INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

CA JAYESH KARIYA

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Overview of ICDS

ICDS implementation in India – Story so far

1996

The Central Government notified two accounting standards under section 145(2) of the Income Tax Act, 1961 (the IT Act).

December 2010

The CBDT constituted AS Committee to suggest the following :

- AS to be notified under the Act
- Amendments to the Act
- Method to determine book profit for MAT purposes on transition to Ind AS

October 2012

- Final report of the Committee with 14 draft ICDS
- Comments invited from public on the Draft ICDS

July 2014

- Finance Bill 2014 amended section 145(2) of the IT Act. ICDS applicable from FY 1 April 2015
- ICDS to be notified separately

January 2015

- CBDT issued 12 draft ICDS, after incorporating suggestions by stakeholders and providing transitional provisions
- The draft ICDS were open for comments and suggestions till 8 February 2015

March 2015

- 10 Final ICDS notified on 31 March 2015
- Draft ICDS on leases and Intangible not notified
- Applicable from AY 2017-18

All legal entities in India would be required to comply with ICDS from 1 April 2016*

*** Except individuals and HUFs not liable to Tax Audit u/s 44AB of the Act**

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. 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 - except those decisions which relied on commercial principles and accounting practices then followed

ICDS - Key Impact Areas

Scope of Delegated Legislations

✓ ICDS notified by the Central Government is a piece of delegated legislation.

✓ Such delegated legislation cannot override the provision of the Act

- **Assam Co. Ltd. & Anr. Vs. State Of Assam & Ors. - 248 ITR 567(SC)**

  *"A delegate cannot override the Act either by exceeding the authority or by making provision which is inconsistent with the Act. Any rule made in exercise of such delegated power has to be in consonance with the provisions of the Act, and **if the rule goes beyond what the Act contemplates, the rule becomes in excess of the power delegated under the Act, and if it does any of the above, the rule becomes ultra vires of the Act**"*

✓ **Notification that goes beyond the statute** – curtailing the scope of deduction **(CIT vs. Sirpur Paper Mills Etc. 237 ITR 41(SC)]** or imposing a tax without the authority of law cannot be held to be valid **[District Council Of Jowai Autonomous Distt & Ors. Vs. Dwet Singh Rymbai & Ors 169 ITR 468(SC)]**

Can ICDS modify the basis of taxation hitherto upheld by the Apex Court?

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.**

ICDS III – Construction Contracts

Scope of ICDS III – Construction Contracts

- ICDS III applies to a 'contractor' for a construction contract
- ICDS III defines the term construction contract to mean a "contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use and includes:
  - (a) contract for the ***rendering of services*** which are directly related to the construction of the asset, for example, those for the services of project managers and architects;
  - (b) contract for ***destruction or restoration of assets***, and the restoration of the environment following the demolition of assets. "
- ICDS III applies to fixed price contracts, cost plus contracts or hybrid contracts (i.e. mix of fixed and cost plus contract)
- ICDS III provides guidelines vis-à-vis application to each construction contract, application to group of contracts and to identifiable components of a single contract.
- **To be applicable to contracts commencing from 1 April 2016 prospectively**

Whether ICDS III – Construction Contracts applicable to Real Estate Developers and Service Concessioners?

ICDS III – Construction Contracts- Relevant Concepts

- **Service Concession Arrangements**
  - ICDS is silent of the treatment of Service Concession Arrangements – Contracts executed on BOT, BOOT, PPP, basis – largely applied in infrastructure construction projects
  - There is no specific accounting standard prescribed for these arrangements. In 2014 ICAI has issued Guidance on Service Concession arrangement, which has still not been notified.
  - Divergent accounting practice is followed by the industry – largely costs are recognised as Property, Plant & Equipment (PPE)
  - Ind AS 11 provides specific guidance for public-to-private service concession arrangements in which
    - ✓ The public sector entity controls or regulates services and prices;
    - ✓ Controls significant residual interest in such infrastructure
  - If applicable, the Operator would have to recognise the infrastructure either as a financial asset or intangible asset or both and not as PPE
  - ICDS III does not apply to such arrangements and ICDS IV 9Revenue Recognition) could be considered on case to case basis.

Refer FAQ Question No. 12

ICDS – FAQs issued by CBDT on 23 March 2017

- ✓ **Question 12 : Since there is no specific scope exclusion for real estate developers and Build -Operate- Transfer (BOT) projects from ICDS-IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.**

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

ICDS III – Construction Contracts- Relevant Concepts

- **Contract Revenue** shall comprise of:
  - the initial amount of revenue agreed in the contract, including **retentions**; and
  - variations in contract work, claims and incentive payments:
    - ✓ to the extent that **it is probable that they will result in revenue**; and
    - ✓ they are capable of being **reliably measured.**
- Where contract revenue already recognised as income is subsequently written off in the books of accounts as uncollectible, the same shall be recognised as an expense and not as an adjustment of the amount of contract revenue.
- **Contract Costs** shall comprise of:
  - costs that relate directly to the specific contract;
  - costs that are attributable to contract activity in general and can be allocated to the contract;
  - such other costs as are specifically chargeable to the customer under the terms of the contract; and
  - **allocated borrowing costs** in accordance with the ICDS on Borrowing Costs.

