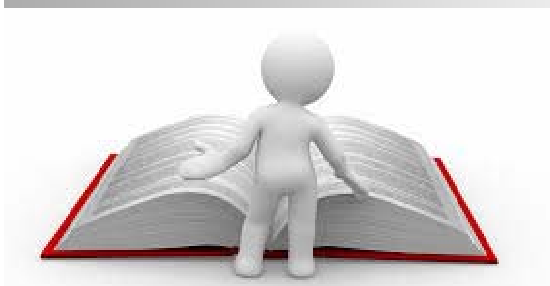

Income Computation & Disclosure Standards (ICDS)

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INTRODUCTION

- The Income Computation and Disclosure Standards (ICDS) were issued by the Ministry of Finance and notified by the CBDT vide Notification No.33/2015[F. No.34/48/2010-TPL] / SO 892(E) dated 31 March 2015
- In Jan 2015, the CBDT placed revised draft of 12 ICDS (earlier referred to as TAS) in public domain for comments & suggestion
- Finally, In exercise of the powers conferred by Sec. 145(2) CBDT has notified 10 ICDS (ICDS on Leases and Intangible asset not notified)
- ICDS shall be applicable from 1st April, 2015

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INTRODUCTION

- In case of conflict between the Income Tax Act, 1961 and ICDS, the Act shall prevail
- 9 out of 10 ICDS have a transitional provision to avoid any double taxation/ non taxation in pre and post ICDS periods
- ICDS shall apply to all assessees i.e. Corporate and Non corporate Assessees who follow the Mercantile System of accounting
- ICDS has no requirement to maintain books of accounts, it is only for the purpose of computation of income

PURPOSE

- The ICDS are a framework for the computation of income under the heads 'Profit and Gains of Business and Profession' and 'Income From Other Sources'
- Standardization of computation of income so as stabilize tax treatments of various items to prevent avoidance of taxes
- Promote the convergence of Ind-AS with IFRS

ICDS	Topic	Parallel AS	Parallel Ind-AS
ICDS 1	Accounting Policies	AS 1	8
ICDS 2	Valuation On Inventories	AS 2	2
ICDS 3	Construction Contracts	AS 7	115
ICDS 4	Revenue Recognition	AS 9	115
ICDS 5	Tangible Fixed Assets	AS 10	16
ICDS 6	Effects of Changes in Foreign Exchange Rates	AS 11	21
ICDS 7	Government Grants	AS 12	20
ICDS 8	Securities	AS 13	32/109
ICDS 9	Borrowing Costs	AS 16	23
ICDS 10	Provisions, Contingent Liabilities and Assets	AS 29	37

ICDS 1- Accounting Policies

- Fundamental Accounting Assumptions:
  - Going Concern
  - Consistency
  - Accrual
- It must be disclosed if the fundamental accounting assumptions are not followed
- The fundamental assumption of Materiality has been omitted
  - Though there will be no significant impact, there may be litigation on small value items if the tax authority is adamant
- Accounting Policies must be adopted so as to represent a True and Fair View of the state of affairs and income

ICDS 1- Accounting Policies

- The Concept of Prudence has been modified as it led to differential treatment of income and loss.
  - Hence Marked to Market Loss shall not be recognized as per ICDS 1 (unless in provision with another ICDS)
- Transactions shall be governed by their Substance over Legal Form
- Change in accounting policies must be due to a "reasonable cause"
  - this provision shall invite litigation as what constitutes reasonable cause has not been defined

ICDS 2- Valuation of Inventories

- Inventories shall be valued at the lower of cost or net realizable value (NRV- estimated selling price *less* estimated costs of completion)
- As opposed to AS 2, ICDS 2 shall apply even to service providers
- Materials held for use in production shall not be written down below cost when the finished products are expected to be sold above cost
- Transitional Provisions: If Interest and borrowing costs were included in the cost of opening inventory as on 1st April 2015, 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 1st April 2015.
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ICDS 2- Valuation of Inventories

- Cost of Inventories shall include:
- Costs of Purchase – consists of purchase price including duties, taxes, freight inwards…
- Cost of Services – consists of labor and other costs of personnel directly engaged in providing the service
- Cost of Conversion – consists of costs related to the units of production and involves allocation of fixed and variable production overheads
- Exclusions from cost of inventories :
- Abnormal losses
- Storage Costs
- Administrative Overheads
- Selling & Distribution Costs
- Borrowing costs (normally)

ICDS 2- Valuation of Inventories

- Methods for calculating Cost of Inventory:
  - FIFO
  - Weighted Average Cost Formula
  - Retail method
  - Net Realizable Value
- Contrasting to AS 2, Standard Cost method has not been prescribed by ICDS 2 as a method for the valuation of inventories
- In case of dissolution of partnership firm, AOP or Body of Individuals, inventory shall be valued at NRV
- The method of valuation should not be changed unless there is a reasonable cause.

