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- CA Neelesh Khandelwal

Introduction

Income Computation and Disclosure Standards (ICDS) are guidelines using which taxpayers and the Income Tax Department can calculate the taxable income obtained by an Assessee in a financial year

The ICDS were framed by the Government of India with the objective of inculcating uniformity in accounting policies

ICDS has been framed using Generally Accepted Accounting Principles (GAAPs) with the assistance of the Institute of Chartered Accountants of India (ICAI). It has been in existence from the financial year of 2015-16

Background

ICDS- Income Computation and Disclosure Standard

CG has power to notify ICDS – Sec 145(2)

CBDT notified ICDS on 31st March, 2015 which was applicable **for AY 2016-17**

CBDT notified revised ICDS on 29th September, 2016 which replaced the earlier notification and was made applicable from AY 2017-18 and subsequent assessment years

Roots of ICDS

Accounting Standards

- Accounting Standards (AS): Roots of ICDS are in accounting standards. An accounting standard is a principle that guides and standardizes accounting practices
- Accounting standards are concerned with the preparation, presentation and disclosure requirements regarding books of accounts. These are drafted by ICAI
- The CBDT had constituted an Accounting Standard Committee in year 2010 and this committee had drafted 14 Tax Accounting Standards (though they were not made applicable)

Provision at Glance – Section 145

Method of Accounting

- Taxable income under the heads "PGBP" or "IFOS" computed in accordance with cash or mercantile system of accounting, being regularly employed
- CG may notify ICDS to be followed by any class of Assessees or in respect of any class of income
- If the AO is not satisfied about the correctness or completeness of the accounts, or method of accounting has not been regularly followed, or income has not been computed in accordance with ICDS, the AO may make a Best Judgment Assessment (BJA) under Sec 144
- At present there are 10 ICDS notified by CBDT which shall be applicable in computing income under the head "PGBP" or "IFOS“

Applicability of ICDS

Applicability

All assessees following the mercantile system of accounting for the purpose of computation of income chargeable to tax under the head “PGBP” or “IFOS” which also means that it may be applicable to assesses covered under presumptive scheme

Non Applicability

- Individuals or a HUF who is not required to get his accounts of the PY audited as per Sec 44AB
- Cash system of accounting is followed by the Assessee
- Income chargeable under heads of income other than PGBP or IFOS

Notified ICDS

S.No	ICDS	Linked AS
1	I - Accounting Policies	AS 1- Disclosure of Accounting Policies
2	II - Valuation of Inventories	AS 2- Valuation of Inventories
3	III - Construction Contracts	AS 7- Construction Contracts
4	IV - Revenue Recognition	AS 9 - Revenue Recognition
5	V - Tangible Fixed Assets	AS 10- Property, Plant and Equipment
6	VI- The Effects of changes in Foreign Exchange Rates	AS 11- The Effects of changes in foreign exchange rates
7	VII - Government Grants	AS 12- Accounting for Government Grants
8	VIII - Securities	AS 13- Accounting for Investments
9	IX - Borrowing Costs	AS 16- Borrowing Costs
10	X - Provisions, Contingent Liabilities and Contingent Assets	AS 29- Provisions, Contingent Liabilities and Contingent Assets

ICDS-I Accounting Policies

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ICDS-I Accounting Policies

Scope

ICDS I deals with significant accounting policies

Fundamental Accounting Assumptions	Description
Going Concern	Person has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocation and intends to continue the same for the foreseeable future
Consistency	Accounting policies are consistent from one period to another
Accrual	Revenue and costs are recorded on accrual basis and not on receipt basis

ICDS I vs AS 1

Points of Comparison	ICDS I	AS 1	Impact
Prudence	Expected losses shall not be recognised unless any other ICDS provides for it	Anticipated profits are not recognised and the expected losses are recognised	There would be a timing difference as per ICDS Delhi HC has done away with this mismatch.
Materiality	Does not recognise the concept of materiality for computation of taxable income	Recognise the concept of ‘materiality’ as important factor for selecting/changing accounting policies	In the absence of materiality concept considerable time and cost will be involved making trivial adjustments in net profit as per books of account to arrive at PGBP
Change in Accounting Policies	Accounting policy cannot be changed without reasonable cause	Flexibility in changing accounting policy for appropriate presentation of accounts	ICDS is more rigid for allowing change of accounting policy


Inventory
Valuation

ICDS-II Valuation of Inventories

Scope

ICDS II shall be applied for valuation of inventories

ICDS II is not applicable to

Where derivatives are held as stock-in-trade, the provisions of ICDS-II would apply

- WIP arising under ‘construction contract’ including directly related service contract
- WIP dealt with by other ICDS
- Shares, debentures and other financial instruments held as stock-in-trade
- Producers’ inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at NRV
- Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular

Measurement

Inventories shall be valued at **Cost or NRV, Whichever is lower**

Definition of inventory and NRV

Inventories are Assets

- Held for sale in the ordinary course of business (Finished goods)
- In the process of production for such sale (WIP)
- In the form of materials or supplies to be consumed in the production process or in the rendering of services (Raw materials)