  Cost incurred for securing contracts are also included – identifiable and probable to win the contract

  These costs shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in contract revenue.

ICDS III – Construction Contracts- Relevant Concepts

- **Combining and Segmenting Construction Contracts**

➢ This ICDS shall be applied separately to each construction contract except as provided below. For reflecting the substance of a contract or a group of contracts, where it is necessary, the ICDS should be applied to the separately identifiable components of a single contract or to a group of contracts together.

➢ Where a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when-

- ✓ separate proposals submitted,
- ✓ each asset has been subject to separate negotiation, and
- ✓ the costs and revenues of each asset can be identified.

➢ A group of contracts, whether with a single customer or with several customers should be treated as a single contract when:

- ✓ the group of contracts is negotiated as a single package;
- ✓ The contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
- ✓ The contracts are performed concurrently or in a continuous sequence.

➢ Construction of additional asset at the option of the customer should be treated as separate construction contract when asset differs significantly and price negotiated separately.

ICDS III – Construction Contracts- Relevant Concepts

- **Recognition of Contract Revenue and expenses**

  - It should be recognised with reference to the stage of completion of the contract activity at the each reporting date – profits to be recognised on POCM basis only – CCM cannot be applied.
  - Stage of completion shall be determined based on following approaches:
    - ✓ Expenditure approach; or
    - ✓ Work survey approach; or
    - ✓ Physical work completion approach.
  - When stage of completion is determined basis expenditure approach then costs incurred in relation to work performed only should be considered and following costs to be excluded:
    - ✓ Contract costs that relate to future activities;
    - ✓ Advance payments to sub-contractors
  - Profits shall be recognised only when 25 percent of the stage of completion is achieved

- **Changes in Estimates**

  - The percentage of completion method is applied on a cumulative basis in each previous year to the current estimates of contract revenue and contract costs. Where there is change in estimates, the **changed estimates** shall be used in determination of the amount of revenue and expenses in **the period in which the change is made and in subsequent periods**.

Comparison of AS, ICDS and Ind AS

Particulars	AS- 7	ICDS- III	Ind AS 115/ Ind AS 11
Contract Revenue- Recognition	• As per AS-7, provides for recognition of revenue basis Percentage of Completion Method ('POCM'). • Where outcome of a construction contract cannot be estimated reliably, the revenue to be recognized to the extent of contract costs incurred • Stage of completion of contract for recognizing contract revenue and contract cost **not prescribed under AS-7**.	• ICDS III provides for recognition of revenue basis Percentage of Completion Method ('POCM'). • During early stages of a contract, where the outcome of the contract cannot be estimated reliably, contract revenue is recognized only to the extent of costs incurred • Early stage of contract **shall not extend beyond 25%** of stage of completion	• Entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. • Revenue to be recognised as and when the performance obligation are satisfied
Contract Revenue- Certainty of collection	• AS-7 is silent about the recognition of revenue based on **reasonable certainty** of its ultimate collection	• ICDS-III provides for the recognition of revenue when there is **reasonable certainty** of its ultimate collection	• As per Ind AS 115, revenue is to be recognised when it is **probable** that the entity will collect the consideration

Comparison of AS, ICDS and Ind AS

Particulars	AS- 7	ICDS- III	Ind AS 115
Contract Costs- Incidental Income	• As per AS-7, any incidental income shall be reduced from the contract cost.	• Any incidental income being interest, dividend, capital gains are specifically **not allowed to be reduced** from contract costs.	• Ind AS 115 does not provide for any such guidance.
Contract Revenue- Variable consideration, contingent considerations	• Incentive payments are included in contract revenue when the contract is sufficiently advanced that it is probable the specified performance standards will be met or exceeded and the amount of the incentive payments can be measured reliably.	• Contract revenue shall comprise of variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and their capable of being reliably measured. • **Retention money** is also considered to be a part of contract revenue	• Variable considerations (including potentially contingent considerations) are only included in the transaction price **to the extent that it is probable that the amount of cumulative revenue recognised would not be subject to a significant future revenue reversal when such estimates are revised.**
Contract Revenue- allocating the transaction price	• No guidance included	• Not covered by ICDS	• Allocated to each performance obligation identified in the contract on the basis of a relative standalone selling price determined at contract inception

ICDS – FAQs issued by CBDT on 23 March 2017

- ✓ **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 para 9 of ICDS-III on Construction contracts.

