Interplay between **Indian Accounting Standards (“Ind AS”)** and **Income Computation and Disclosure Standards (“ICDS”)**

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February 18, 2022

Synopsis of Discussion

S. No.	Topic	S. No.	Topic
1	Dismantling / Restoration Costs	8	Employee Loans
2	Sales Returns	9	Long Term Bonds
3	Significant financing	10	Redeemable Preference Shares
4	Allocation of Transaction Price	11	Forward Contracts for firm commitment
5	Lease Accounting & Tax	12	Guarantee Commission
6	Financial Instruments	13	Interest on Non-Performing Assets
7	Interest Free Deposits	14	Property, Plant & Equipment – Deferred Payment

Dismantling / Restoration Costs…

- Para 16 of Ind AS 16 – Cost of asset to include "initial estimate" of dismantling cost / restoration cost, etc.

  "the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

- Correspondingly, if the effect of time value of money is material, amount of provision should be recognised at their present value (Ind AS 37)

  "Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation."

Dismantling / Restoration Costs…

- Example –
  - Co. A purchases a machine of Rs. 5,00,000 to be used for 10 years
  - The cost of dismantling the machine is Rs. 50,000 which will be incurred on completion of the 10th year
  - Co. A follows straight line method of depreciation
  - Assume present value of dismantling costs is Rs. 30,000

- ***What would be the accounting treatment of dismantling costs under Ind AS ?***

…Dismantling / Restoration Costs - Accounting…

- At the time of purchase of machine

Machine Dr.	5,30,000	
To Bank		5,00,000
To Provision for dismantling		30,000

- Year on year basis

Depreciation Dr. (Rs. 5,30,000 / 10 years)	53,000	
To Machine		53,000

Interest Dr. (assumed-this will change based on disc.)	3000	
To Provision for dismantling		3000

…Dismantling / Restoration Costs - Accounting…

- At the end of 10th year
  - The machine will be fully depreciated
  - The provision for dismantling will stand in the books at Rs. 50,000
  - Now, at the time of discharging the dismantling costs, the following entry will be passed :

Provision for dismantling Dr.	50,000	
To Bank		50,000

  - In case the actual dismantling costs are more or less than the provision amount, then the balance will be recognized in the Statement of Profit and Loss

- ***What would be the tax treatment?***

…Dismantling / Restoration Costs - Tax

Normal tax / ICDS

- ❑ Definition of actual cost u/s. 43(1) – Challapalli Sugar Case (98 ITR 167) (SC)
- ❑ ICDS V is silent on treatment of dismantling cost. Para 5. "Purchase price, import duties and other taxes, and any directly attributable expenditure on making the asset ready for its intended use".
- ❑ ICDS X – present obligation arising out of past event.
- Whether the same have to be capitalised or claimed as revenue:
  - Udaipur Mineral Development Syndicate P. Ltd. v. DCIT 261 ITR 706 (Raj)
  - CIT v. Gogte Minerals 220 ITR 29 (Kar)
- If revenue, which year – first year or over the term of the agreement or the last year?
  - Madras Industrial Investment Corporation 225 ITR 802 (SC)
  - Taparia Tools 231 Taxmann 5 (SC)
- Para 12 of ICDS X – Amount of a provision cannot be discounted to its present value

Sales Return - Accounting…

- Assume Co. E sold 100 units of toys. Sale price of each toy is Rs. 10 and cost is Rs. 7
- Expected units likely to be returned based on past estimates is 10 (return policy is for 1 month)
- After 1 month, actual units returned is 4.
- Ind AS 115, para 55: *"An entity shall recognise a refund liability if the entity receives consideration from a customer and expects to refund some or all of that consideration to the customer. …. To account for a refund liability relating to a sale with a right of return, an entity shall apply the guidance in paragraphs B20–B27."*
- **Accounting entries – On the day of sale of 100 units**

Bank Dr. (100 units x Rs. 10)	1,000	
To Revenue (90 units x Rs. 10)		900
To Provision for return (10 units x Rs. 10)		100