ICDS 3- Construction Contracts

- A construction contract is a contract specifically negotiated for the construction of an asset or a combination of interrelated or interdependent assets
- Like AS 7, this ICDS is not applicable to Real Estate Developers
- Contract Revenue shall be recognized when there is reasonable certainty of its collection on Percentage Of Completion Method (POCM)
- Revenue and expenses shall be recorded with proportion to work completed
- Losses incurred on a contract shall also be allowed in proportion to the stage of completion

ICDS 3- Construction Contracts

- In case of early stages of contract (up to 25% of the stage of completion), revenue is to be recognized only to the extent of cost incurred

- Unlike ICDS 3 and AS 7, Ind-AS 115 permits contractors to follow completed contract method as well

- Contract revenue is to be recognized when there is reasonable certainty of its collection

- Contract revenue shall comprise of initial amount of revenue including retentions and variations in contract work, claims & incentive payments

ICDS 3- Construction Contracts

- Contract costs shall not be reduced by any incidental income being in the nature of interest, dividend and capital gains (that is not included in contract revenue). The same shall be separately chargeable to tax

- Provisions for anticipated losses are not allowed but contract costs related to future activities will be recognized as assets irrespective of the probability of their recovery

- Uncollectible Contract revenue already recognized as income is to be written off as bad debt (not as an adjustment of the amount of contract revenue)

ICDS 4- Revenue Recognition

- Includes Revenue income from the sale of goods, rendering of services, interest, royalties or dividend

- Revenue shall be recognized when its collection is reasonably certain, However, inability to measure the revenue reliably would not suffice as a reason to postpone its recognition

- Costs related to activities yet to be carried out or advance payments are excluded when determining the stage of completion through costs

- Following revenue transactions shall be recorded according to :
  - **Sale of goods** –When the seller has transferred to the buyer, the risks & rewards of Ownership and the seller does not retain effective control of the goods

ICDS 4- Revenue Recognition

- **Rendering of Services** – By Percentage Of Completion Method
- **Interest** – Accrual on Time Basis; Discount/ Premium related to Debt Securities shall accrue over the period of maturity of the security
- **Royalties** – Terms of Relevant Agreement; Other systematic and rational basis may also be used
- **Dividends** – As per ITA

- Service contracts must follow disclosure requirements similar to that of construction contracts

- For practical purposes, AS 9 allowed the use of straight line method for recognition of revenue, however this will not be permitted under ICDS

ICDS 4- Revenue Recognition

- Treatment of Bad Debts:

  Previously, no deduction would be available to a taxpayer if unrecorded income, offered to tax as per ICDS, turns into bad debt, as there would be no ‘write off’ in the books of accounts. However, to align the provisions of the Act with ICDS 4, the Amendment to the Finance Act provides that bad debts could be claimed without writing off corresponding sum in books of account provided the amount of such debt or part thereof has been taken into account in computing income of any earlier year on the basis of notified ICDS

ICDS 5- Tangible Fixed Assets

- The Actual cost of acquisition comprises of the purchase price, duties, taxes and directly attributable expenses which would render the asset ready for intended use, while any trade discounts and rebates must be deducted

- ICDS 5 provides that Depreciation shall be calculated as per the provisions of the Act

- ICDS is silent on the treatment of inspection costs, however it states that expenditure which increases future benefits from an existing asset beyond its previous performance can be added t the asset cost. Since inspection cost does not normally fall into this category, it shall not be included in the cost of the asset

ICDS 5- Tangible Fixed Assets

- Ind-AS contains provisions for decommissioning, restoration and liabilities previously recognized as a part of the cost of property, plant and equipment and are adjusted for changes in the amount or timing of future costs and for changes in market based discount rates. ICDS mentions that they should be reviewed at each balance sheet date and adjusted so as to show the best current estimate. However, it does not provide for discounting to present value
- AS requires statement of assets held for disposal at the lower of their NRV or book value where expected losses are to be recognized immediately, however ICDS does not permit writing off the cost of such assets

ICDS 5- Tangible Fixed Assets

- ICDS is silent on the treatment of expenses incurred during the period post completion of test runs and pending commencement of commercial production

- The cost of additions/extensions to an existing asset which are of a capital nature shall be added to the gross value of the asset