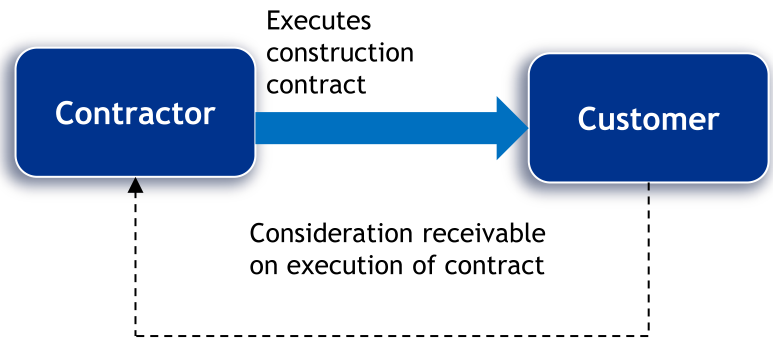
Tax Treatment under Pre-ICDS vis-à-vis Post-ICDS

Sr. No.	Particulars	Tax Treatment under Pre-ICDS	Tax Treatment under Post-ICDS
1	**Contract Revenue**	• **AS-7 does not prescribe inclusion of retention money in contract revenue.** • As per AS-7 considers variations in contract work, claims and incentive payments to the extent that it is ***probable* that *they will result in revenue and they are capable of being reliably measured*** • **It also considers decrease in contract revenues on account of damages or variations** • Further, based on various judicial precedents, retention money is taxable on its accrual i.e. on completion of contract or satisfaction of conditions	• **ICDS III requires to include retention money as part of contract revenues** • Variations in contract work, claims and incentive payments to the extent ***probable* that *they will result in revenue and they are capable of being reliably measured and*** there is ***reasonable certainty of its collection*** • **ICDS do not consider decrease in revenues on account of damages or variations** • **Will ICDS override principle laid down by judicial precedents on Accrual?**
2	**Contract Costs**	• As per AS-7, contract cost **does not include allocated borrowing costs.** Such costs are accounted as period costs in the financial statements • As **per AS-7, any incidental income shall be reduced from the contract cost.**	• As per ICDS III, contract cost shall comprise of **allocated borrowing costs in accordance with the *ICDS on Borrowing Costs*** • **Any incidental income being interest, dividend, capital gains are specifically not allowed to be reduced from contract costs.**

Tax Treatment under Pre-ICDS vis-à-vis Post-ICDS

Sr. No.	Particulars	Tax Treatment under Pre-ICDS	Tax Treatment under Post-ICDS
3	**Actual Loss**	• **Allowed in the year in which loss is incurred**	• **Allowed as part of POCM**
4	**Revenue recognition**	• Stage of completion of contract for recognizing contract revenue and contract cost **not prescribed under AS-7**.	• **Early stage of contract shall not extend beyond 25% of stage of completion**
5	**Contract cost relating to future activity**	As per AS-7, contract costs relating to future activity on the contract is recognized as an asset **provided that recovery of the contract costs is probable.**	Contract cost relating to future activity are recognized as an asset **irrespective of probability of recovery of contract costs.**
6	**Provision for Future/ anticipated losses**	• **As per AS-7, the provision for future/ anticipated losses are recognized as expenses immediately** • Various judicial precedents have held that the provision for future/ anticipated losses should be allowed on prudent basis	• ICDS III is silent on provision for future/ anticipated losses. However, as per ICDS I, an expected loss is not allowed unless it is specifically allowed by other ICDS. **Since ICDS III does not contain any specific provision for recognition of expected loss, it should not be allowed.**

Case Study 1 – Retention Money



Consideration receivable from customer	
Total Consideration (From Year 1 – Year 4)	INR 100
Retention money receivable at the end of Year 4 on completion of contract	INR 100
Total	**INR 200**

** CIT vs. Simplex Concrete Tiles Pvt. Ltd. [1989] 179 ITR 8 (Cal), CIT vs. East Coast Constructions & Industries Ltd. [2007] 283 ITR 596 (Mad), CIT vs. Associated Cables Pvt. Ltd. [2006] 286 ITR 596 (Bom) and CIT vs. P&C Constructions Pvt. Ltd. [2009] 318 ITR 113 (Mad)*

Facts

- Contractor obtains and executes a construction contract with customer for a total consideration of INR 200
- Contractor to receive INR 100 during the period of construction i.e. Year 1 to Year 4
- Balance consideration of INR 100 i.e. retention money to be received by the Contractor on completion of the construction contract i.e. at the end of Year 4 subject to satisfaction of conditions under the contract.

Position under Pre-ICDS

- Various judicial precedents* have laid down the principle that retention money accrues to the contractor only when there is right to receive such income.
- Basis the above principles, contractor to offer retention money to tax on completion of contract i.e. in Year 4

Position under Post-ICDS

- Under ICDS III, contract revenue to include retention money. Hence, retention money will be taxable on POCM basis if its receipt is probable and the amount of retention money can be reliably measured

Does ICDS override judicial precedents?

Case Study 1 – Retention Money

Position under Pre-ICDS

Particulars	Year 1	Year 2	Year 3	Year 4
Total Contract Revenue (excluding Retention Money)	100	100	100	100
Percentage of Completion (Cumulative)	25%	50%	75%	100%
Cumulative Contract Revenue to be recognised	25	50	75	100
Contract Revenue to be recognised in each year	25	25	25	25
Retention Money taxable in Year 4	0	0	0	100
Total Revenue	25	25	25	125
Taxable Profit earned on Contract @ 20%	5	5	5	25
Tax under Normal Provisions @ 30%	1.5	1.5	1.5	7.5
Tax under MAT Provisions @ 18.5%	0.925	0.925	0.925	4.625
MAT Applicable	**No**	**No**	**No**	**No**

