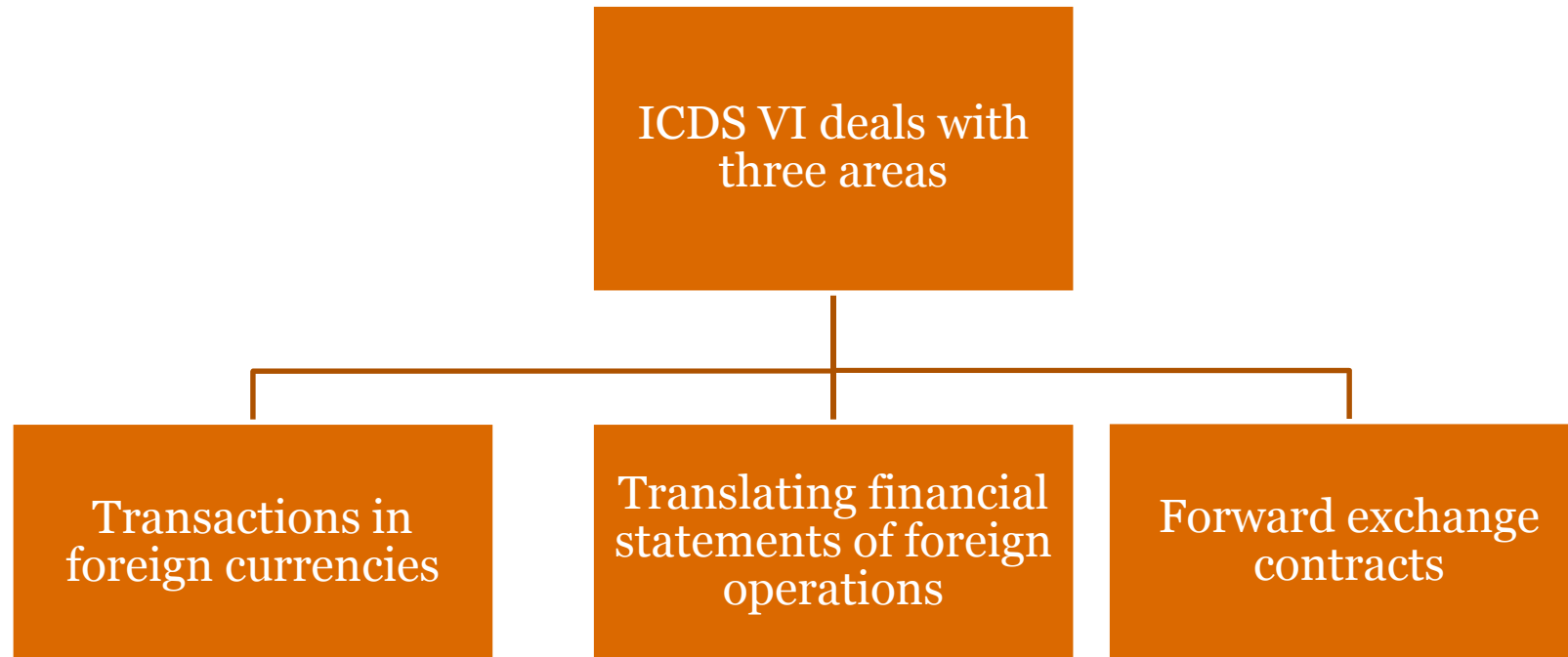
Tax Audit Report



ITR-6

ICDS VI- Effects of changes in Forex Rates

Scope of ICDS- VI



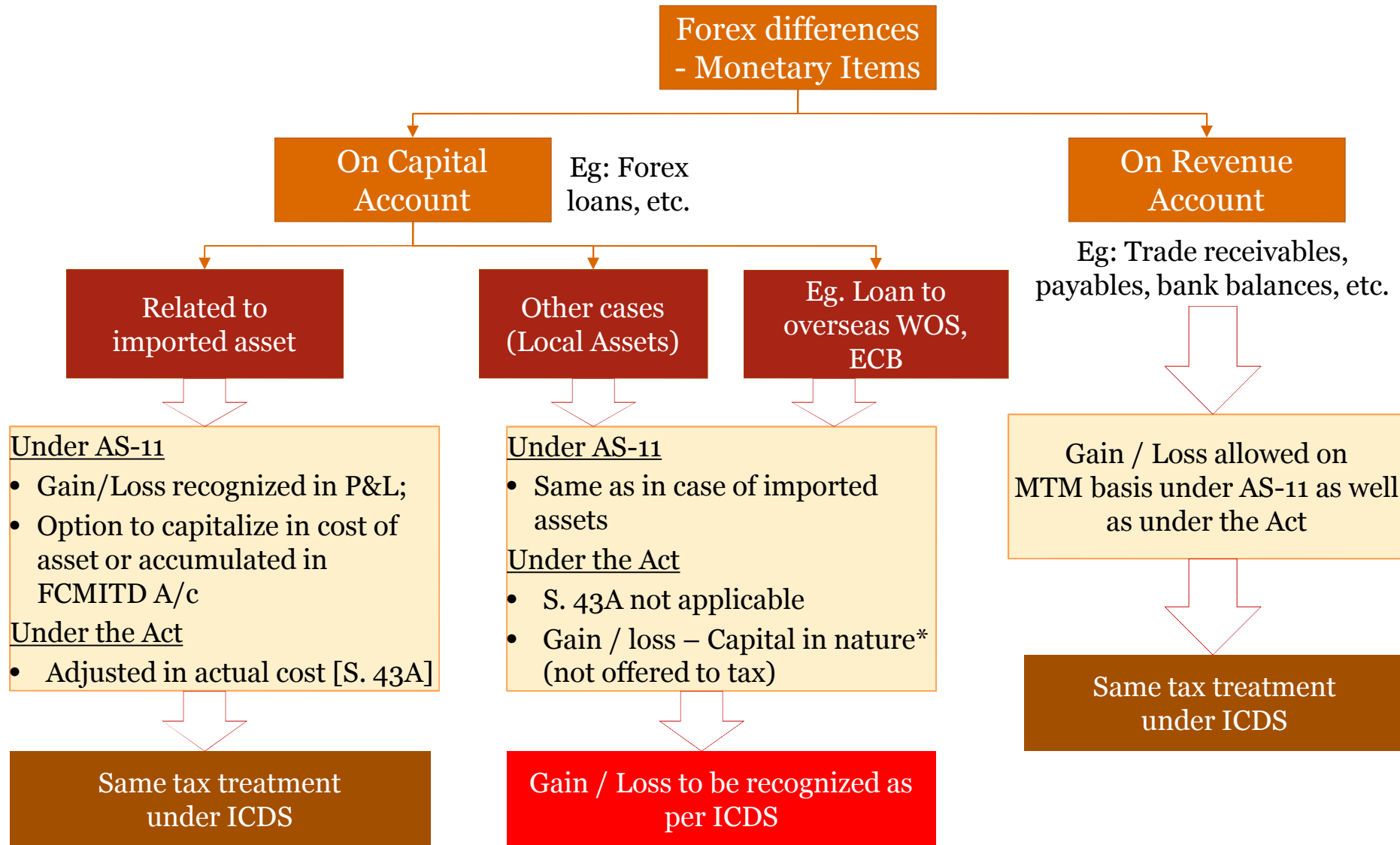
Key Definitions

- Monetary items are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables, and payables are examples of monetary items.
- Non-monetary items are assets and liabilities other than monetary items. Fixed assets, inventories, and investments in equity shares are examples of non-monetary items.
- “Foreign operations of a person” is a branch, by whatever name called, of that person, the activities of which are based or conducted in a country other than India.
- “Forward exchange contract” means 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

ICDS VI- Initial Recognition , Foreign Operations and Forex Fluctuations on Non-Monetary Items

Nature	Position under AS-11	Position under ICDS	Impact in ICDS
Initial Recognition	Date of transaction	Date of transaction	No change
Foreign Operations	Classification of integral and non integral operations	Classification of integral and non integral removed*	Change in ICDS
Non-monetary items carried at <u>historical cost</u> (eg. Fixed Assets, Long-term Invt)	Date of transaction	Date of transaction	No change
Non-monetary items carried at <u>fair value</u> , etc. (eg. Inventory)	Date on which such value was determined	Date on which such value was determined	No change