Net Realisable Value

Estimated Selling Price	**XXX**
Less: Estimated cost of completion	(XXX)
Less: Estimated costs necessary to make the sale	(XXX)
NET REALISABLE VALUE (NRV)	**XXX**

Exclusions from the Cost of Inventories

Costs that are excluded and recognized as expenses of the period in which they are incurred

- Abnormal amounts of wasted materials, labour or other production costs
- Storage costs, unless those costs are necessary in the production process prior to a further production stage
- Administrative overheads that do not contribute to bringing the inventories to their present location and condition
- Selling Costs

ICDS II vs AS 2

Points of Comparison	ICDS II	AS 2
Work in progress	ICDS II does not deal with Work-in-progress which is dealt with by any other ICDS. It does not specifically provide for work in progress arising in business of service provider	Work in progress arising in the ordinary course of business of service providers is not covered by AS.
Machine Spares	ICDS II does not deal with machinery spares, which are dealt with by ICDS V on tangible fixed assets.	Stores and spares are one of the classification of inventories. AS 2 does not specifically exclude machine spares
Borrowing cost	It includes interest and other borrowing cost in inventory cost, if they satisfy the condition of ICDS IX on borrowing cost	It does not include interest and other borrowing cost to the cost of inventory
In case of dissolution	Cost of inventory will be valued at net realizable value	Does not specifically provide for the valuation of inventory in case of dissolution

Valuation of Inventories in case of Firm/AOP/BOI Dissolution

According to ICDS, in case of dissolution of a partnership firm or association of person or body of individuals, ***notwithstanding whether business is discontinued or not***, the inventory on the date of dissolution shall be valued at the ***net realizable value***

Provisions of Section 9B may also get triggered

This is unfair particularly as there is no specific provision for allowing such NRV as the cost to the successor of the business

Also this is contrary to law settled by Apex court in the case of *Sakthi Trading Co. v. CIT*

Case laws and Impact of Delhi HC Judgement

Case	Principle
A.L.A. Firm v. CIT [1991] 55 Taxman 497 (SC) / 189 ITR 285	In cases of dissolution of firm, the stock-in-trade will have to be valued at the prevailing market price while preparing the accounts if the business of the firm is discontinued
Sakthi Trading Co. v. CIT [2001] 118 Taxman 301 (SC) /250 ITR 871	If on dissolution of the firm the business is not discontinued, then, the ordinary principle of commercial accounting permitting valuation of stock-in-trade at Cost or Net Realizable value whichever is lower will apply

The Delhi HC has struck down ICDS II to the extent that it provides for recognizing inventory at market value even in case of no discontinuation of business

ICDS-III Construction Contracts

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ICDS-III Construction Contracts

Scope

ICDS III shall be applied in determination of income for a construction contract of a contractor

Construction Contracts

- **Fixed Price Contract** — The contractor agrees to receive fixed rate per unit of output or fixed price for the whole contract
- **Cost Plus Contract** — The cost with a defined percentage markup on the cost is reimbursed to the contractor

CBDT vide Circular 10/2017 dated 23rd March, 2017 has clarified that since there is no specific ICDS notified for real estate developers, BOT projects and leases, provisions of the Act and ICDS shall apply to these transactions as may be applicable

ICDS III vs As 7 - Retention Money

ICDS III	AS 7
Contract revenue shall comprise: The initial amount of revenue agreed in the contract, ***including retentions***	Contract revenue shall comprise: The initial amount of revenue agreed in the contract

Impact Analysis: There are various judicial precedents like Angelique International Ltd vs Department of Income Tax ITA No 4085 / 2011 which does not recognize retention money as income for tax purpose if there is no enforceable debt ICDS leads to deviation from the settled judicial position

The CBDT clarified that 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

The Delhi HC has struck down ICDS III, to the extent it seeks to bring retention money to tax at the earliest stage

ICDS III vs As 7 - Incidental Income

ICDS III	AS 7
Contract cost shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in the contract revenue	Any incidental income, not included in the contract revenue, shall be deducted while computing construction cost

Impact: Therefore, those interest income, dividend income and capital gains shall be taxed as income in accordance with the applicable provisions of the Act

The Supreme Court, in the case of *CIT vs. Bokaro Steel Ltd*., held that receipts which are inextricably linked to the setting up of plant or machinery can be reduced from the cost of asset.
The Delhi HC struck down the provisions of ICDS III to the extent contrary to the settled judicial position

Introduction of Section 43CB

Section 43CB was introduced vide Finance Act, 2018

To provide that profits arising from a construction contract or a contract for providing services

shall be determined on the basis of percentage of completion method

contract revenue shall include retention money

contract cost shall not be reduced by incidental interest, dividend and capital gains

ICDS III vs As 7 - Recognition of foreseeable losses

ICDS III	AS 7
ICDS does not permit recognition of the foreseeable/expected losses on a contract ICDS on accounting policies also does not permit recognition of foreseeable loss	It permits to recognise immediately the foreseeable losses on a contract regardless of commencement or stage of completion of Contract

Impact:
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

Example

Year	Loss	Unrelated Income	Computation		Remarks
			Income Tax	Books of Accounts	
1	Expected loss INR 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 INR 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

ICDS-IV Revenue Recognition

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ICDS-IV Revenue Recognition

Scope

ICDS IV deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from the following activities:

- Sale of goods
- Rendering of services
- Use by others of the person's resources yielding interest, royalties or dividends.