Position under Post-ICDS

Particulars	Year 1	Year 2	Year 3	Year 4
Total Contract Revenue (including Retention Money)	100	100	100	100
Percentage of Completion (Cumulative)	25%	50%	75%	100%
Cumulative Contract Revenue to be recognised	25	50	75	100
Contract Revenue to be recognised in each year	25	25	25	25
Retention Money taxable in Year 1 on POCM basis	**25**	**25**	**25**	**25**
Total Revenue	50	50	50	50
Taxable profit earned on contract @ 20%	10	10	10	10
Tax under Normal Provisions @ 30%	3	3	3	3
Tax under MAT Provisions @ 18.5%	0.925	0.925	0.925	**4.625**
MAT Applicable	**No**	**No**	**No**	**Yes**

Tax Payable under MAT in Year 4

Case Study 2 – Revenue recognition not beyond 25% Stage of Completion

Position under Pre-ICDS

Recognition of Contract Revenue				
Particulars	Year 1	Year 2	Year 3	Year 4
Contract Revenue	100	100	100	100
Stage of Completion	25%	50%	75%	100%
Contract Revenue recognized	Nil*	50	25	25

*No revenue is recognized in Year 1 since contractor recognizes revenue only when stage of completion is 30%

Position under Post-ICDS

Recognition of Contract Revenue				
Particulars	Year 1	Year 2	Year 3	Year 4
Contract Revenue	100	100	100	100
Stage of Completion	25%	50%	75%	100%
Contract Revenue recognized	25	25	25	25

Facts

- In the instant case, it is assumed that construction contractor recognizes contract revenue only on completion of 30% of the contract in its books of account
- Under Pre-ICDS, the contractor follows similar policy for recognizing revenue for the tax purpose
- Under Post-ICDS, it is mandatory to recognize contract revenue on completion of 25% of the contract

Case Study 2 – Revenue recognition not beyond 25% Stage of Completion

Position under Pre-ICDS

Particulars	Year 1	Year 2	Year 3	Year 4
Total Contract Revenue	100	100	100	100
Percentage of Completion (Cumulative)	25%	50%	75%	100%
Cumulative Contract Revenue to be recognised	0	50	75	100
Contract Revenue to be recognised in each year	0	50	25	25
Total Revenue	0	50	25	25
Taxable Profit earned on Contract @ 20%	0	10	5	5
Total Book Profits	0	10	5	5
Tax under Normal Provisions @ 30%	0	3	1.5	1.5
Tax under MAT Provisions @ 18.5%	0	1.85	0.925	0.925
MAT Applicable	**No**	**No**	**No**	**No**

Position under Post-ICDS

Particulars	Year 1	Year 2	Year 3	Year 4
Total Contract Revenue	100	100	100	100
Percentage of Completion (Cumulative)	25%	50%	75%	100%
Cumulative Contract Revenue to be recognised	25	50	75	100
Contract Revenue to be recognised in each year	25	25	25	25
Total Revenue	25	25	25	25
Taxable Profit earned on Contract @ 20%	5	5	5	5
Total Book Profits	0	10	5	5
Tax under Normal Provisions @ 30%	**1.5**	1.5	1.5	1.5
Tax under MAT Provisions @ 18.5%	0	**1.85**	0.925	0.925
MAT Applicable	**No**	**Yes**	**No**	**No**

Tax Payable under MAT in Year 2

Case Study 3 – Recognition of Foreseeable Loss

Year	Loss	Unrelated Income	Computation		Comments
			Income Tax	Books of Account	
1	Expected loss = 5,000	4,000	4,000	(1,000)	Foreseeable loss of contract is not allowed as deduction in Year 1 as per ICDS and thus tax is required to be paid as per Normal Provisions.
2	Contract concludes on loss of 5,000	4,000	(1,000)	4,000	The foreseeable loss is recorded in year 1 as per AS 7 and as per ICDS the same will now be allowed in year 2. However, MAT will apply and tax is required to be paid as per the provisions of MAT.

<u>Impact:</u> ICDS deviates from the present legal settled position in the case of *CIT V/s. Triveni Engineering & Industries Ltd (49 DTR 253) (Del) & CIT v. Advance Construction Co. (P) Ltd (275 ITR 30) (Guj))* in which foreseeable losses on construction contracts were allowed as a deduction for tax purpose.

Disclosure Requirements

- The amount of contract revenue recognised as revenue in the period;
- The methods used to determine the stage of completion of contracts in progress.
- For contracts in progress at the reporting date:—
  - ✓ amount of costs incurred and recognised profits (less recognised losses) upto the reporting date;
  - ✓ the amount of advances received; and
  - ✓ The amount of retentions.

ICDS IV – Revenue Recognition

Scope of ICDS IV – Revenue Recognition

ICDS IV applicable to recognition of income arising in the course of the ordinary activities of a person from:

- The sale of goods
- The rendering of services
- The use by others of the person's resources yielding interest, royalties or dividends

Applicability of ICDS IV to Real Estate Sector and Lease Transactions?