Cost of sales Dr. (90 units x Rs. 7)	630	
Asset (for return) (10 units x Rs. 7)	70	
To Inventory		700

…Sales Return - Accounting…

- **Accounting entries – On completion of 1 month**

Provision for return Dr. (6 units x Rs. 10)	60		For goods actually sold – Sale price
To Revenue		60	

Cost of sales Dr. (6 units x Rs. 7)	42		For goods actually sold – Cost price
To Asset (for return)		42	

Inventory Dr. (4 units x Rs. 7)	28		For goods finally returned – When goods are received
To Asset (for return)		28	

Provision for return Dr. (4 units x Rs. 10)	40		For goods finally returned – When amount is refunded
To Bank		40	

…Sales Return - Tax

Normal Tax

- ❑ In absence of specific provisions under the Act - Follow commercial accounting principles unless they are in conflict with express provisions of the Act
  - CIT v. U.P. State Industrial Development Corporation (225 ITR 703) (SC)

- ❑ ICDS IV defines revenue as "gross inflow" of cash or receivables. However, ICDS IV, para 4 requires that revenue shall be recognized when there is reasonable certainty of its ultimate collection.

- ❑ ICDS X allows recognition of provision when it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation.
  - Rotork Controls India (P.) Ltd. (314 ITR 62) (SC)

- ❑ Provision on scientific basis – allowable.

Significant Financing…

- ❑ Co. X sells a product to the customer for Rs. 1,21,000 which is payable 24 months after delivery
- ❑ Customer obtains control of the product at contract inception
- ❑ The cash selling price of the product if the amount is paid on contract inception is Rs. 1,00,000
- ❑ The implicit interest rate is 10% (i.e., rate that discounts Rs. 1,21,000 to Rs. 1,00,000 over 24 months)
- ❑ ***What would be the accounting treatment ? – Ind AS 115 para 48(c) r.w. para 60 to 65***

The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

(a) ….

(b) ….

(c) the existence of a significant financing component in the contract (see paragraphs 60–65);

(d) ….

…Significant Financing - Accounting…

Debtor Dr.	1,00,000		At contract inception
To Revenue		1,00,000	

Debtor Dr. (1,00,000 * 10%)	10,000		At the end of 12 months
To Interest Income		10,000	

Debtor Dr. (1,10,000 * 10%)	11,000		At the end of next 12 months
To Interest Income		11,000	

Bank Dr.	1,21,000		On receipt of money
To Debtor		1,21,000	

…Significant Financing - Tax…

Normal Tax / ICDS

- ❑ Whether interest income credited in yr. 1 and 2 taxable ?
  - ED Sassoon & Co. Ltd v. CIT (26 ITR 27) (SC)
  - Godhra Electricity Co. Ltd. v. CIT (225 ITR 746) (SC)

- ❑ ICDS IV – Revenue is gross inflow of cash, receivables - Recognise revenue when the risks and rewards are transferred

- ❑ Can ratio laid down in UP Sugar be applied here ?

- ❑ Practical aspects of making ROI – in depth analysis of “interest” income and expense is necessary in every case.

Allocation of Transaction Price…

- 2-year mobile phone contract where two performance obligations are identified
  - Phone; and
  - Data, calls and texts

- Total transaction price = Rs. 1,000

- Price of the phone on the maker's website = Rs. 700

- The entity sells a 24 month plan without a phone that includes the same level of data, calls and texts for Rs. 15 per month = INR 360 (24 months x Rs. 15)

…Allocation of Transaction Price - Accounting…

- Para 73 of Ind AS 115:
  - *The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.*

- The entity uses observable price to allocate the transaction price

- **Phone price = Rs. 1,000 x Rs. 700 / Rs. 1,060 = Rs. 660**
- **Data, calls and texts – Rs. 1,000 x Rs. 360 / Rs. 1,060 = Rs. 340**

- Revenue from sale of phone will be recognised on day 1 at Rs. 660 but revenue from data, calls and text will be recognised over 24 months equally

…Allocation of Transaction Price - Tax

- Can the composite consideration be broken? Yes – See Continental Constructions 195 ITR 81(SC)

- Section 43CB provides for recognizing income from services involving indeterminate number of acts over a specific period on a straight line basis. This corresponds to para of ICDS IV – para 6, last sentence.