ICDS VI- Forex Fluctuations on Monetary Items



Forex Fluctuations on Foreign Exchange Contracts

- For Hedging Purposes
 - Gain / Loss on Ex. Diff. allowed on MTM basis
 - Premium / Discount – To be amortized over contract life (Same as AS-11)
 - No distinction between capital and revenue account in ICDS (Conflicts CBDT Instruction No. 3/2010) (to the extent of MTM Loss)
- Trading, Speculation, Firm commitment, highly probable forecast
 - Gain / Loss on Ex. Diff. allowed at the time of settlement
 - Premium / Discount – allowed at the time of settlement (AS-11 – Gain/loss on MTM basis)

Forward Exchange Contracts

Nature of the Forward Contract	Treatment as per AS-11	Treatment as per ICDS
Firm Commitment having an underlying asset on the last day of the year	Premium or discount to be amortised over the period of the contract. Exchange difference to be recognised on the last day of the previous year	Premium or discount to be amortised over the period of the contract. Exchange difference to be recognised on the last day of the previous year
Firm Commitment not having an underlying asset on the last day of the year	AS-11 not applicable	Premium or discount and exchange difference to be recognised at the date of settlement.
Highly Probable Forecast Transaction	AS-11 not applicable	

Other Forex Derivatives

Forex Derivatives like cross
currency swaps and interest rate
swaps?

ICDS is silent

Principle contained in ICDS-1 to
apply-CBDT circular

Transitional Provisions

- All foreign currency transactions undertaken on or after 1 April 2016 shall be recognized as ICDS VI;
- Exchange Difference in respect of monetary/non-monetary items on settlement/translation during the previous year commencing on 1 April 2016 and subsequent years shall be recognized as per ICDS VI (after considering the amount recognized on 31 March 2016)
- Financial Statements of foreign operations for the previous year commencing on 1 April 2016 shall be translated as per ICDS –VI (after considering the amount recognized on 31 March 2016);
- All forward exchange contracts existing on 1 April 2016 or entered on or after 1 April 2016 shall be dealt with as per ICDS –VI (after considering the amount recognized on 31 March 2016).
- CBDT circular provides that the opening balance in the FCTR relating to non integral operations shall be recognised to the extent not recognised in the income computation in the past.

Issues in ICDS-VI

- Whether exchange gain on conversion of a foreign currency loan used for the purpose of acquiring an asset will be taxable in India if not covered under Section 43A of the Act
- Whether exchange gain on conversion of a non-monetary item of a non integral operation at a closing rate be taxable

ICDS VII- Government Grants

ICDS VII- Government Grants

Government

- Government,
- Government agencies and
- Similar bodies whether local, national or international