ICDS IV – Revenue Recognition

Revenue from sale of goods- When to be recognised-

- ✓ when the property in the goods has been transferred for a price or
- ✓ all significant risks and rewards of ownership have been transferred and the seller retains no effective control over the goods.
- ✓ In a situation, where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognised at the time of transfer of significant risks and rewards of ownership to the buyer.
- ✓ Escalation of price/ export incentives – uncertainty - no revenue recognition.- Whether Principles of the decision of SC in the case of CIT v. Excel Industries Ltd. (358 ITR 295) can still be applied?

Reasonable Certainty of ultimate collection- a must for revenue recognition

ICDS IV – Revenue Recognition

Rendering of services

- ✓ Percentage Completion Method
- ✓ If duration of service contract is **<u>not more than 90 days</u>**, then revenue may be recognised when the rendering of services is **<u>completed</u>** or **<u>substantially completed</u>**.

If the services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on **<u>Straight Line Basis</u>** over the specific period
Eg: Retainership fees, AMC contracts etc.

ICDS IV – Revenue Recognition

Percentage Completion Method

- ✓ Revenue and Costs proportionate to the stage of completion recognised.
- ✓ stage of completion of a contract shall be determined with reference to:
  - (a) the proportion of costs incurred upto the reporting date to the estimated total costs; or
  - (b) surveys of work performed; or
  - (c) completion of a physical proportion of the work.
- ✓ Progress payments and advances received from customers are not determinative of the stage of completion of a contract.
- ✓ During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred.
- ✓ The early stage of a contract shall not extend beyond **25 % of the stage of completion**.

ICDS IV – Revenue Recognition

Interest

- ✓ Interest shall accrue on the **time basis** determined by the amount outstanding and the rate applicable.
- ✓ Interest on refund of any tax, duty or cess – deemed to be income of the year in which it is received
- ✓ Discount or premium on debt securities shall be spread over the term of the security

Royalties

- ✓ Royalties shall accrue in accordance with the terms of the relevant agreement and shall be recognised on that basis unless, having regard to the substance of the transaction, it is more appropriate to recognise revenue on some other systematic and rational basis.

Dividends

- ✓ Dividends are recognised in accordance with the provisions of the Act.- Refer section 8.

Tax Treatment under Pre-ICDS vis-à-vis Post-ICDS

Sr. No	Relevant Aspect	Tax Treatment under Pre-ICDS	Tax Treatment under Post-ICDS
1	Sale of goods	• Revenue to be recognised on fulfillment of conditions: o Property in goods transferred or all significant risks and rewards of ownership transferred; and o No significant uncertainty regarding amount of consideration	• The conditions for revenue recognition remains the same as AS-9 • No illustrations as provided in AS -9 to determine when the conditions are fulfilled– o Whether illustrations in AS-9 be referred and relied? o Whether the conditions contained in various Acts (such as Sale of Goods Act) be referred and relied?
2	Rendering of Services	• As per AS-9, revenue from service transactions is recognized either by: o the proportionate completion method or o the completed service contract method	• Under ICDS, revenue from service transactions to be recognized mandatorily by the percentage completion method • The provisions of ICDS III relating to construction contracts vis-à-vis recognition of revenue shall apply mutatis mutandis • **However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period.** • **Revenue from service contracts with duration of not more than ninety days may be recognised when the rendering of services under that contract is completed or substantially completed.**

Tax Treatment under Pre-ICDS vis-à-vis Post-ICDS

Sr. No.	Relevant Aspect	Tax Treatment under Pre-ICDS	Tax Treatment under Post-ICDS
3	Recognition of Interest Income	• As per AS-9 interest income is recognized on time basis • As per Act, interest income is taxable basis the accrual concept	• Similar to AS-9, interest income to be recognized on time basis • Interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received • Test of accrual not relevant? • Impact on interest on sticky loans ○ Time basis Vs Real income theory
4	Recognition of Royalty Income	• Recognized as per the terms of the agreement	• No change in ICDS
5	Recognition of Dividend	• Dividend to be recognised in accordance with the provisions of the Act – ○ In the previous year in which it is declared, distributed or paid; ○ Interim dividend – when the dividend is unconditionally made available	• Dividend to be recognised in accordance with the provisions of the Act – ○ In the previous year in which it is declared, distributed or paid; ○ Interim dividend – when the dividend is unconditionally made available

Tax Treatment under Pre-ICDS vis-à-vis Post-ICDS

Sr. No.	Relevant Aspect	Tax Treatment under Pre-ICDS	Tax Treatment under Post-ICDS
6	Uncertainty in collection of Interest and Royalties	• As per AS-9, the revenue recognition of interest could be postponed ***if it would be unreasonable to expect ultimate collection***	• Silent on such condition ○ Prudence / Real Income Theory still applicable? ○ Refer FAQs issued by CBDT

Judicial Precedents on Interest income-

✓ Right to receive - E.D. Sassoon & Co. Ltd. v. CIT (SC) (26 ITR 27)

✓ Interest income to accrue on coupon date - DIT v. Credit Suisse First Boston (Cyprus) Ltd 351 ITR 323 (Bom.)

Interest income from NPAs- Real Income Theory

✓ Godhra Electricity 225 ITR 746 (SC)

✓ State Bank of Travancore v. CIT 158 ITR 102 (SC)

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **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 S.36 (1) (vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS.

What if offered to tax under the head income from other sources?