- For sale of goods, revenue is to be recognized under para 3 of ICDS IV when property in the goods is transferred or all significant risks and rewards are transferred.

- Thus, revenue recognition under Ind AS and under ICDS, in this case, is the same.

- Differentiate between a combo-product and a composite product. In the former, allocation is possible, may not be in the later.
  - State of Punjab Vs. M/s. Associated Hotels of India Ltd. (1972) (2) SCR 937 (SC)
  - Madras v. Gannon Dunkerley and Co. Ltd. [1958] 9 S.T.C. 353 (S.C.); [1959] S.C.R. 379(SC)

Leases – Accounting - Lessee…

- Commencement date – Recognise a right-of-use asset (at cost) and a lease liability (at present value of the lease payments that are unpaid) – IND AS 116, para 22:

  “At the commencement date, a lessee shall recognise a right-of- use asset and a lease liability.”

- Subsequent measurement Para 36 –
  - Right-of-use asset - Apply cost or revaluation model and accordingly, depreciate
  - Lease liability
    - Increase the carrying amount to reflect interest in the lease liability
    - Reduce the carrying amount to reflect the lease payments made
    - Remeasure the carrying amount to reflect any remeasurement or lease modifications, or to reflect revised in-substance fixed lease payments

…Leases – Accounting - Lessee…

- Assume lessee A enters into a 5 year lease of one equipment
- Lease payments are Rs. 80,000 p.a. payable at the end of each year
- Direct cost incurred to obtain this lease is Rs. 25,000
- Assume that the interest rate implicit in the lease is 6%
- Present value of the lease liability on the initial recognition is Rs. 3,36,990
- Lease liability to be recognised for 5 years would be:

Year	Opening balance	Finance Cost (6%)	Actual cash flow	Closing balance
1	3,36,990	20,219	(80,000)	2,77,208
2	2,77,208	16,633	(80,000)	2,13,841
3	2,13,841	12,830	(80,000)	1,46,671
4	1,46,671	8,800	(80,000)	75,472
5	75,472	4,528	(80,000)	0

- ***What would be the accounting entries in the books of the lessee ?***

…Leases – Accounting - Lessee…

- **Initial Recognition**

Right of use asset Dr. (3,36,990+ 25,000)	3,61,990		Commencement date
To Lease Liability		3,36,990	
To Bank		25,000	

- **Subsequent measurement**

Depreciation Dr. (3,36,990 / 5 years)	67,398		Assume straight line depreciation for 5 years
To Right of use asset		67,398	

Interest Dr.	20,219		Interest @ 6%
To Lease Liability		20,219	

Lease Liability Dr.	80,000		Actual cash outflow
To Bank		80,000	

…Leases – Accounting – Lessee /Lessor

Tax

- No ICDS issued on leases. (Initial plan of the Special Committee had a proposal)
- Lessee not being an owner, is not allowed depreciation u/s. 32.
- Lessor uses the asset in his business of leasing and hence allowed depreciation – 350 ITR 527 (SC)
- Lessee to be allowed rental payable as per the lease agreement.

Financial Instruments under Ind AS

Type of Financial Asset	Recognition under Ind AS
Traded equity instruments	FVTPL
Equity shares of subsidiaries,associates & JVs	Option either at cost or Fair value under Ind AS 109
Other long term equity investments	Option either FVTPL or FVTOCI
Liquid Mutual Funds	FVTPL
Fixed Maturity Plan Funds	Amortised cost
Lease Deposit	Amortised cost

Type of Financial Liability	Recognition under Ind AS
Financial liabilities held for trading including derivatives	FVTPL
Interest bearing loans and borrowings	Amortised cost

Financial Instruments – Transaction costs- Ind AS

Financial Asset (FA)	Initial measurement	Transaction costs
At FVTPL	Fair value	Expense
At FVTOCI	Fair value	Add to the FA
At amortised cost	Fair value	Add to the FA