Revenue

- Gross inflow of cash
- Receivable or other consideration arising in the course of ordinary activities mentioned above
- In an agency relationship, the revenue is the amount of commission

Criteria for Recognizing Revenue

Sale of goods

- When the seller of goods has transferred to the buyer the property in the goods for a price
- All significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred
- When the seller of goods has transferred to the buyer the property in the goods for a price
- When there is reasonable certainty of its ultimate collection after transfer

Rendering of services

- Recognised on the percentage completion method
- 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

ICDS IV vs AS 9

ICDS IV	AS 9
❖ ICDS is silent on same	❖ It does not apply to companies engaged in insurance business
❖ ICDS IV provides only for percentage completion method (POCM) for recognition of service transactions ❖ ICDS IV provides that revenue from service contracts with duration of not more than 90 days may be recognized under completed contract method ❖ ICDS IV provides that when service is provided by an indeterminate number of acts over a specific period of time, revenue may be recognized on straight line basis over the specific period	❖ Revenue from service transactions are recognised as percentage completion method or by the completed service contract method

The Delhi HC has struck down ICDS IV to the extent that it only permits POCM

Introduction of Section 43CB

Newly inserted Section 43 CB in Finance Act, 2018 provides only for percentage completion method for recognition of service transactions

Proviso to newly inserted Section 43 CB provides that revenue from service contracts with duration of not more than 90 days may be recognized under completed contract method

Proviso to newly inserted Section 43 CB provides that when service is provided by an indeterminate number of acts over a specific period of time, revenue may be recognized on straight line basis over the specific period

Newly inserted Section 145B of the Act provides that any compensation or enhanced compensation like Interest on refund of any tax, duty or cess shall be taxable on receipt basis

Impact of Delhi High Court on Export Incentives

The Supreme Court ruled that export incentives are taxable only in the year when the claim is accepted by the Government, aligning with the moment when the taxpayer's right to receive payment is established

However, the Income Computation and Disclosure Standards (ICDS) IV contradict this by requiring recognition of such income in the year of claim if there's reasonable certainty of collection, which the Court deemed unlawful

ICDS IV, being contrary to the SC ruling, is ultra vires the ITA provisions and, hence, struck down to that extent

ICDS-V Tangible Fixed Assets

Scope

ICDS V deals with treatment of Tangible fixed assets

Tangible Fixed Assets → An asset being land, building, machinery, plant or Furniture → 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

ICDS V vs AS 10

ICDS V	AS 10
It applies to only Tangible Fixed Assets	It applies to Tangible Fixed Assets
It has similar definition to AS 10 but the words used are actual cost as compared to cost in AS 10	Cost of fixed asset comprises its purchase price, non refundable taxes and any directly attributable cost of bringing the asset to its working condition for its intended use

Impact:

The Act provides for the definition of the term 'actual cost' and it is again repeated in the ICDS but it does not modify the concept of actual cost. However when there is conflict in interpreting the abovementioned term under ICDS and Act, the Act will prevail over ICDS. Such a narrow definition in ICDS might encourage the taxpayer to contend that expenditure on acquisition which is not part of actual cost should be deductible as revenue instead of capitalising

ICDS V vs AS 10

ICDS V	AS 10
It provides that machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, shall be Capitalized	AS 10 read with guidance note on Machinery for Spares provides for charge to P/L, however spares to specific asset should be capitalised and shall form part of that Asset

Impact:

ICDS specifies that machinery spares dedicated to a tangible fixed asset should be capitalized, it does not provide any further guidance on subsequent treatment that whether it will form part of the block of the asset However, in absence of such clarification spares would form part of the block and once the principal asset is put to use, the spares shall qualify for the depreciation at the same rate

Miscellaneous Points

- **Assets held for rental:** If income from such assets is taxable under PGBP or IOS, ICDS V is applicable
- Purchase of insignificant items to be expensed under AS 10. Under ICDS-V no distinction between significant and non significant items as materiality not relevant
- Land is a qualifying asset under ICDS on Borrowing Costs Capitalisation of interest
- Under AS 10, dismantling cost and the cost of removing the item and restoring the site is required to be capitalized at the inception. However ICDS does not provide for the same. Adjustment will be required to block of assets and in computation to the net profit as per P/L A/c. These costs will be allowed in the year in which it is actually incurred

ICDS-VI : Effects of Changes in Foreign Exchange Rates:

Scope

i. Treatment of transactions in foreign currencies
ii. Translating the financial statements of foreign operations;
iii. Treatment of foreign currency transactions in the nature of forward exchange contracts

Monetary Items:
Money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money

Recognition of Exchange Difference

In case of Monetary Items

Exchange difference arising on Settlement or on Conversion thereof at the last day of the previous year- **Recognize as Income/Expense**

In case of Non-Monetary Items

Exchange difference arising on Conversion thereof at the last day of the previous year- **Shall not be recognized as Income/Expense**

Non- Monetary Items:
Assets and Liabilities other than monetary items

ICDS VI vs AS 11

ICDS VI	AS 11
➢ Requires recognition in P&L A/c subject to provisions of Section 43 A ➢ No Para 46 & 46A exists	➢ Requires recognition in P&L A/C ➢ Option of capitalization u/s 211(3C) of Companies Act, 1956 as per which (Para 46 46 A) exchange differences arising in case of long term foreign currency monetary items shall be either adjusted to capital asset or accumulated in FCMITDA

Impact relating to imported assets:

- Presently, Section 43A permits capitalization on payment basis of exchange differences relating to asset acquired from a country outside India
- Hence, there would be no change in the tax position

Capital Monetary Items- Not Relating to Imported Assets

Impact not relating to imported assets:

- Section 43A does not apply since it applies only if it relates to the imported assets
- Presently, such FE differences are not recognized for tax purposes i.e. gain is not taxable, loss is not deductible/allowable
- Since ICDS requires recognition in P&L A/c subject to provisions of Section 43A and Section 43A applies only if it relates to imported assets, a controversy may arise, whether such exchange fluctuation gain or loss on capital monetary items (not relating to imported assets) would be allowable as an income or expense as per ICDS or not
- However, Finance Act 2018 inserted new Section 43 AA providing that "subject to the provisions of section 43 A, any gain or loss arising on account of effects of changes in foreign exchange rates in respect of specified foreign currency transactions shall be treated as income or loss"

Judicial Precedents

➢ Section 43A of the Act was introduced by the Finance (No.2) Act, 1967 with effect from 1st April, 1967

Tata Iron & Steel [TISCO- (1998) 231 ITR 285 (SC)]

The Supreme Court ruled that the cost of an asset and the cost of raising money for its purchase are separate transactions. Fluctuations in foreign exchange rates during loan repayment do not change the actual cost of the asset for depreciation calculation

Provisions of Section 43A requiring foreign exchange gain/loss to be adjusted with the cost of the assets, apply only with respect to imported assets

Indigenous assets will continue to be governed by the ratio of the Tata Iron & Steel's decision

Gains arising on deposits (in foreign currency) are capital receipt as the deposits were in essence loan/capital and not a trading receipt -Shell Company of China Ltd. [22 ITR 1 (CA)]

Profit or loss from foreign currency conversion is considered capital in nature if the currency is held as a capital asset or fixed capital

Implication of Delhi High Court Judgement

ICDS

- Exchange fluctuation losses or gains on forward exchange contracts used for trading or speculation are recognized upon actual settlement, not on a mark-to-market basis

Sutlej Cotton Mills Ltd .vs. CIT

- Exchange fluctuation gain/loss in relation to loan utilised for acquiring a capital item would be capital in nature. Consequently, the loans have to be valued at the closing rate thereby giving rise to foreign exchange gain/loss irrespective of the fact that such loan has been taken for capital purposes

Delhi HC Judgement

- The HC held that this is not consonant with the ratio laid down by the SC in the *Sutlej Cotton Mills* ruling and, therefore, struck it down

Implication of Delhi High Court Judgement

CBDT Circular

- The opening balance of the Foreign Currency Translation Reserve Account as of April 1, 2016, which includes accumulated exchange fluctuation gains or losses from non-integral foreign operations, is taxable to the extent it pertains to monetary items

Godhra Electricity Co. Ltd. vs. CIT

- Hypothetical Income cannot be taxed

Delhi HC Judgement

- Valuation of monetary assets and liabilities of foreign operations at year-end isn't considered real income, as it's hypothetical and notional, thus not taxable

ICDS-VII : Government Grants:

Scope

1. Treatment of Government Grants
2. Government Grants are often called by other names such as subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursement, etc.