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.

Royalty / FTS taxable under the Tax Treaty only when amount actually paid

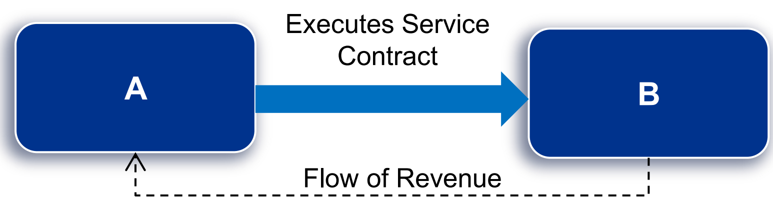
ICDS – FAQs issued by CBDT on 23 March 2017

- ✓ **Question 18 : If the taxpayer sells a security on the 30th day of April, 2017. The interest payment dates are December and June. The actual date of receipt of interest is on the 30th day of June, 2017 but the interest on accrual basis has been accounted as income on the 31st day of March, 2017. Whether the taxpayer shall be permitted to claim deduction of such interest i.e. offered to tax but not received while computing the capital gain?**

  - Yes, the amount already taxed as interest income on accrual basis shall be taken into account for computation of income arising from such sale.

Under which provisions of the Act??

Case Study – Percentage Completion Method



Facts

- ‘A’ obtains and executes a service contract with ‘B’
- Billing milestone at completion of 60% of work
- At the end of Year 1, ‘A’ has completed 50% of the work
- By the end of Year 2, ‘A’ has completed all the work and recognized revenue earned from the contract in its books

Table 1: Pre-ICDS (Contract Completion Method)

Particulars	Year 1	Year 2
Net Profit as per Books	-	INR 1000
Tax Payable @ 30%	-	INR 300
Tax Payable as per MAT @ 18.5%	-	INR 185
Total Tax Liability	INR 300	

Table 2: Post-ICDS (Percentage Completion Method)

Particulars	Year 1	Year 2
Net Profit as per Books	-	INR 1000
Net Profit Under ICDS	INR 500	INR 500
Tax Payable @ 30%	INR 150	INR 150
Tax Payable as per MAT @ 18.5%	-	INR 185
Total Tax Liability	INR 335	

Case Study – Percentage Completion Method

- Mr. Salman Khan, a professor, conducts a coaching class for CA Students. Since, the curriculum goes on for more than a year, therefore, he recognises revenue once the batch is over. i.e. after completion of the batch.
- In FY 16-17, 2 batches were conducted. One was carry forward batch started in the earlier year of which 20% work was complete upto 31.3.2016.
- The said batch was completed in FY 16-17 to the extent of 80% and total revenue from the said batch was Rs. 25,00,000/-.
- In respect of other batch, it was started in March 2017 and only 10% work was complete. Estimated revenue from the said batch was Rs. 16,00,000/-.

Please advise.

Case Study – Export Incentives

- A ltd is engaged in the business of providing services to overseas clients
- It is entitled to duty credit on exports of services under SFIS / SEIS
- Such credit can be utilized against customs duty payable on import of capital goods or it can be sold to other importers
- Such credit would lapse after 3 years, if unutilised
- On account of exports made by A Ltd in year 1, it is entitled to the duty credit worth INR 3 Crores
- Duty credit of INR 1 Crores utilized in year 2 by importing capital goods
- Further credit of INR 1.50 Crores utilized in year 3 by selling it to other importers
- Balance credit of INR 0.50 Crore got lapsed as unutilised

Case Study – Export Incentives

Tax treatment pre ICDS

- As regards year of taxability, based on the decision of SC in Excel Industries, taxable in the year of actual utilization -

  ✓ INR 1 Crore taxable in year 2 and
  ✓ INR 1.50 Crores taxable in year 3

Tax treatment post ICDS

- Can it be argued that there is no certainty of the receipt in year 1?
- Can the ICDS overrule the SC decision?
- Arguably, tax treatment pre ICDS should continue
- Alternate argument can be that Export Incentive is outside the scope of ICDS IV.

Disclosure Requirements

- Following disclosures shall be made in respect of revenue recognition, namely:—
  - ✓ in a transaction involving sale of good, total amount not recognised as revenue during the previous year due to lack of reasonably certainty of its ultimate collection along with nature of uncertainty;
  - ✓ the amount of revenue from service transactions recognised as revenue during the previous year; and
  - ✓ the method used to determine the stage of completion of service transactions in progress.

- For service transactions in progress at the end of the previous year:—
  - ✓ amount of costs incurred and recognised profits less recognised losses upto end of previous year;
  - ✓ the amount of advance received; and
  - ✓ the amount of retentions.

ICDS V – Tangible Fixed Assets

Scope of ICDS V – Tangible Fixed Assets

Assets included

- Land, building, machinery, plant or furniture;
- Held with the intention of using for producing / providing goods or services; and
- Not held for sale in the normal course of business

Components of Actual Cost

- Actual cost of an acquired tangible fixed asset shall comprise its purchase price, import duties and other taxes, excluding those subsequently recoverable, and any directly attributable expenditure on making the asset ready for its intended use. Any trade discounts and rebates shall be deducted in arriving at the actual cost.
- Cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of price adjustment, changes in duties or similar factors, or exchange fluctuation as specified in ICDS VI.
- Admin and other general overhead expenses not relating to a specific tangible fixed asset to be excluded.
- Expenditure on start-up, commissioning of project, test runs to be capitalised.