Financial Liability (FL)	Initial measurement	Transaction costs
At FVTPL	Fair value	Expense
At amortised cost	Fair value	Deduct from FL

Financial Instruments – Transaction costs- Tax

Nature of Financial Instrument	Applicable ICDS for transaction cost	Tax Treatment
Capital Asset	None	To be capitalised to the cost of asset
Stock In Trade	ICDS VIII	Para 5 forms part of actual cost
Financial Liability	None- ICDS IX only to interest and other costs incurred in connection with borrowings	Allowed as a deduction-no enduring benefit –India Cements (60 ITR 52)

Interest free deposits

- **Ind AS 32 / 109**
  - Valuing interest free deposits at amortised cost (i.e., present value) and corresponding debit or credit to **opening balance of retained earnings / profit and loss / other asset or liability**
  - Every year, notional interest income / expense would be credited / debited to profit or loss section

- **Normal tax / ICDS**
  - ICDS IV - Interest shall accrue on the time basis determined by the amount outstanding and the rate applicable
  - Is the notional interest recognised in profit and loss account under Ind AS = "Interest" u/s. 2(28A)?
  - S. 2(28A) – Uses the words 'interest payable'

- **MAT**
  - Since credit / debit is to profit or loss, it is liable to MAT / allowable

Interest free deposits

- Interest free deposits taken from dealer for 5 years : Rs.100
- Under Ind AS 109, the FL has to be recognised at amortised cost (Say Rs.90)
- Notional income recognised upfront of Rs.10
- Notional income to be unwound over 5 year period by debiting the P&L Account

- Tax Treatment:
  - Rs.10 recognised as income in accounts is not "income" for tax purposes.
  - Pepsu Road Transport Corporation(130 ITR 18)(P&H HC)
  - Amount debited to P&L from year to year is not expenditure.
  - Indian Molasses(37 ITR 66)(SC)

- No role of ICDS.Rs.10 is not revenue as contemplated under ICDS IV and yearly debit to profit & loss account is not a liability separate from the original liability of Rs.100.

Employee loan - Accounting...

- Assume Co. M lent Rs. 150 to employees @ 5% interest p.a. (market interest is 10%) for 5 years
- The fair value of the loan on 1st day is Rs. 120
- The accounting entries to be passed by Co. M are as under:

- **On day 1**

Employee loan Dr.	120	
Prepaid expense Dr.	30	
To Bank		150

...Employee loan - Accounting...