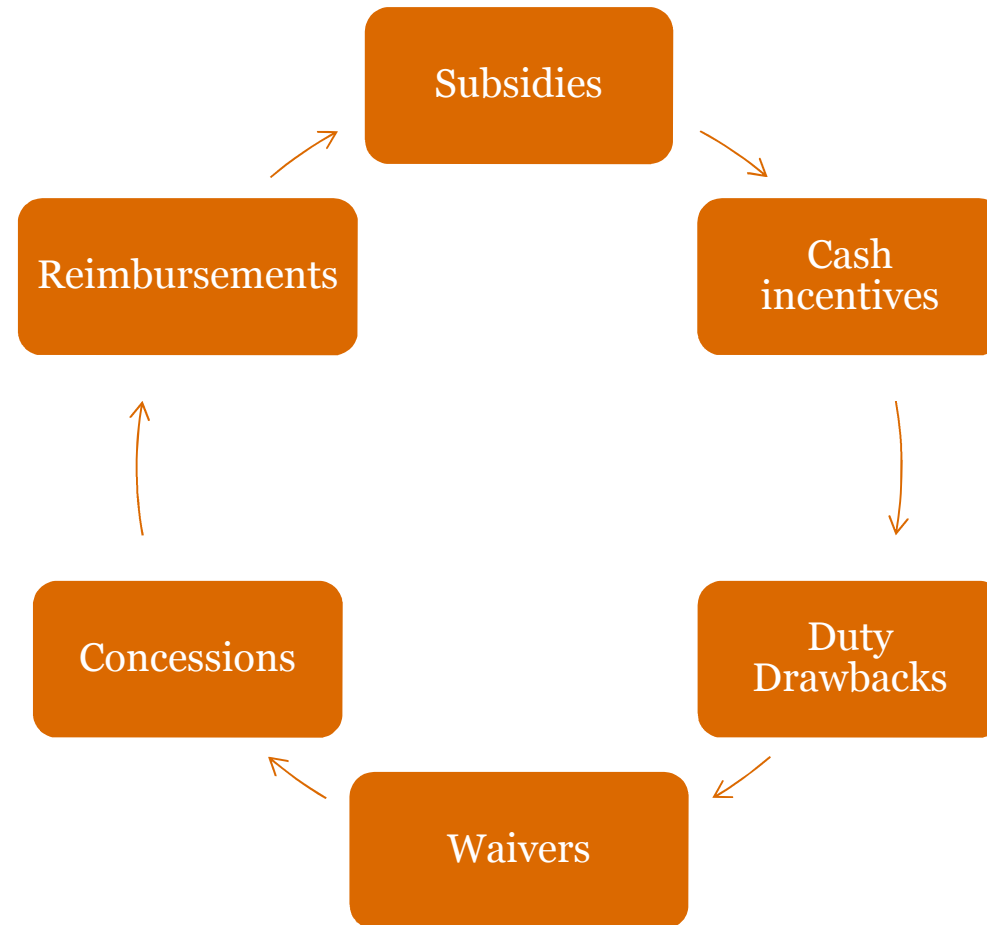
Government Grants

Assistance by government in cash or kind to an enterprise for past or future compliance

Exclusions:

- Government assistance which cannot have a value placed on them
- Transactions with the government which cannot be distinguished from the normal trading transactions

ICDS VII- Coverage of Government Grants



Excludes:

- a) Assistance other than in the form of Government grants
- b) Government participation in the ownership of the enterprise

ICDS VII- Distinction between ICDS and AS-12

Basis of Distinction	ICDS VII	AS-12
Recognition	Reasonable Assurance required for: a) Conditions of the grant should be met and b) Grant shall be received	Reasonable Assurance required for: a) Conditions of the grant to be met and b) Grant shall be received
Depreciable Assets	Grants should be deducted from the cost of the assets or the WDV of the block of assets. <i>(No option to recognise as deferred revenue)</i>	Either deducted from the gross value of the asset or treated as deferred income and recognised in the P&L on a systematic basis over the useful life of the assets.

Recognition of the Government Grant should not be postponed beyond actual receipt

Treatment of Government Grants

Depreciable
Fixed
Assets

- Grant shall be deducted from the actual cost of the asset or the WDV of the block of assets

Non
Depreciable
assets

- If grant requires fulfilment of certain conditions then grant shall be recognised as income over the same period over which the cost of meeting such obligations is charged to income.

Not directly
relatable

- Proportionate amount should be reduced from actual cost/written down value.

Treatment of Government Grants

Compensation
and Financial
Support

- Shall be recognised as income of which such grant is receivable

Non monetary
assets at
concessional
rates

- Grants in the form of non-monetary assets given at a concessional rate shall be accounted for on the basis of the acquisition cost.

Others

- Recognised as income over periods necessary to match them with related costs which they intend to compensate

