

WIRC-ICAI

ICDS IX – Borrowing Costs ICDS X – Provisions, Contingent Liabilities and Contingent Assets

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ICDS IX – Borrowing Costs

Central Theme of ICDS IX

- Borrowing cost need not be capitalised (hence not allowed when incurred) :
 - On capital assets- till they are put to use
 - On certain inventories- till prepared for sale

ICDS IX – Borrowing Costs – Overview

□ Scope –

- (1) This Income Computation and Disclosure Standard deals with treatment of borrowing costs.
- (2) This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.

Issues- Paragraph 1

- “Treatment” – ?
 - Not accounting Treatment
 - Income Computation and Disclosure Treatment

- Interest on Share Application Money :
 - Not share ;
 - Held allowable on grounds of commercial expediency (and not u/s 36(1)(iii)) [See S.R.Thorat Milk Products (P.) Ltd. (159 ITD 255) (Pune Trib.)] ;
 - Share application is not a debt until a company decides to refund [CIT v Lucas TVS Ltd (249 ITR 302)(SC)]

ICDS IX – Borrowing Costs – Overview

□ Definition –

The following terms are used in this Income Computation and Disclosure Standard with the meanings specified:

- (a) “**Borrowing costs**” are interest and other costs incurred by a person in connection with the borrowing of funds and include:
- (i) commitment charges on borrowings;
 - (ii) amortised amount of discounts or premiums relating to borrowings;
 - (iii) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
 - (iv) finance charges in respect of assets acquired under finance leases or under other similar arrangements.

ICDS IX – Borrowing Costs – Overview

(b) **“Qualifying asset”** means:

- (i) land, building, machinery, plant or furniture, being tangible assets;
- (ii) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- (iii) inventories that require a period of twelve months or more to bring them to a saleable condition.

(2) Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meaning assigned to them in the Act.

Issues- on definition of Borrowing Cost

- ❑ “Interest” – section 2(28A)
 - Interest payable on moneys borrowed or debt incurred ;
 - Service fees or other charge in respect of :
 - moneys borrowed or debt incurred
 - Credit facility which has not been utilised
- ❑ Service fee or other charges – payable to lender only
- ❑ Arranger’s fees / brokerage for loans - not interest
 - Idea cellular Ltd v ADIT (ITA No. 1619/Mum/2011)
 - CBDT Letter : No.F. 164/18/77-IT(A-I), dated 13 July, 1978

Issues- on definition of Borrowing Cost (Contd...)

- Upfront appraisal fees/front end fees – is interest ;
 - JDIT v Commonwealth Development Corporation (ITA No. 1987&1988/Mum/2006)

- Definition : “and other costs in connection with” ;
 - Wider than interest ;
 - Expenditure incurred for raising debt – held as revenue expenditure [India Cements (60 ITR 52)(SC)] ;
 - However, distinguished in Challapali Sugars v CIT (98 ITR 167)(SC) – where production not commenced ;
 - Sub-Clause (iii) refers to “amortised amount” of ancillary cost incurred in connection with the arrangement of borrowings

Issues- on definition of Borrowing Cost (Contd..)

- ❑ Commitment charges :
 - Included in the definition of interest ;
 - No amortisation
- ❑ Amortisation of discounts and premium – straight line or IRR basis ?
- ❑ Amortisation of ancillary cost – In case of demand loans – not applicable
- ❑ Finance charges in finance leases :
 - ICDS LTD v CIT (350 ITR 527) (SC) – depreciation allowable to the lessor even in finance lease ;
 - Circular NO. 2/2001 DATED 9-2-2001- By itself, the accounting standard will have no implication on the allowance of depreciation on assets under the provisions of the Income-tax Act ;
 - ICDS requires capitalisation only of finance charges and not entire lease rental

Issues- on definition of Borrowing Cost (Contd..)

- ❑ Foreign exchange difference arising out of foreign currency borrowings to be capitalised?
- ❑ In case where construction of an asset is suspended, treatment of borrowing costs capitalised?

Issues- on definition of Qualifying Asset

- ❑ Does “land, building” in clause (i) cover stock-in-trade held for trading ?
 - Clause (iii) covers inventories “that require 12 months to bring them to saleable condition”. Land and building held for trading do not qualify under clause (iii);
 - Plain reading of clause (i) includes land , building whether held as stock-in-trade or as capital assets ;
 - Prima facie such stock-in-trade amounts to Qualifying Asset
- ❑ 12 months provided only for “inventories” in clause (iii). Thus, 12 months period not necessary for capital assets as per this definition
 - However, for the limited purpose of paragraph 6 , 12 months period applicable even to capital assets

Issues- on definition of Qualifying Asset (Contd...)