- **Subsequent years**

Employee loan Dr.	12	
To Interest Income (assumed based on EIR)		12

Employee benefit expense Dr.	5	
To Prepaid expense (assumed)		5

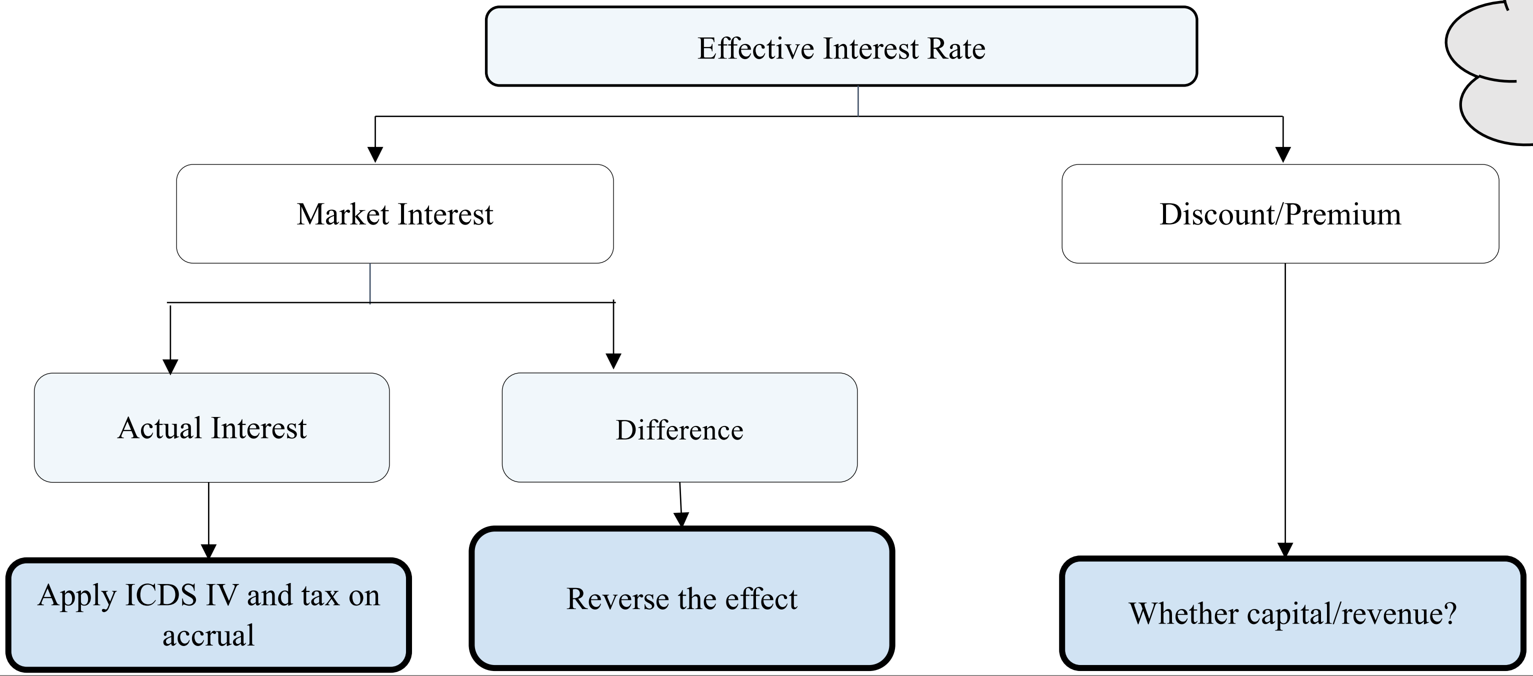
Bank Dr. (actual interest @ 5%)	7.5	
To Employee loan		7.5

- ***What would be the tax treatment ?***
  - No income accrual ; no expense incurred

Long-term Bonds

- Under Ind AS, assume long-term bonds (investments) are recognised at amortised cost using effective interest rate
  - Now, effective interest rate is arrived at after considering market interest and discount/premium
  - Accordingly, for ICDS, following adjustments to be made:

ICDS IV requires treating discount or premium as accruing over the period of debt instrument



Redeemable Preference Shares…

- Assume Co. A issued 5% redeemable preference shares of face value Rs. 100 on April 1, 2019 (Ind AS is applicable from April 1, 2021) – EIR is 10% (Assume 80 is the present value on transition date)
- Under AS, Rs. 100 was shown as part of share capital
- Under Ind AS, since there is a contractual obligation to pay dividend and redemption amounts, the same is treated as a financial liability to be measured at amortised cost
- Accordingly, on the date of transition, Co. A to pass following entries

Share Capital	100	
To Financial Liability		80
To Other Equity		20

…Redeemable Preference Shares…

- On subsequent measurement, Co. A to measure financial liability at amortised cost by using effective interest rate method whereby Co. A would pass the following journal entries:

Interest expense (at EIR) (assumed)	9	
To Financial Liability		9
Financial Liability	5	
To Cash		5

- Therefore, effectively, the financial liability increase by Rs. 4 such that at the end of the tenure, the liability would be reflected at Rs. 100
- Interest expense of Rs. 9 includes:
  - Coupon (i.e., dividend) payable
  - Amortised amount of discount / premium on redemption

…Redeemable Preference Shares

- **Normal tax / ICDS**
  - No impact on date of transition
  - Even on subsequent measurement, there will be no impact on account of effective interest rate
  - Actual dividend on preference shares – Not Allowable