Scope of ICDS V – Tangible Fixed Assets

Self Constructed Tangible Fixed Assets

- Same principles mentioned above shall apply.
- Cost of construction that relate directly to specific tangible fixed asset and costs that are attributable to the construction activity in general and can be allocated to the specific tangible fixed asset shall be included in the actual cost.
- Any internal profits shall be eliminated in arriving at such costs.

Improvements and Repairs

- Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost.
- Cost of an addition or extension to an existing tangible fixed asset of a capital nature and which becomes an integral part of the existing tangible fixed asset is to be added to its actual cost.
- Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of, shall be treated as separate asset.

Scope of ICDS V – Tangible Fixed Assets

Other points

- Where several assets are purchased for a consolidated price, consideration shall be apportioned to various assets on a fair basis – *does not specifically indicate valuation is needed*
- Fair value of a tangible fixed asset acquired in exchange constitutes cost of asset received
  - *No option of adopting fair value of assets given up*

Transitional Provisions

- Actual cost of tangible fixed assets, acquisition or construction of which commenced on or before 31 May 2015, but not completed by the said date, shall be recognised in accordance with this ICDS.

Comparison of AS, ICDS and Ind AS

Particulars	AS- 10	ICDS- V	Ind AS 16
Property, Plant and Equipment- Identification of Fixed Assets	• Fixed asset is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business. • However an enterprise may decide to expense an item which could otherwise have been included as fixed asset, because the amount of the expenditure is not material.	• The tangible fixed asset is any asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of producing goods or services and is not held for sale in the normal course of business. • There is no option of expensing off of immaterial assets.	• Similar to AS-10. • However, Ind AS 16 does not prescribe expensing off of any immaterial item.
Property, Plant and Equipment- Major spare parts	• Machinery spares are usually charged to profit and loss account as and when consumed. • However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, it may be appropriate to allocate total cost on a systematic basis over a period not exceeding the useful life of the principal item.	• Machinery spares which can be used only in connection with a Tangible fixed asset and where use is irregular, have to be capitalised.	• Spare parts are recognised in accordance with Ind AS 16 when they meet the definition of Property, Plant or Equipment. • Otherwise such items are classified as inventory

Comparison of AS, ICDS and Ind AS

Particulars	AS- 10	ICDS- V	Ind AS 16
Property, Plant and Equipment- Exchange of Assets for Non-monetory consideration	• When a fixed asset is acquired in exchange or part exchange for another asset, the cost of the asset acquired should be recorded either at the fair market value or at the net book value of the asset given up, adjusted for any balancing payment of receipt of cash or other consideration. • For this purpose, fair market value may be determined by reference either to the asset given up or to the asset acquired, whichever is more clearly evident.	• Fair value of a tangible fixed asset acquired in exchange constitutes cost of asset received • No option of adopting fair value of assets given up	• Similar to AS-10.
Property, Plant and Equipment- Assets acquired against issue of shares	• Fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.	• When a tangible fixed asset is acquired in exchange for shares or other securities, the fair value of the tangible fixed asset so acquired shall be its actual cost.	• Similar to AS-10.

Comparison of AS, ICDS and Ind AS

Particulars	AS- 10	ICDS- V	Ind AS 16
Property, Plant and Equipment- Replacement Costs	• Replacement cost of an item of property, plant and equipment is generally expensed when incurred. • Only expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is capitalised. • From FYs commencing on or after 1 April 2015, Schedule II mandates fixed assets to be componentised for the purposes of depreciation and therefore, the position will be similar to that under Ind AS.	• Similar to AS-10	• Replacement cost of an item of property, plant and equipment is capitalized if replacement meets the recognition criteria. Carrying amount of items replaced is derecognized
Property, Plant and Equipment- Revaluation	• No specific requirement on frequency of revaluation	• Not covered by ICDS. • However, under the Act, income/ expenses recognised only on actual realisation.	• Revaluations are required to be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period

Comparison of AS, ICDS and Ind AS

Particulars	AS- 10	ICDS- V	Ind AS 16
Property, Plant and Equipment- Residual Value	• Estimates of residual value are not required to be updated	• Not covered by ICDS	• Estimates of residual value need to be reviewed at least at each year end
Property, Plant and Equipment- Compensation for impairment	• No specific requirement. In practice, compensation is offset against replaced items of property, plant and Equipment	• Not covered by ICDS. • However, reliance can be placed on existing judicial precedents for taxability	• Compensation from third parties for impairment or loss of items of property, plant and equipment are included in profit or loss when the compensation becomes receivable.
Property, Plant and Equipment- Change in method of depreciation	• Requires retrospective recomputation of depreciation and any excess or deficit on such recomputation is required to be adjusted in the period in which such change is effected. • Such a change is treated as a change in accounting policy and its effect is quantified and disclosed	• Not covered by ICDS. • However, change in accounting policy such as change in method of depreciation can be made only when there is a reasonable cause under ICDS I.	• Changes in depreciation method are considered as change in accounting estimate and applied prospectively