- ICDS does not deal with the compensation for impairment of assets

- In case of acquisition in exchange for another asset, shares or other securities, the fair value of the tangible fixed asset so acquired shall be its actual cost

ICDS 5- Tangible Fixed Assets

- ICDS requires that machinery spares be charged to revenue (except insurance spares)
- In conformity with the provision of the Act, the concept of revaluation of assets is not recognized
- ICDS prescribes disclosure requirement similar to requirement of Tax Audit Report, even for the persons not subject to tax audit

ICDS 6- Foreign Exchange Fluctuations

- Transactions covered under ICDS 6:
- Transactions in foreign currencies –
  - Such transactions shall be initially recognized at the rate prevailing on the date of the transaction. An average rate of a week or month may also be used
  - Monetary transactions need to be translated at year end rates (where monetary items mean money held and assets/liabilities to be received or paid in fixed or determinable amounts of money)
  - Non monetary transactions shall be converted at the exchange rate used on the date of the transaction. Any exchange gain or loss should not be treated as taxable

ICDS 6- Foreign Exchange Fluctuations

- Forward exchange contracts in foreign currency-
  - Premium or discount arising at the inception shall be amortized as an expense or income over the life of the contract
  - This shall apply to contracts not intended for trading/speculation, hedge transactions and entered into to establish the amount of reporting currency required or available at the settlement date
- Translating financial statements of Foreign Entities-
  - Types of Foreign Operations: Integral & Non-Integral
  - Non Integral Operators are those which have 1 or more characteristics of independent operations as a branch e.g. autonomy, etc…

ICDS 6- Foreign Exchange Fluctuations

- **Integral Operations** are to be translated as if they were a part of the assessees own controlled operations
- Monetary Assets: Translated at closing rate
- Non Monetary Assets: Translated at transaction rate
- For **Non Integral Operations**, assets & liabilities are to be translated at year end closing rate and Income & Expenditure at the rate on the date of the transaction. Resulting Exchange differences shall be recognized as income or expenses. However as per AS 11 the resulting exchange difference is accumulated in foreign currency translation reserve until the disposal of investment

ICDS 6- Foreign Exchange Fluctuations

- Exchange difference on monetary items could be recognized under "Foreign Currency Monetary Item Translation Difference Account" and amortized over the period as per AS 11 which must now be recognized as income or expense.
- **Marked to market** gains or losses are unrealized in nature. All gains or losses on forward exchange or similar contracts entered into for trading or speculation contracts shall be recognized only on settlement.

ICDS 7- Government Grants

- Recognition of Grants is done when there is reasonable assurance that the person shall comply with the conditions attached to them and the grants shall be received. However, recognition shall not be postponed beyond the date of actual receipt

- Government grants related to depreciable fixed assets must be reduced from actual cost or Written Down Value while being treated as deferred for non depreciable assets

- Grants for compensation for expenses or losses incurred or for giving immediate financial support are received as income

ICDS 7- Government Grants

- ICDS does not distinguish between capital and revenue nature of a Government Grant. There is no express clarification that the requirement to recognize Government grants as upfront or deferred income will not apply to grants in the nature of promoters' contribution and other capital grants.

- AS and ICDS follow a similar treatment for refund of grants and for grants related to non monetary assets whereas Ind-AS requires such grants received at a concessional value to be accounted for at a fair value

- ICDS further requires grants not for any specific asset to be apportioned to the various assets. AS is silent on this matter

ICDS 7- Government Grants

- In case of any obligations are to be met, they should be credited to income over the period in which the cost of meeting the obligation is charged to income. Under ICDS there is no option of credit to the capital reserve in this respect

- Additional disclosures are required to be made for each previous year which inter-alia includes nature & extent of grants reduced from the block of asset, grants not reduced from the block of assets with reasons & grants not recognized as income with reasons

ICDS 7- Government Grants

- Amendment to Section 2(24)(xviii):
    - In line with ICDS VII, amended bill has inserted a new clause (xviii) to section 2(24) of the Act to provide that assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the taxpayer [other than those under Explanation 10 to Section 43(1) defining the actual cost relevant to income from PGBP] would be included In taxpayer's income.