- **MAT**
  - Since Rs. 20 is adjusted in other equity on convergence date, it will be entirely be liable to MAT over 5 years (no exception) – However, actual dividend paid / declared to be adjusted
  - Interest expense of Rs. 9 includes dividend of Rs. 5. Dividend will not be allowed for MAT purposes (Q No. 8 of the CBDT Circular 24/ 2017 dated July 25, 2017)

Forward Contracts on Firm Commitments…

❑ Ind AS

- Entity may adopt fair value hedge (adjustments in profit or loss) or cash flow hedge (adjustments in OCI to be reclassified to profit or loss)
- Recognise all gains and losses as on the reporting date

❑ ICDS

- S. 43AA r.w. ICDS VI – Recognise premium, discount or exchange differences on contracts entered into to hedge foreign currency risk of firm commitment at the time of settlement

❑ MAT

- Fair value hedge – No adjustment in book profits - Liable to MAT
- Cash flow hedge – No adjustment in book profits – Liable to MAT as and when amount is reclassified from OCI to profit or loss

…Forward Contracts on Firm Commitments – Fair Value Hedge…

Particulars	Amount (Rs.)
Price of commodity X on March 1, 2021	100
March 1, 2021 - Agrees to buy commodity X on June 30, 2021 – Forward rate	103
Actual market price on June 30, 2021	104
Therefore, gain on account of fair value hedge	1 (Rs. 104 – Rs. 103)
March 31, 2021 – Forward rate on June 30, 2021	101

Profit or Loss for period ending March 31, 2021			
To Loss on account of fair value hedge	Rs. 2		
(Rs. 103 – Rs. 101)			

Profit or Loss for period ending June 30, 2021			
To Purchase Price	Rs. 104	Gain on Settlement	Rs. 3
		(Rs. 104 – Rs. 101)	

…Forward Contracts on Firm Commitments – Fair Value Hedge…

- **FY 2020-21**
  - Rs. 2 allowable under MAT
  - Not allowable under ICDS

- **FY 2021-22**
  - Rs. 3 taxable under MAT
  - Rs. 1 taxable under ICDS (Rs. 104 – Rs. 103)

…Forward Contracts on Firm Commitments – Cash Flow Hedge…

Particulars	Amount
Firm export order on March 1, 2021	USD 100
Exported on June 30, 2021 - Amount receivable on June 30, 2021	USD 100
Forward contract entered on March 1, 2021 to sell USD 1 at	Rs. 65
Spot Rate on March 1, 2021	Rs. 63
Spot rate on March 31, 2021	Rs. 64
Forward rate for 3 months on March 31, 2021	Rs. 65.50
Spot rate on June 30, 2021	Rs. 66

OCI for period ending March 31, 2021		
To Loss on account of cash flow hedge	Rs. 50	
(Rs. 65.50 – Rs. 65) x USD 100		

…Forward Contracts on Firm Commitments – Cash Flow Hedge

OCI for period ending June 30, 2021	
	By reclassified to profit or loss Rs. 50
Profit or Loss for period ending June 30, 2021	
To reclassification of loss of year ending March 31, 2021 from OCI Rs. 50	
To further loss during this period Rs. 50	
(Rs. 66 – Rs. 65.50) x USD 100	

- **FY 2020-21**
  - Rs. 50 – Debited to OCI – Not allowable for MAT
  - Rs. 50 – Debited to OCI – Not allowable under ICDS

- **FY 2021-22**
  - Rs. 50 – Credited to OCI – Not taxable under MAT
  - Rs. 100 – Debited to profit or loss – Allowable under MAT
  - Rs. 100 – Debited to profit ot loss – Allowable under ICDS

Guarantee Commission…

- Assume Hold Co. has given guarantee to the bank on behalf of Sub Co. with respect to loan availed by it without charging any guarantee commission for 5 years (Assume fair value of similar guarantee commission is Rs. 15 crore)

- Ind AS – Entries to be passed as under:

In the books of Hold Co.			In the books of Sub Co.		
Initial Recognition					
Investment in Sub Co.	15		Prepaid expense	15	
To Financial Guarantee Liability		15	To Equity		15
Subsequent recognition (assumed straight-line basis)					
Financial Guarantee Liability	3		Guarantee Expense	3	
To Guarantee Income		3	To Prepaid expense		3