- ❑ Stock-in-trade in a real estate business :
 - Clause (iii) covers such stock-in-trade ;
 - Section 36(1)(iii) and the proviso thereto – whether applicable to a stock-in-trade ? Interpretation of “put to use” ;
 - Lokhandwala Construction Inds. Ltd. 260 ITR 579 (Bombay HC) ;
 - Wall Street Construction Ltd v JCIT (5 SOT 103) (SB) ;
 - Taparia Tools (372 ITR 605) (SC)

Issues- on definition of Qualifying Asset (Contd...)

- ❑ Draft ICDS on Real Estate Transactions : released on 11 May 2017 for comments from stakeholders on the draft by 26th May, 2017
 - Project cost defined to include : Borrowing costs – Costs which are incurred directly in relation to a project or which are apportioned to a project in accordance with Income Computation and Disclosure Standard IX relating to Borrowing Costs

- ❑ Whether TDR can be regarded as QA?

Recognition of Borrowing cost (para 3 & 4)

3. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and Disclosure Standard. Other borrowing costs shall be recognised in accordance with the provisions of the Act.
 4. For the purposes of this Income Computation and Disclosure Standard, “capitalisation” in the context of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph means addition of borrowing cost to the cost of inventory.
- ❑ These paragraphs lay down the central theme of ICDS-IX

Borrowing Costs Eligible for Capitalisation (para 5)

- Subject to paragraph 8, the extent to which funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised on that asset shall be the actual borrowing costs incurred during the period on the funds so borrowed.

Issues on para 5

- Funds borrowed specifically for QA, but temporarily parked in bank FD's etc till actual utilisation :
 - Capitalized to what extent - gross or net of interest income. AS-16 Para 10 requires capitalisation net basis. ICDS silent.
 - Tuticorin Alkali Chemicals & Fertilizers Ltd v ACIT (227 ITR 172) (SC) ;
 - India Cements (60 ITR 52)(SC) –

”A loan may be intended to be used for the purchase of raw material when it is negotiated, but the company may, after raising the loan, change its mind and spend it on securing capital assets. Is the purpose at the time the loan is negotiated to be taken into consideration or the purpose for which it is actually used ?”
 - JF Laboratories v ITO (96 ITD 448) (Mum ITAT) – interest expenditure allowable against interest income

Issues on para 5

- Explanation 8 to section 43(1)
 - DCIT v Core Healthcare (298 ITR 194) (SC)
 - Proviso to section 36(1)(iii) – earlier applied for extension of existing business. Amended by Finance Act, 2015 to apply irrespective of extension- FM Speech- to align with ICDS
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- ❑ Ancillary costs in connection with arrangement of borrowings – only amortized amount to be capitalized. (Para 5 – “borrowing costs incurred during the period”) ;
 - ❑ For inventories, 12 month test relevant but for capital asset not relevant for para 5;
 - ❑ Capitalisation not applicable where building held as capital asset for the purpose of letting - Income taxable under the head “IFHP” – ICDS not applicable

Borrowing Costs Eligible for Capitalisation (para 6)

6. Subject to Para 8, in respect of borrowing other than those referred to in Para 5, if any, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely :— $A \times B / C$

Where A = borrowing costs incurred during the previous year except on borrowings referred to in Para 5 above;

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

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

Borrowing Costs Eligible for Capitalisation

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

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

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

Issues on para 6

- ❑ Borrowing cost considered in para 5 is to be excluded in computing “A” ;
- ❑ Assets directly funded out of specific borrowings to be excluded in computing “B” ;
- ❑ Such directly funded assets also to be excluded in computing “C” ;
- ❑ Whether discount charges on bills discounted for specific debtors – to be included in “A”? ;
- ❑ If interest-bearing customer advance is specifically utilised for executing the customers order , should such interest be included in “A”? ;
- ❑ If an asset is acquired partly from specific loan and partly from fresh capital raised, should such asset be included in “B” and/or “C”? ;

Issues on para 6 (Contd..)

- ❑ If the borrowings have been utilised for funding losses, should such debit balance of P&L A/c be included in “C”? ;
- ❑ If an item of plant and machinery does not take 12 months period for construction, it is not to be included in “B”. Should it be included in “C” ?;
- ❑ Because of the Explanation to para 6,QA for para 5 and for para 6 will have to be separately identified/computed ;
- ❑ How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS-IX to different qualifying assets?
 - The capitalisation of general borrowing cost under ICDS-IX shall be done on asset-by-asset basis (Q No 22 of FAQ)

Issues on para 6 (Contd..)

There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a)(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?

Answer: 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. (Q No 20 of FAQ)

The above is contradictory to the concept of “actual cost”

Issues on para 6 (Contd...)