ICDS 8- Securities

- Deals with securities held as stock-in-trade.
- Actual cost of securities shall include acquisition charges e.g. brokerage, tax, duty, cess etc.
- Where unpaid interest has accrued before acquisition and is included in its price, the pre acquisition interest is to be deducted from the actual cost
- At the end of any previous year, securities held as stock-in-trade have to be valued at actual cost initially recognized or net realizable, whichever is lower.
- ICDS VIII prescribes FIFO method for valuation of securities instead of average cost as prescribed in AS 13. This difference in method of valuation of inventories would have an impact on the total income

ICDS 8- Securities

- Such comparison of actual cost initially recognized and net realizable value has to be done category-wise (Shares, Debt Securities, Convertible Securities and any other Securities)
- This provision is not in line with the settled judicial position that anticipated profit should not be taken into consideration for valuation of stock-in-trade. It virtually leads to recognition of anticipated profits since appreciated value of certain securities will absorb fall in value of other securities
- MTM/ expected losses allowed for loss on valuation of securities
- Where a security is acquired in exchange for another, cost shall be fair value of the security acquired
- Un listed Securities shall be valued at actual cost initially recognized.

ICDS 9- Borrowing Costs

- ICDS 9 deals with the treatment of borrowing costs and not with the actual or imputed cost of owners' equity and preference share capital
- It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset.
- Income on Temporary investments of those borrowings cost eligible for capitalization is not reduced by any income on temporary investment under ICDS. However, the same is reduced from Borrowing cost under AS 16.
- It requires disclosure of the accounting policy adopted for borrowing costs and the amount of borrowing costs capitalized during the year
- Unlike AS -16, suspension of capitalization of borrowing cost is not covered in the ICDS.

ICDS 9- Borrowing Costs

- **Qualifying asset** has been defined to mean – land, building, machinery, plant or furniture, being tangible assets; know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets; inventories that require a period of twelve months or more to bring them to a saleable condition

- As per ICDS 9, qualifying assets shall include only those inventories which take a minimum period of 12 months to be brought to saleable condition, AS 16 does not stipulate any such minimum period

ICDS 9- Borrowing Costs

- Exchange difference arising from foreign currency borrowing has been excluded from borrowing costs in ICDS 7 as opposed to AS 16
- Under AS 16 and Ind- AS 23, the exchange difference representing the difference between the interest on local and foreign currency borrowing is considered as borrowing cost whereas ICDS 9 does not make any such distinction
- Borrowing Cost in respect of borrowings partly used for acquisition of the qualifying asset to be capitalized in accordance with the following formula: (A)* (B)/(C)
- Where, (A) = Borrowing cost except directly relatable to specific purpose
- (B) = Average cost of qualifying asset at the first day and last day of the previous year
- (C) = Average cost of asset at the first day and last day of the previous year

ICDS 9- Borrowing Costs

- Amendment to Finance Act:

  The Act specifically provided for disallowance of interest paid in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. ICDS IX provides for capitalization of borrowing costs in respect of qualifying assets. The condition of acquisition of asset 'for extension of existing business or profession' for disallowance of borrowing costs under the Act, resulted in anomaly. The amended bill provides for removal of those words and thus, interest on borrowings used for acquisition of asset till the asset is put to use shall not be all owed as deduction in any case.

ICDS 10- Provisions, Contingent Liabilities & Contingent Assets

- This ICDS does not deal with provisions, contingent liabilities and contingent assets –
  - resulting from **financial instruments**,
  - resulting from **executory contracts**,
  - arising in **insurance business** from contracts with policyholders
  - recognition of revenue covered by **another ICDS**

- The ICDS specifies the conditions for recognition of a provision :
  - present obligation as a result of a past event
  - reasonable certainty of an outflow of resources
  - reliable estimate of obligation

ICDS 10- Provisions, Contingent Liabilities & Contingent Assets

- A person shall not recognize a contingent liability or a contingent asset
- However, contingent assets to be assessed continually. When it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income have to be recognized in the previous year in which the change occurs
- It provides for recognition of provision at best estimate of the expenditure required to settle the obligation/ value of economic benefit
- Estimate not to be discounted to its present value
- Provision to be reviewed at year end

ICDS 10- Provisions, Contingent Liabilities & Contingent Assets

- It also provides that a provision shall be used only for expenditure for which the provision was originally recognized.
- ICDS are not applicable to executory contracts but are silent on onerous contract (a contract where the costs involved with fulfilling the terms and conditions of the contract are higher than the amount of economic benefit received) and restructuring provisions whereas AS- 29 mandates recognition of present obligation under onerous contracts
- The extent of absorption of MAT credit will be affected due to enhancement or preponement of the tax liability computed under the Act

ICDS 10- Provisions, Contingent Liabilities & Contingent Assets

- AS-29 recognizes that, apart from legal / contractual obligations, obligations may arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. However, ICDS 10 provides that provisions should be recognized if they meet the criteria of reasonably certainty. This deviation is likely to unsettle the legal position and create confusion for taxpayers leading to litigation

Thank You