Case Study - Grant related to depreciable fixed asset

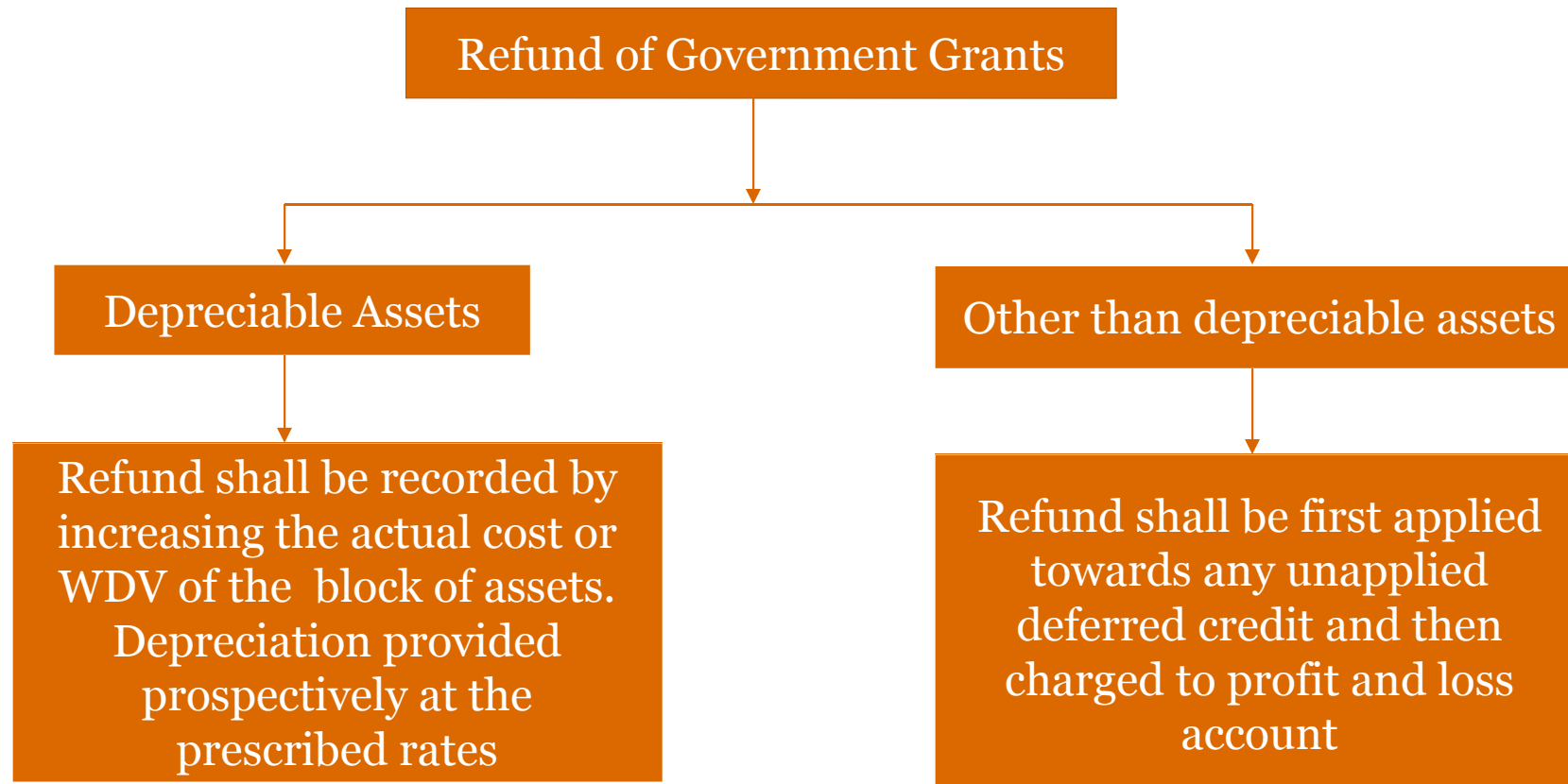
Co A has received grant of Rs. 10 crores from Gujarat Government to procure a machinery of 25 crores to be used in manufacturing unit based in Vadodara

Balance Sheet

Asset	25 crore
Grant	-10 crore
Net Amount to be shown as per ICDS	15 crore

No difference in Pre and Post ICDS implications- subsidy will be reduced from the cost of asset

ICDS-VII Refund of Government Grants



Case study on Refund of Government Grants (Depreciable Assets)

On 1 April 2016 A Co has received a conditional grant of Rs 10 crores from Maharashtra Government to procure a plant worth Rs 25 crores to be used in manufacturing unit based in Aurangabad. The life of the plant is 10 years.

On 1 April 2017 the A Co has failed to satisfy a condition as a result of which 9 out of 10 crores has been refunded to the government. How this plan should be recognised under ICDS

WDV = 13.5 crore
Grant Refund= 9 crore
Asset after refund= 22.5 crore

ICDS VII- Disclosure and Transition Provisions

Disclosure Requirements

- Nature and extent of Government grants recognised by way of deduction from the actual cost of the assets or from the WDV of the block of assets
- Nature and extent of government grants recognised
- Nature and extent of Government grants not recognised and reasons thereof.

Transitional Provisions

- All the Government grants which meet recognition criteria on or after 1 April 2016 shall be recognised as per ICDS VII (*after considering amount recognized in any previous year commencing on or before 31 March 2016*)

Impact of ICDS VII

- Option for treating government grants as capital receipt is not available
- Grants need to be mandatorily recognized on receipt basis whether or not compliance to conditions is assured.
- Applicability of ICDS VII on grants partly recognised before 1 April 2016 and partly after that ?
- Promoters Contribution covered in ICDS?