Tax Impact of ICDS V – Tangible Fixed Assets

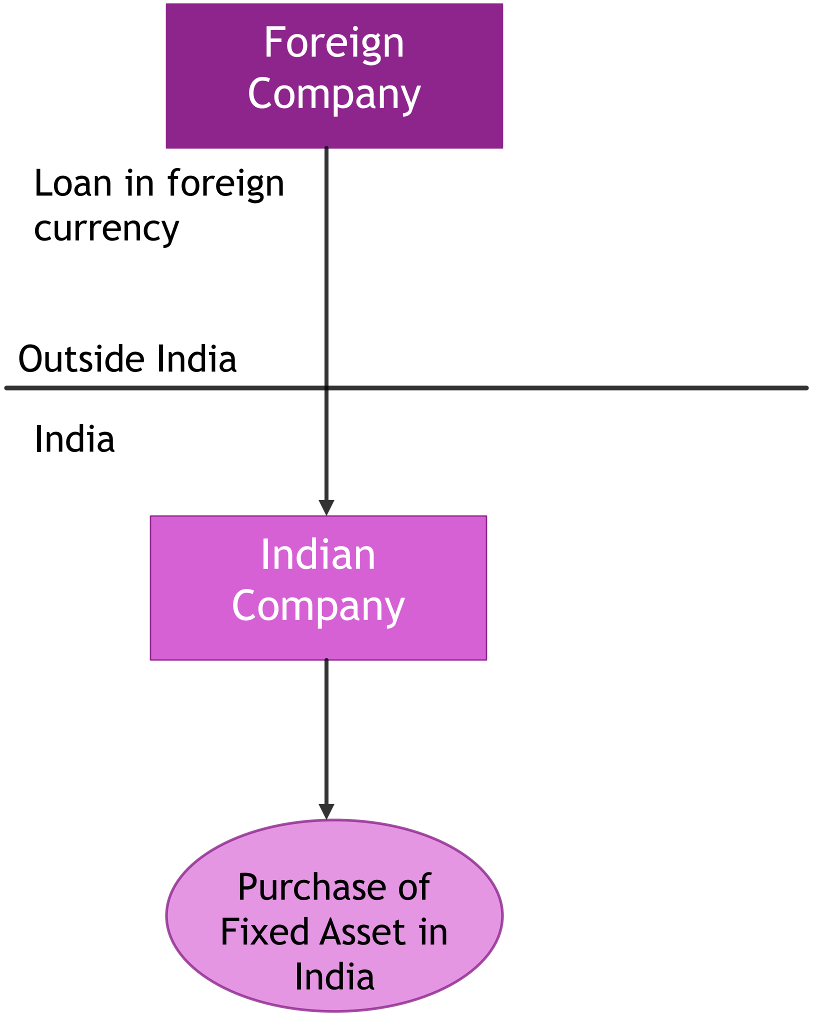
Taxation Impact in line with the provisions of the Act

- Cost of assets largely aligned with Section 43(1) of the Act
- Capitalisation of exchange differences relating to fixed assets shall be in accordance with section 43A and other similar provisions of the Act.

Issues

- In absence of valuation for assets purchased for consolidated price, AO may allocate more cost to non-depreciable assets?
- Can exchange difference arising on External Commercial Borrowings be capitalized even if used for acquiring domestic assets – Para 5 and 6 of ICDS VI?

Case Study – Exchange difference on ECB



Facts

- Indian Company borrows foreign currency loan (ECB) from Foreign Company repayable after 5 years
- Indian Company utilizes ECB proceeds to acquire assets in India
- At the end of year 1, due to reinstatement of principal amount of loan, Indian Company incurs MTM loss of INR 50 lacs

Case Study – Exchange difference on ECB

Tax Treatment - Pre ICDS	Tax Treatment - Post ICDS
➢ Distinction between capital and revenue nature of exchange fluctuation is well settled ➢ Exchange fluctuation of capital nature ignored under tax (gain not taxable, loss not deductible) ➢ Sec 43A permits capitalization in case of imported assets only ➢ MTM loss of INR 50 lacs is a sunk loss	➢ In contrast to settled judicial position, ICDS requires recognition of MTM gain/loss as income/expense (subject to Sec 43A) ➢ Can the Indian Company claim deduction of MTM loss of INR 50 lacs • Applicability of section 37(1)? ➢ Will revenue authorities tax gains relying on ICDS?

ICDS – FAQs issued by CBDT on 23 March 2017

✓ **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.

Disclosure Requirements

- Description of asset or block of assets;
- Rate of Depreciation;
- Actual cost or Written Down Value ('WDV'), as the case may be;
- Additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of-
  - ✓ CENVAT Credit claimed and allowed under the CENVAT Credit Rules, 2004;
  - ✓ Change in rate of exchange of currency;
  - ✓ Subsidy or grant or reimbursement, by whatever name called.
  - ✓ Actual cost or Written Down Value, as the case may be;
- Depreciation Allowable; and
- WDV at the end of the of the year.

Thank You

CA Jayesh Kariya

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.