This ICDS does not deal with

1. Government assistance other than in the form of Government grants; and
2. Government participation in the ownership of the enterprise

Recognition of Government Grants

1. Should not be recognized until there is reasonable assurance that-
   - The person shall comply with the conditions attached to them, and
   - The grants shall be received
2. Recognition of Government grant shall not be postponed beyond the date of actual receipt

Treatment of Government Grants

Treatment of Government Grants

In case of Depreciable Fixed Asset

Deduct grant from the Actual Cost of Asset or from the WDV of the block of Asset

In case the Grant cannot be directly relatable to asset acquired

Deduct proportionate grant from the Asset Costs

In case of Non- Depreciable Fixed Asset

Recognize the grant as income over the period over which the cost of meeting such obligation is charged to income

In case grant is receivable as compensation for expenses or losses incurred

Recognize as income of the period

In Any other case

Recognize as income over the period to match them with related costs

Grant in form of Non-monetary Assets, given at concessional rates

Account on the basis of Acquisition cost

Refund of Government Grant

Refund of Government Grant

- Related to Non-depreciable asset, Compensation for expenses or losses or in any other case
  - Unamortized deferred credit remaining:
    Charge to P&L- (Refund-Unamortized deferred credit)
  - Unamortized deferred credit not available:
    Charge to P&L- Entire Refund Amt.
- Related to Depreciable Fixed Asset
  - Increase the cost of the Asset. Depreciation on the increased cost shall be provided on prospective basis.

ICDS VII vs AS 12

ICDS VII	AS 12
❑ **Recognition of Grant:**	
➢ On reasonable assurance of compliance of attached conditions and reasonable certainty of ultimate collection ➢ Recognition cannot be postponed beyond date of actual receipt	➢ On reasonable assurance of compliance of attached conditions and reasonable certainty of ultimate collection ➢ Mere receipt is not sufficient
Impact: If the grant is recognized on receipt basis, it would create DTA/DTL and MAT mismatch also	

Impact of HC Judgement:
ICDS VII which provides that recognition of government grants cannot be postponed beyond the date of accrual receipt, being in conflict with the accrual system of accounting. To that extent it is held to be ultra vires the Act and struck down as such

ICDS VII vs AS12

ICDS VII	AS 12
❑ Relatable to depreciable fixed assets:	
➢ Consistent with Explanation 10 to Section 43(1), requires reduction from the cost of fixed asset	➢ Requires reduction from the cost of fixed asset or recognition as deferred revenue by systematic credit to P&L A/c
❑ Relatable to non depreciable fixed assets:	
➢ To be treated as income- ▪ Over period over which cost of meeting conditions is incurred ▪ In case where there are no obligations, since there is no specific provision given, therefore should be recognized on an upfront basis	➢ To be credited as capital reserve, if no conditions attached to the grant ➢ To be credited to P&L A/c over period of incurring cost of meeting conditions of grant
❑ Grant in the nature of promoter's contribution	
➢ No such clarity for grants in the nature of promoter's contribution ➢ Therefore, by implication, requires recognition as income	➢ To be credited to capital reserve and to be treated as shareholders funds

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ICDS VII vs AS-12

<table>
<tr><th>ICDS VII</th><th>AS 12</th></tr>
<tr><td colspan="2">❑ Compensation for expenses/loss incurred or for giving immediate financial support</td></tr>
<tr><td>➢ Same as AS-12</td><td>➢ To be recognized in P&L A/c in the year in which it is receivable</td></tr>
<tr><td colspan="2">❑ Disclosure requirement:</td></tr>
<tr><td>➢ Disclosure of unrecognized grants</td><td>➢ No disclosure of unrecognized grants</td></tr>
<tr><td colspan="2">❑ Grants other than those covered by specific provisions:</td></tr>
<tr><td>➢ Same as AS-12 but no clarification that it is restricted only to revenue grants</td><td>➢ Revenue grant to be credited as income or reduced from related expenses</td></tr>
</table>

Miscellaneous Points:

- Based on the purpose and object for which the subsidy has been given, various judgments have been pronounced
- ICDS does not seek to recognize the need for assessing characterization of subsidy into a revenue or a capital grant on the basis of motive test
- To the extent ICDS requires recognition of any subsidy as income (for example, subsidy of a capital nature relatable to non depreciable fixed asset) will have conflict with the Act
- Definition of 'Income' under Section 2(24)(xviii) to provide that assistance in the form of a subsidy/grant/cash incentive/duty drawback/waiver/concession/reimbursement by the CG/SG/any authority or body or agency in cash or kind to the assesse [other than one considered under Explanation 10 to Section 43(1)] shall be the income of an assessee. Subsidy which is reduced from the actual cost of the asset as per Explanation 10 to Section 43(1) shall not be taxable as revenue receipt

ICDS VIII: Securities

- **ICDS-VIII**
  - **Part A**
    - Deals with securities held as Stock-in-Trade
  - **Part B**
    - Deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 or the Companies Act, 2013

ICDS VIII- Part A

Scope

i. Deals with Securities held as “Stock-in-Trade”

This ICDS does not deal with

i. Recognition of Interest and Dividends on securities
ii. Securities held by a person engaged in the business of insurance
iii. Securities held by mutual funds, VC funds, banks and Public Financial Institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013)

Securities

i. “Securities” defined as per Section 2(h) of the Securities Contract (Regulation) Act, 1956
   includes share of a closely held company
   excludes derivatives referred to in sub-clause (ia) of that clause (h)

Initial Recognition of Securities:

- Recognition of Securities
  - Security Acquired through monetary consideration
    - **Actual Cost** - Purchase Price, Brokerage, Fees, Duty, etc.
  - Security acquired in exchange for other securities
    - **Actual Cost** – Fair Value of Security Acquired
  - Security acquired in exchange for another asset
    - **Actual Cost** - Fair Value of Security Acquired

Subsequent Recognition/Measurement of Securities held as Stock-in-Trade:

At the end of any Previous Year- Lower of Cost or NRV

The comparison of Cost and NRV shall be done categorywise and not for each individual security

Categories of Securities:
- ❑ Shares;
- ❑ Debt Securities;
- ❑ Convertible Securities;
- ❑ Any other security not covered above

Example:

Security	Category	Cost	NRV	Lower of Cost or NRV	ICDS Value
A	Share	100	75	75	
B	Share	120	150	120	
C	Share	140	120	120	
	Total	360	345	315	345
D	Debt Security	150	160	150	
E	Debt Security	105	90	90	
F	Debt Security	125	135	125	
	Total	380	385	365	380
Securities Total		740	730	680	725

ICDS-VIII : Securities: Part B

Scope

i. Deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013)

Securities

i. "Securities" defined as per Section 2(h) of the Securities Contract (Regulation) Act, 1956
   includes share of a closely held company

Classification, Recognition & Measurement

i. In accordance with the extant guidelines issued by the RBI
ii. To this extent, the provisions of Income Computation and Disclosure Standard VI on the effect of changes in foreign exchange rates relating to forward exchange contracts shall not apply

ICDS VII vs AS 13

ICDS VIII	AS 13
❑ **Applicability**	
➢ This ICDS deals with securities held as stock in trade	➢ This Standard deals with accounting for investments in the financial statements of enterprises ➢ Assets held as stock-in-trade are not ‘investment’
❑ **Carrying Amount**	
➢ At the end of the previous year securities held as Stock-in-trade shall be valued at actual cost or NRV, whichever is lower. (where the actual cost cannot be ascertained by reference to specific identification, the cost shall be determined on the basis of FIFO or weighted average formula)	➢ Current investments are valued at lower of cost and fair value ➢ Adjustment to the carrying value of Long term investments are made only in case of permanent decline in the value

ICDS VII vs AS 13

ICDS VIII	AS 13
➢ Category wise Valuation ➢ Valuation of unlisted/thinly traded securities at cost- At the end of any previous year, securities not listed on a recognized stock exchange; or listed but not quoted on a recognized stock exchange with regularity from time to time, **shall be valued at actual cost** initially recognized	➢ Individual Scrip wise valuation

The Delhi HC has struck down the category wise valuation provided in ICDS

ICDS-IX : Borrowing Cost

Scope	Deals with treatment of borrowing costs
This ICDS does not deal with	This ICDS does not deal with the actual or imputed cost of owners' equity and preference share capital
Borrowing Costs	They are interest and other costs incurred by a person in connection with the borrowing of funds and include: • commitment charges on borrowings; • amortised amount of discounts or premiums relating to borrowings; • amortised amount of ancillary costs incurred in connection with the arrangement of borrowings; • finance charges in respect of assets acquired under finance leases or under other similar arrangements

ICDS IX vs AS 16

ICDS IX	AS 16
❑ **Qualifying Asset**	
• Land, building, machinery, plant or furniture, being tangible assets; • know-how, patents, copyrights, trade marks, licences, 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	• Qualifying Asset is an asset that takes substantial period of time to get ready for its intended use or sale

Impact

- Specified tangible and intangible assets are qualifying assets as per ICDS regardless of substantial period condition as specified in AS
- However, in case of capitalization of general borrowing cost a qualifying asset has been defined to be an asset that requires a period of 12 months or more for its acquisition, construction or production
- ICDS includes ‘land’ also in the definition of qualifying assets, unlike AS 16. As per ICDS, the borrowing cost in respect of land shall be capitalized. No depreciation will be available, however, cost will be available while computing Capital Gains

ICDS IX vs AS 16

ICDS IX	AS 16
❑ **Commencement of Capitalisation:**	
➢ Specific borrowings- Date on which funds were borrowed ➢ General borrowings- Date on which funds were utilized	➢ The date of fulfilment of three conditions viz. incurrence of capex, incurrence of borrowing costs and preparatory activities are in progress
Impact: ➢ The capitalization period starts early under the ICDS as compared to AS-16	
❑ **Method of Capitalization:**	
➢ Specific Borrowings: Actual borrowing costs incurred during the period on the funds borrowed	➢ Specific Borrowings: Actual borrowing costs incurred on the borrowing during the period less any income from temporary investment of those borrowings
Impact: AS-16 requires income from temporary deployment of unutilised funds to be reduced from borrowing cost. However, ICDS does not provide for the same The income from temporary deployment of unutilised funds from specific loans shall be taxable as Income from other sources under the ICDS as held in SC ruling in Tuticorin Alkali Chemicals (227 ITR 172)	