Judicial Precedents

CIT v Pooni Sugars and Chemicals Ltd (306 ITR 392) (SC)

- The purpose for which the subsidy is given is relevant
- The source , form and the mechanism of the subsidy is irrelevant
- If the object of the subsidy is to enable the business to run more efficiently the subsidy would be a revenue receipt
- If the object of the subsidy was to enable setting up of a plant or expand an existing unit it would be a capital receipt
- Since the Assessee was required to use the subsidy for repayment of term loan the same was considered to be capital in nature

Judicial Precedents

Sahney Steel & Press Works Ltd v CIT (228 ITR 253) (SC)

- If the subsidy is given after commencement of production in order to run the business more profitably the same would be in the nature of revenue receipt
- What is material is the purpose for which the subsidy is granted and not the source of the subsidy
- In the instant case the subsidy was granted after commencement of production for carrying out the business and not for purchase of any plant or asset, hence it is revenue in nature

CIT v Chaphalkar Brothers (351 ITR 309) (Bom HC)

- The object of the subsidy was for construction of multiplex theatres
- Merely because the subsidy was not utilized for repayment of loan would not change its character from a capital receipt to a revenue receipt

ICDS VIII- Securities

ICDS VIII- Securities- Part A

- Deals with securities held as stock in trade
 - FPI's and FII's should be excluded since security is a capital asset in their hands
- It does not apply to
 - Securities held by a person engaged in the business of insurance
 - Securities held by mutual funds, venture capital funds, banks and public financial institutions
- Securities is defined to have the meaning assigned to it in clause (h) of Section 2 of the SCRA Act and shall include the share of a company in which the public are not substantially interested but shall not include derivatives

Will cover stock brokers , NBFC 's etc

ICDS VIII- Securities

Criteria	ICDS	AS- 13
Scope	Only securities held as stock in trade fall within the scope of ICDS VII and long term investments do not fall under this standard.	AS 13 deals with accounting for investments. Stick-in-trade is outside the scope.
Measurement	Cost should be determined either on actual cost or based on FIFO/ WAC method and not on specific identification method.	In respect of shares, debentures and other securities held as stock-in-trade, the cost of stocks would be the lower of the cost or the fair value
Valuation	Treated as one group each and the total gain/ loss of the category is considered: Shares Debt Convertible Any other	Valuation done scrip wise- cost or NRV whichever is less

Initial Recognition and Measurement

- A security on acquisition shall be recognised at actual cost
- The actual cost of a security shall comprise of its purchase price and include acquisition charges such as brokerage, fees, tax, duty or cess
- Where a security is acquired in exchange for other securities, the fair value of the security so acquired shall be its actual cost
- Where a security is acquired in exchange for another asset, the fair value of the security so acquired shall be its actual cost
- In respect of unpaid interest which has been accrued before acquisition of an interest bearing security and is included in the price paid for the security , the subsequent receipt of the interest is allocated between pre acquisition and post acquisition periods and the pre acquisition interest would be deducted from the actual cost

Subsequent Measurement of Securities

- Securities held as stock in trade shall be valued at cost or NRV whichever is lower
- In order to compare the actual cost with the NRV shall be done category wise and not for each individual security. The categories are as under
 - Shares
 - Debt Securities
 - Convertible Securities
 - Any other securities

Classification of Securities other than those mentioned above?

Case study on classification of securities

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

Subsequent Measurement of Securities

- Unlisted securities and securities which are listed but not quoted on a stock exchange from time to time should be valued at actual cost.
- The value of the opening inventory of stock in trade is as under:
 - Cost of the securities on the day of the commencement of business in case of a newly commenced business
 - In other cases opening value shall be the same as closing value of the previous year
- If the actual cost initially recognised cannot be ascertained with reference to specific identification then the cost shall be determined on the basis of FIFO and weighted average method

Issues in ICDS VIII- Part A

- Section 145A vs ICDS- VIII
- Interest accrued before the acquisition of an interest bearing security- Judicial precedents
- Trader- treatment of bonus shares ?
- Determination of shares as stock in trade?

ICDS VIII- Securities Part B

- Inserted by the CBDT through its Notification no. 86/2016
- Part –B deals with the “Securities held by scheduled bank or public financial institutions”
- Securities shall be classified, recognized and measured in accordance with the existing guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the guidelines shall not be taken into account
- To this extent, the provisions of ICDS VI (Effect of changes in foreign exchange rates) relating to forward exchange contracts shall not apply

Questions?

Thank You