



# Income Computation And Disclosure Standards (ICDS)

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**Care, Pair, and Share**

**KNOWLEDGE THAT MATTERS. EXPERIENCE THAT COUNTS.**

# Agenda

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- ICDS – Holistic View
- Accounting Policies – ICDS 1 vis-à-vis AS 1
- Inventories - ICDS 2 vis-à-vis AS 2
- Tax Audit perspective and reporting

# Need for ICDS

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- CIT vs. Excel Industries (SC) CIVIL APPEAL NO.125 OF 2013
  - As the dispute was only as to the year of taxability and as the rate of tax remained the same the dispute raised by the Revenue is entirely academic or at best may have a minor tax effect. There was, therefore, no need for the Revenue to continue with this litigation when it was quite clear that not only was it fruitless (on merits) but also that it may not have added anything much to the public coffers. It is hoped that the Revenue implements its litigation policy a little more practically and a little more seriously.
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# What if not followed?

- Sec. 145(3) authorizes AO to make best judgment assessment if the income has not been computed in accordance with ICDS
  - ▶ Whether in all respect?
  - ▶ Or only to the extent it is not followed?
- Can One error make accounts unreliable?

# Who is supreme – ICDS or Act?

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- Preamble of each ICDS –
- *In the case of conflict between the provisions of Income Tax Act 1961 and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent*
- ▶ Examples –
  - ▶ Sec. 43A providing for adjustment of forex gain/loss
  - ▶ Sec. 43D providing for taxability of interest on NPAs
  - ▶ Sec. 145A(2) providing for taxability of interest on compensation

# Court Decisions – still valid?

- ICDS is conflicting with the judiciary principles laid down by the courts
    - ▶ Retention money
    - ▶ Export incentives
    - ▶ Exchange fluctuation on capital field [other than imported assets]
    - ▶ Accrual of interest on sticky loans
    - ▶ Accrual of interest only on due dates
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# Court Decisions – still valid?

- ▶ Interpretation of the specific provision of the Act
- ▶ ICDS may not override
- ▶ In case of conflict, the provision of the Act shall prevail
- ▶ Relying on commercial accounting principles in the absence of contrary provision of the Act
- ▶ ICDS may override to the extent of deviations
- ▶ Woodward Governor India (P) Ltd. 312 ITR 254 (SC) - **Foreign Exchange fluctuation losses are allowable on accrual basis**

# Woodward Governor India (P)

## Ltd. 312 ITR 254 (SC)

- *As profits for income-tax purposes are to be computed in accordance with ordinary principles of commercial accounting, unless, such principles stand superseded or modified by legislative enactments ..... At this stage, **we need to emphasise once again that the above system of commercial accounting can be superseded or modified by legislative enactment. This is where s. 145(2) comes into play.** Under that section, the Central Government is empowered to notify from time to time the Accounting Standards to be followed by any class of assesseees or in respect of any class of income. In other words, **Accounting Standard which is continuously adopted by an assessee can be superseded or modified by legislative intervention. However, but for such intervention or in cases falling under s. 145(3), the method of accounting undertaken by the assessee continuously is supreme.***



# ICDS & Presumptive Schemes

- ▶ Presumptive Scheme - Altogether a different base for computing the income
  - ▶ Only 'turnover' or 'gross receipts' is required to be computed and not the income
  - ▶ ICDS is for computation of income
  - ▶ ICDS IV – Recognition of Revenue – Gross Inflow of cash, receivables, or other consideration – 28 (iv)
  - ▶ Provisions of the Act to prevail over ICDS
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# Impact on Books of Account

- AS 22 – Accounting for Taxes on Income
    - ▶ ICDS - result into early recognition of income or deferment of expenses / losses
    - ▶ Timing differences except few cases; e.g. recognition of government grant in the nature of promoters' contribution as income
    - ▶ Mostly will result in recognition of Deferred Tax Asset
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# Introduction - ICDS

- Notification No.33/2015 [F. No.34/48/2010-TPL] / SO 892(E) dated 31 March 2015
- Jan 2015 - Revised draft of 12 ICDS (earlier referred to as TAS) in public domain for comments and suggestions
- Notified 10 ICDS (ICDS on Leases and Intangible asset not notified)
- Deferral for one year
- ICDS shall be applicable from 1<sup>st</sup> April, 2016 (Assessment Year 2017-18)