…Guarantee Commission…

- **Normal tax / ICDS**
  - ED Sassoon & Co. (1954) (26 ITR 27) (SC) – *Income accrues when a right vests to receive it and accrues to a person who has the right on the date when income arises*
    - Hold Co. – No accrual
  - Indian Molasses Co. (P.) Ltd (1959) (37 ITR 66) (SC) – *Expenditure" is thus what is "paid out or away" and is something which is gone irretrievably*
    - Sub Co. – No expenditure
  - CIT v. A. Raman & Co. (1968) 67 ITR 11 (SC) - *The law does not oblige a trader to make the maximum profit that he can out of his trading transactions. Income which accrues to a trader is taxable in his hands: income which he could have, but has not earned, is not made taxable as income accrued to him*

…Guarantee Commission

- **MAT – Hold Co.**
  - On initial recognition – no MAT implications
  - In subsequent years – Credit to profit or loss to be taxed

- **MAT – Sub Co.**
  - On initial recognition – no MAT implications
  - Year on year debit to profit and loss – deducted for MAT

Interest on Non-Performing Assets…

- NBFC D has Rs. 200 of financial assets classified for Stage 3 Expected Credit Loss since the same are non-performing (Interest is 5% on these assets)

- Based on the ECL model, the NBFC recognises 95% of the non-performing assets as expected credit loss – Therefore, Rs. 190 is recognised as expected credit loss

- Under AS, no interest income on NPAs was recognised by NBFCs in their books

- However, under Ind AS, companies have to recognise interest income on the net amount, i.e., Rs. 10 – Therefore, interest of Rs. 0.5 (5% of Rs. 10) is recognised in the books

- ***What would be the tax implications with respect to such interest income ?***

…Interest on Non-Performing Assets

- Earlier position – In the absence of specific provisions, interest on bad and doubtful debts cannot be taxed on accrual basis on the real income theory

- Under Ind AS, since the interest is being recognised in the books, should the interest be offered to tax ?
  - From AY 2020-21 onwards, s.43D is amended to include NBFCs and tax their income in the year in which it is credited to profit and loss account or when it is received, whichever is earlier

For entities other than those covered u/s.43D-real income theory continues to apply.Note Para 84 to 87 of Delhi HC decision in the case of Chamber of Tax Consultants v. UOI (87 taxmann.com 92)

Property, Plant and Equipment – Deferred Payment…

- On April 1, 2018, a plant is purchased at Rs. 100 with payment terms being 2 equal instalments of Rs. 50 over a 2-year period
- Payments are to be made on March 31, 2019 and March 31, 2020
- Implicit interest rate is 5% p.a.
- ***What would be the accounting treatment of the plant purchased ?***
- The above illustration also applies to inventories

…Property, Plant and Equipment – Deferred Payment…

- Measure the plant at cost – It is the cash price equivalent at the recognition date
- If payment is deferred beyond the normal credit terms, difference between cash price equivalent and total payment is recognised as interest

Year	Actual cash flows	Disc. Factor of 5%	Present Value
1	50	0.952	47.62
2	50	0.907	45.35
Total Present Value			**93**

Year	Opening balance	Finance Cost (5%)	Actual cash flow	Closing balance
1	93	4.65	(50)	47.62
2	47.62	2.38	(50)	0

…Property, Plant and Equipment – Deferred Payment…

- Entries would be:

Plant Dr. (At PV)	93		Initial recognition of plant – On April 1, 2018
To Creditor		93	

Interest Dr. (Unwinding)	4.65		On March 31, 2019 – Interest Unwinding
To Creditor		4.65	

Creditor Dr.	50		On March 31, 2019 – Actual cash flow
To Bank		50	

…Property, Plant and Equipment – Deferred Payment

Normal Tax / ICDS

- S. 43(1) and ICDS V use the word ‘actual cost’ – Whether Rs. 93 (present value) should be added to the cost of fixed asset ?

- Whether interest debited in P&L would be allowed ?

THANK YOU!!!