ICDS IX vs AS 16

ICDS IX	AS 16
❑ **Suspension of Capitalisation:**	
➢ No provision regarding suspension of capitalization of borrowing costs	➢ During extended periods in which active development of the asset is interrupted
Impact: Borrowing cost incurred during the periods in which active development of the asset is interrupted can also be capitalised under the ICDS	
❑ **Cessation of Capitalisation:**	
➢ Qualifying Asset- when such asset is first put to use ➢ Inventory- When substantially all activities necessary to prepare it for its intended sale are complete	➢ When substantially all activities necessary to prepare the qualifying asset for its intended use or sale are complete
Impact: Income-tax Act allows capitalisation of the borrowing cost till the asset is put to use (Section 43(1) r.w. Expl. 8). ICDS also allows the capitalisation till the date of put to use. Hence, there is no impact	

Certain issues clarified by CBDT Circular 10/2017:

Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under sections like 14A, 43B, 40(a)(i), etc. of the Act?

Since specific provisions of the Act override the provisions of ICDS, the borrowing costs to be considered for capitalization under ICDS-IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act

Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost?

The definition of borrowing cost is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing cost

ICDS-X : Provisions, Contingent Liabilities & Contingent Assets

Scope

Deals with provisions, contingent liabilities & contingent assets, except those:

- resulting from financial instruments;
- resulting from executory contracts;
- arising in insurance business from contracts with policyholders; and
- covered by another Income Computation and Disclosure Standard

This ICDS does not deal with

i. The recognition of revenue, which is dealt with by ICDS IV- Revenue Recognition
ii. Provisions related to depreciation, impairment of assets and doubtful debts

Recognition of Provision

- a person has a present obligation as a result of a past event;
- it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation;
- a reliable estimate can be made of the amount of the obligation

ICDS X vs AS 29

ICDS X	AS 29
➢ Provisions shall be recognised if it is **reasonably certain** that outflow of economic resources will be required	➢ Provisions shall be recognized if it is **probable** that outflow of economic resources will be required

Impact:

- ➢ The criterion for recognition of provisions on the basis of the test of 'probable' (i.e. more likely than not criterion) replaced with the requirement of 'reasonably certain'
- ➢ In the absence of definition and scope of 'reasonably certain' criterion, an ambiguity would arise on assessment of 'reasonably certain' criterion
- ➢ In the Act, there is no specific provision for recognition of provisions. However, provisions are allowed based on accrued liabilities as per ordinary principles of commercial accounting
- ➢ Provision for Warranty is allowed as an expenditure upholding the test of 'probable' warranty obligation in the following judgement:
- Rotork Controls India P. Ltd. (2009) 314 ITR 62 (SC) (extract on next slide)

Recognition of Provisions

Rotork Controls India (P.) Ltd. v. CIT [2009] 180 TAXMAN 422 (SC)

- A provision to qualify for recognition, there must be a present obligation arising from past events, settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate of amount of obligation is possible

- If historical trend indicates that in past large number of sophisticated goods were being manufactured and defects existed in some of the items manufactured and sold, then provision made for warranty in respect of army of such sophisticated goods would be entitled to deduction from gross receipts under section 37(1), provided data is systematically maintained by assessee

ICDS X vs AS 29

ICDS X	AS 29
➢ Contingent assets/ reimbursement claims to be recognized if inflow of economic benefits/ reimbursements is "reasonably certain"	➢ Contingent assets/ reimbursement claims are recognized if inflow of economic benefits/ reimbursement is "virtually certain"

Impact:

➢ Revenue authorities may contend that 'reasonably certain' is a lower threshold than 'virtually certain'

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Revenue during early stage of construction, when outcome cannot be estimated reliably	Revenue recognised to the extent costs are recoverable. No threshold is prescribed for early stage	Same as AS. However, the early stage shall not extend beyond 25% completion. (ICDS III – Construction Contracts)	No change
Retention money	Forms part of contract revenue and POCM is applied to entire contract revenue	Same as AS (ICDS III – Construction Contracts)	Retention money accrues to the taxpayer only when the related performance conditions are fulfilled, for eg. when the defect liability period is over and the Engineer-in-Charge certifies that no liability is attached to the tax payer. Retention money cannot form part of the revenue unless the same has accrued

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Export incentive	When it is reasonably certain that all conditions will be fulfilled and the ultimate collection will be made	In the year of making claim, if there is a reasonable certainty of ultimate collection (ICDS VII – Government Grants)	Income will not accrue, till the time conditions attached to it are fulfilled and there is corresponding liability on Government to pay the benefit. (SC in *Excel Industries* case)
Revenue from construction contracts	POCM	POCM	Not discussed.
Revenue from service contracts	POCM or CCM	• Only POCM for long duration contracts (> 90 days) • CCM permitted for short duration contracts (< 90 days) (ICDS IV – Revenue Recognition)	Accounting principles and Judicial precedents permit, both POCM and CCM