Notification No. S.O. 3079 (E) dated September 29, 2016

# Introduction

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- Conflict between the Income Tax Act 1961 and ICDS, the Act to prevail
- 9 out of 10 ICDS - transitional provision to avoid any double taxation/ non taxation in pre and post ICDS periods
- ICDS shall apply to all assesseees (except Individuals / HUFs not under audit under section 44AB) following Mercantile System of accounting and offering income under the head Business or Other sources
- No need to maintain separate books of account or follow ICDS for book keeping – AS to follow
- Only computation of income

# Standards

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- AS by ICAI
- AS by MCA
- Ind AS by MCA
- ICDS

# FAQs.

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- Circular No. 10/2017 dated March 23, 2017
  - 25 FAQs.
  - 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.
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# FAQs.

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- **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.

# FAQs.

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- **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.**



# FAQs.

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- **Question 8: Para 4(ii) of ICDS-I provides that Market to Market ( MTM) loss or an expected loss shall not be recognized unless the recognition is in accordance with the provisions of any other ICDS. Whether similar consideration applies to recognition of MTM gain or expected incomes?**
  - Same principle as contained in ICDS-I relating to MTM losses or an expected loss shall apply *mutatis Mutandis to MTM gains or an expected profit.*

# FAQs.

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- **Question 11: Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?**
  - Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition contained in pars 9 of on Construction contracts.

# FAQs.

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- **Question 13: The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even when the collection thereof is uncertain?**
  - As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non recovery in either cases can be claimed as deduction in view of amendment to 5.36 (1) (vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS.

# FAQs.

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- **Question 15: Para 8 of ICDS-V states expenditure incurred on commissioning of project, including expenditure incurred on test runs and experimental production shall be capitalized. It also states that expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption shall be treated as revenue expenditure. What shall be the treatment of expense incurred after the conduct of test runs and experimental production but before commencement of commercial production?**
    - As clarified in Para 8 of ICDS-V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure.
    - Ready to use vis-à-vis put to use
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# FAQs.

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- **Question 20: There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 4311, 40(a)(i), 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.

# FAQs.

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- **Question 24: 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.

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# **AS 1 / ICDS 1 – ACCOUNTING POLICIES**

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# Objective

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- Disclosure of significant accounting policies
  - Views presented in the financial statements (FS) of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of FS
  - **ICDS - Accounting policies adopted by a person shall be such so as to represent a true and fair view of the state of affairs and income of the business, profession or vocation.**
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# Objective - Comparision

- Better understanding of FS
- Establishing through an AS disclosure of significant accounting policies, and
- The manner in which accounting policies are disclosed in FS

# Fundamental Accounting Assumptions

- Disclosure is necessary if they are not followed.
    - Going Concern
    - Consistency
    - Accrual
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# Specific Principles – Cash System

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- “It is the policy of the Assessee to prepare his financial statements on the cash receipts and disbursements basis. On this basis, revenue and the related assets are recognized when received rather than when earned, and expenses are recognized when paid rather than when the obligation is incurred. In our opinion.....”

# Accounting Policies – meaning

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- Specific accounting principles, and
- The methods of applying those principles adopted
- Choice to adopt different AP – Generally Acceptable Accounting Principles....

# Areas in Which Differing Accounting Policies are Encountered

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- Methods of depreciation, depletion and amortization – AS 6.....**Now AS-10**
  - Treatment of expenditure during construction
  - Conversion or translation of foreign currency items
  - Valuation of inventories
  - Treatment of goodwill
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# Areas in Which Differing Accounting Policies are Encountered

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- Valuation of investments
  - Treatment of retirement benefits
  - Recognition of profit on long-term contracts
  - Valuation of fixed assets....**Property, plant and Equipment**
  - Treatment of contingent liabilities.
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# Considerations in the Selection of Accounting Policies

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- Represent a true and fair view of the state of affairs and income of the business, profession or vocation.