- Should “A” be the whole year’s interest cost even if the QA is commissioned during the year?;
 - Para 6 to be read alongwith para 7 and 8

Commencement of Capitalisation (para 7)

7. The capitalisation of borrowing costs shall commence:

- (a) in a case referred to in paragraph 5, from the date on which funds were borrowed;
- (b) in a case referred to in paragraph 6, from the date on which funds were utilised.

Issues on para 7

- ❑ In case of specific borrowings capitalisation commences from the date on which funds were borrowed. Thus actual utilization is not considered as relevant;
- ❑ In case of indirect borrowings- date of utilisation is stated as the commencement date. The word “utilised”, whether refers to utilization of QA or for utilisation for any other purpose ?

Issues on para 7

Particulars	Amount (Rs.)	Particulars	Amount (Rs)
CC A/c outstanding on 31/3/2016	1000	Interest for PY 2016-17 ("A")	120
QA as on 1/4/2016	NIL	Avg QA ("B"(ii))	250
QA acquired on 1/3/2017	500	Total assets ("C")	2000
QA as on 31/3/2017	500	Capitalisation amount (A*B/C)	15
CC A/c outstanding on 31/3/2017	1000	Or $120 * 1/12 * B/C$?	1.25

Cessation of capitalization (para 8)

- Capitalisation of borrowing costs shall cease:
 - (a) in case of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, when such asset is first put to use;
 - (b) in case of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, when substantially all the activities necessary to prepare such inventory for its intended sale are complete.

Issues on para 8

- ❑ Clause (a) applies to only capital asset or also to land and building held as stock-in-trade?
Interpretation of put-to-use ?

- ❑ Clause (b) – for inventory – ready for sale

- ❑ For flats sold under construction, when does capitalisation cease ?
 - On entering into agreement for sale ; or
 - On the flat being ready for delivery/ possession ?

Part completion (para 9)

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part shall cease:—

- (a) in case of part of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2, when such part of a qualifying asset is first put to use;

- (b) in case of part of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2, when substantially all the activities necessary to prepare such part of inventory for its intended sale are complete.

Transitional provision (para 10):

All the borrowing costs incurred on or after 1st day of April, 2016 shall be capitalised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount of borrowing costs capitalised, if any, for the same borrowing for any previous year ending on or before 31st day of March,2016.

Disclosure (para 11):

11. The following disclosure shall be made in respect of borrowing costs, namely:—

(a) the accounting policy adopted for borrowing costs; and

(b) the amount of borrowing costs capitalised during the previous year.



ICDS X – Provisions, Contingent Liabilities and Contingent Assets

ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Overview

□ Scope:

This ICDS deals with provisions, contingent liabilities and contingent assets, except:

- (a) financial instruments;
- (b) executory contracts;
- (c) insurance business;
- (d) provision for doubtful debts

□ A provision shall be recognised when:

- present obligation arising out past event;
- it is *reasonably certain* that an outflow of resources embodying economic benefits will be required to settle obligation; and
- a reliable **estimate** of the obligation could be made

ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Overview (contd...)

- ❑ A Contingent Liability
 - a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the person
 - a present obligation that arises from past events but is not recognised because:
 - it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - a reliable estimate of the amount of the obligation cannot be made
- ❑ Contingent assets shall be recognised as income when it becomes reasonably certain that inflow of economic benefit will arise
- ❑ Reimbursement to be recognised when it is reasonably certain that reimbursement would be received

ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Analysis

- Whether ICDS will have any impact on Provision on Warranty?
 - Accounting Standard –
 - Provision of warranty can be recognised.
 - Judicial Pronouncement –
 - Supreme Court has upheld the allowance of provision for warranty in case of Rotork Controls v. CIT 314 ITR 62 (SC)
 - ICDS –
 - Requires recognition of provision when it is reasonably certain that an outflow of resources embodying economic benefits would be required to settle the obligation

ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Analysis (contd...)

- Will ICDS impact current treatment of contingent asset?
 - Accounting Standard –
 - Requires recognition when there is virtual certainty of inflow of economic benefits
 - Committee Report –
 - To remove differential treatment between recognition of income and expense.
 - Judicial Pronouncements –
 - Basic concept of accrual & real income theory
 - ICDS –
 - Requires recognition of contingent asset if it becomes ‘**reasonably certain**’ that inflow of economic benefit will arise (for eg. Export incentives – whether to be recognised?)

ICDS X – Provisions, Contingent Liabilities and Contingent Assets – Analysis (contd...)

- ❑ Under Ind AS, long-term provisions have to be recognized at amortised cost (i.e., at their present value); (For eg. Site restoration costs)
- ❑ ICDS - Para 12 – Amount of a provision cannot be discounted to its present value. Hence, adjustment made in Ind AS has to be reversed while computing tax under ICDS

Clarifications issued by CBDT

- 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. (Q No. 24 of FAQ)



THANK YOU