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Real Estate Developers	As per Guidance Note on *Accounting for Real Estate Transactions*, only P OCM is allowed.	No ICDS for real estate developers. Judicial precedents will apply. Therefore, POCM or CCM will be allowed per the method of accounting regularly employed by the taxpayer. The acceptance of CCM by the tax authorities for real estate developers is a contentious issue and generally resisted by the Tax Department. There are also cases where CCM has been disallowed by courts. Currently, if taxpayer is following POCM in books, it would be bound u/s.145, which requires income to be computed as per method of accounting regularly followed by the taxpayers in its books. Most corporate real estate developers follow POCM. A few corporates and non-corporates that followed CCM had to face severe litigations and an audit qualification from the auditor on the financial statements	Not discussed

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Onerous Contract	Expected losses are recognised as an expense immediately	Losses incurred on a contract will be allowed only in proportion to the stage of completion (ICDS III – Construction Contracts)	Prudence is inherent in section 37(1) and hence expected losses allowable as per judicial precedents
Borrowing Cost capitalisation – whether substantial period of time is required	Applies only when assets require substantial period of time for completion	No condition w.r.t substantial period of time except for inventory and general borrowing costs (12 months) (ICDS IX – Borrowing Costs)	No change
Capitalisation of specific borrowing cost	Actual borrowing cost	Actual borrowing cost	No change

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Capitalization of general borrowing cost	Weighted average cost of borrowing is applied on funds that are borrowed generally and used for obtaining a qualifying assets	Allocation is based on average cost of qualifying asset to average total assets (ICDS IX – Borrowing Costs)	No Change
Borrowings – Income on temporary investments	Reduced from the borrowing costs eligible for capitalisation	Not to be reduced from the borrowing costs eligible for capitalisation. Thus, it will be taxable income (ICDS IX – Borrowing Costs)	Accounting principles and Judicial precedents permit reduction of incidental income where it has close nexus with construction activity (*SC in Bokaro Steel*)

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Contingent Assets	Recognition is based on virtual certainty	Recognition is based on reasonable certainty (ICDS X – Provisions, Contingent Liabilities and Contingent Assets)	Test of 'reasonable certain' is not in accordance with S. 4/5 of ITA. Hypothetical income not creating enforceable right cannot be taxed
Government Grant classification	• Income related grant • Assets related grant • Grant in the nature of promoter's contribution (credited to capital reserve)	• Income related grant • Assets related grant • (ICDS VII- Government Grant)	No change

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Government Grant- Recognition	Not recognised until there is a reasonable assurance that the entity shall comply with the conditions attached to them and the grants will be received	Similar to AS, except recognition is not postponed beyond the date of actual receipt. (ICDS VII – Government Grant)	Taxable when conditions attached to the receipt of government grant are fulfilled and, there is corresponding liability on Government to pay
Capitalisation of exchange differences on long term foreign currency monetary item for acquisition of fixed assets (AS 11.46A)	Paragraph 46/ 46A of AS 11 provides option for capitalisation	• On imported assets S.43A allows capitalization • On local assets S.43A does not apply. • With respect to local assets, all MTM exchange differences are included in taxable income (ICDS VI – Foreign Exchange)	Distinguish between capital and revenue nature of exchange fluctuation (*Sutlej Cotton Mills*). Thus,exchange difference s on local capital assets, are not revenue in nature; nor, are capitalisable under 43A

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Forward contracts under AS 11 for hedging purpose	Premium/ discount to be amortised over the contract period. Spot-to-spot gains/ losses are recognised in P&L	Same as AS. (ICDS VI – Foreign Exchange)	No change
Foreign currency risk of a firm commitment or a highly probable forecast transaction	As per Guidance Note (GN) on Accounting for Derivative Contracts derivatives are measured at fair value through P&L, if hedge accounting is not applied	Premium, discount or exchange difference, shall be recognised at the time of settlement. (ICDS VI – Foreign Exchange)	ICDS cannot override judicial precedents (which will implicitly include SC ruling in Woodward Governor's case (312 ITR 254) which upheld MTM treatment as per accounting principles). Thus MTM losses/gains are deductible/taxable

Comparison between AS, ICDS and Delhi HC Decision

Points	AS	ICDS	Delhi HC Decision
Foreign currency risk on contract for trading or speculative purposes	As per GN, derivatives are measured at fair value through P&L	Premium, discount or exchange difference shall be recognised at the time of settlement. (ICDS VI – Foreign Exchange)	MTM losses are tax deductible [SC in Sutlej Cotton Mills]. MTM gains – No clarity but on principles, it is taxable
MTM losses on commodity derivatives	As per GN, derivatives are measured at fair value through P&L, if hedge accounting is not applied	• MTM losses are not tax deductible. (ICDS I – Disclosure of Accounting Policies) • CBDT Circular – MTM Gains are not taxable • Consequently, tax will apply on settlement	ICDS cannot override judicial precedents (which will implicitly include SC ruling in Woodward Governor's case (312 ITR 254) which permitted MTM treatment as per accounting principles). Thus MTM losses/gains are deductible/taxable

THANK YOU

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