- Prudence

- Substance over Form

- Materiality

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# Considerations in the Selection of Accounting Policies

- Marked to market loss or an expected loss shall not be recognized unless the recognition of such loss is in accordance with the provisions of any other Income Computation and Disclosure Standard.
- **MTM / expected loss recognized by other ICDS:**
  - ▶ Inventory valuation loss
  - ▶ Valuation loss in securities held as stock-in-trade (subject to bucket approach)
  - ▶ Foreign exchange difference
  - ▶ Provision based on reasonable certainty



# Considerations in the Selection of Accounting Policies

- Derivatives MTM Loss –
  - All types of derivatives
  - Shares F & O
  - Commodities F & O (even if meant for hedging)
  - Excluding forex derivatives meant for hedging – covered by ICDS VI
  - Distinction between ‘expected loss’ and ‘expected expenditure’
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# Change in accounting policy

- When can an accounting policy be changed?
  - ▶ AS:
    - ▶ if it is required by statute
    - ▶ for compliance with an AS
    - ▶ if it is considered that the change would result in a more appropriate presentation of the financial Statements
- ICDS – only for a reasonable cause....**Principle of Prudence**

# Disclosure of Accounting Policies

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- Any change in an accounting policy which has a **material** effect shall be disclosed.
  - ▶ AS – only in the year in which such change is adopted
  - ▶ ICDS – not only in the year in which such change is adopted but also in the year in which such change has material effect for the first time

# Disclosure of Accounting Policies

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- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

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# Inventory

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# Value Addition

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- Notification G.S.R. 364 (E) dated March 30, 2016
- Amendments....
- AS-2, AS-4, AS-10, AS-13, AS-14, AS-21, AS-29

# Valuation of Inventories

- Exceptions:
- Work-in-progress arising under 'construction contract' including directly related service contract which is dealt with by the ICDS on construction contracts;
- Work-in-progress which is dealt with by other ICDS
- Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the ICDS on securities

# Exceptions...

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- Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realisable value;
- Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets.



# Definitions

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- **“Inventories” are assets:**

- (i) held for sale in the ordinary course of business;
- (ii) in the process of production for such sale;
- (iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

- **Cost of Inventories**

- Cost of inventories shall comprise of all costs of purchase, **costs of services**, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
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# Measurement

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- Inventories shall be valued at the lower of cost or net realizable value
- “Net realisable value” is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

# Costs of Purchase

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- AS-2 - The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.
- ICDS 2 - The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase.

# Decisions

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- Sunshield Chemicals Pvt. Ltd. V. Income Tax Officer  
I.T.A. No. 5045 /Mum/2010
  - GN of the ICAI
- Pharma Search v. Assistant Commissioner of Income-tax  
15(3), Mumbai / IT APPEAL NO. 7303 (MUM.) OF 2010 /  
44 Taxmann.com
  - Service transactions not covered by section 145A

# Costs of Services

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- The costs of services shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.

# Other definitions

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- Costs of Conversion
  - Other Costs
  - Interest on borrowing
  
  - Exclusions from the Cost of Inventories
    - Abnormal amounts of wasted materials, labour, or other production costs;
    - Storage costs, unless those costs are necessary in the production process prior to a further production stage;
    - Administrative overheads that do not contribute to bringing the inventories to their present location and condition ;
    - Selling costs.
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# Cost formulae

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- The Cost of inventories of items
  - (i) that are not ordinarily interchangeable; and
  - (ii) goods or services produced and segregated for specific projects shall be assigned by specific identification of their individual costs.
  
  - ‘Specific identification of cost’ means specific costs are attributed to identified items of inventory.
  
  - Otherwise FIFO or Weighted Average
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# Techniques for the Measurement of Cost

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- Standard cost method (ICDS 2015 did not permit)
- Retail method
- Net Realisable Value



# Value of Opening Inventory

Dissolution of firm....

- (i) the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and
- (ii) the value of the inventory as on the close of the immediately preceding previous year, in any other case.
- Change of Method of Valuation of Inventory – Reasonable Cause.**

# Dissolution of firm

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- In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value.
  - Section 45 (4) – Capital Asset
  - In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.
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# Law Vis-à-vis Notification

- Contrary to law settled by hon'ble Apex court in the case of **Sakthi Trading Co. v. CIT** 250 ITR 871 / 118 Taxman 301 [2001] (SC)
- Law – Authority of Legislature
- Notification – Executive Powers conferred

# Transitional Provisions

- If Interest and borrowing costs were included in the cost of opening inventory as on 1<sup>st</sup> April 2016, such cost shall be included in valuation of inventory if the same remains a part of inventory as on the close of the previous year beginning on or after 1<sup>st</sup> April 2016.

# Disclosures

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- 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;
  - The total carrying amount of inventories and its classification appropriate to a person.
    - RMS
    - Components, WIP,
    - FG, Stores and Spares, Loose Tools
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# Tax Audit Perspective

- CBDT Notification No.88/2016 dt. 29 Sept. 2016 - S.O. 3080(E)
- **Clause 13 (d), (e), and (f)**
- ~~(d) Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under Section 145 and the effect thereof on the Profit or Loss :~~

# Tax Audit...

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- (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)

(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	-	-	-



(f) Disclosure as per ICDS:

Annexure 6

(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"	

## ANNEXURE 6

CLAUSE	DISCLOSURES AS PER ICDS		
13(f)			
	<b>ICDS</b>	<b>Model Disclosure required as per ICDS</b>	<b>Disclosures</b>
	I - Accounting Policies	1)All significant accounting policies adopted by a person shall be disclosed	Please refer to Other Notes to Financial Statements
		2)Any change in an accounting policy which has a material effect	No Change
		3)The amount by which any item is affected by such change	Not Applicable
		4)Where such amount is not ascertainable, wholly or in part	Not Applicable
		5)If a change is made in the accounting policies which has no material effect for the current previous year but which is reasonably expected to have a material effect in later previous years.	Not Applicable

II - Valuation of Inventories	1)The accounting policies adopted in measuring inventories including the cost formulae used.	Please refer to Other Notes to Financial Statements
	2) Where Standard Costing has been used as a measurement of cost, details of such inventories	Not Applicable
	3)The total carrying amount of inventories and its classification appropriate to a person.	Refer Note No. 16 of Annual Accounts
III - Construction Contracts	1)Disclose the amount of contract revenue recognised as revenue in the period	Not Applicable
	2)Disclose the methods used to determine the stage of completion of contracts in progress.	
	3)For contracts in progress, amount of costs incurred and recognised profits (less recognised losses) upto the reporting date.	
	4)For contracts in progress, the amount of advances received.	
	5)For contracts in progress, the amount of retentions.	

IV - Revenue Recognition	1)In a transaction involving sale of good, total amount not recognised as revenue during the previous year	NIL
	2)The amount of revenue from service transactions recognised as revenue during the previous year	Refer Note No. 23 of Annual Accounts
	3)The method used to determine the stage of completion of service transactions in progress	Percentage completion method
	4)For service transactions in progress, disclose amount of costs incurred and recognised profits (less recognised losses) upto end of previous year.	NIL
	5)For service transactions in progress, disclose the amount of advances received.	NIL
	6)For service transactions in progress, disclose the amount of retentions.	NIL

V - Tangible Fixed Assets	1)Description of asset or block of assets	Refer Annexure No 8
	2)Rate of depreciation	
	3)Actual cost or written down value, as the case may be	
	4) Deductions during the year with dates.	
	5) In the case of any addition of an asset, date put to use including adjustments on account of—	
	i)Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004.	
	ii)Change in rate of exchange of currency.	
	iii)Subsidy or grant or reimbursement, by whatever name called.	
	6)Depreciation Allowable.	
	7)Written down value at the end of year.	

VII - Governments Grants	1)Nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year.	
	2)Nature and extent of Government grants recognised during the previous year as income.	Not Applicable
	3)Nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons	
	4)Nature and extent of Government grants not recognised during the previous year as income and reasons thereof.	
IX - Borrowing Costs	1)The accounting policy adopted for borrowing costs.	
	2)The amount of borrowing costs capitalised during the previous year.	NIL

<p>X - Provisions, Contingent Liabilities and Contingent Assets"</p>	<p>1)A brief description of the nature of the obligation</p>	<p>A provision shall be recognised when the Assessee has a present obligation as a result of a past event, it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.</p>
	<p>2)The carrying amount at the beginning and end of the previous year.</p>	<p>Please refer to Note No. 9 of Financial Statements</p>
	<p>3)Additional provisions made during the previous year, including increases to existing provisions.</p>	<p>Please refer to Other Notes to Financial Statements</p>
	<p>4)Amounts used, that is incurred and charged against the provision, during the previous year.</p>	<p>Please refer to Other Notes to Financial Statements</p>
	<p>5)Unused amounts reversed during the previous year.</p>	<p>Please refer to Other Notes to Financial Statements</p>
	<p>6)The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.</p>	<p>Nil</p>