



PUNE BRANCH

of WIRC of the ICAI

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Approach to (Revised) ICDS especially for Partnerships

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Approach to ICDS

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2. General Principles
3. Auditor's Responsibility
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6. Approach to Revised ICDS



LEGAL BACKGROUND



Background of ICDS

Section 145(1) of the Income-tax Act, 1961 (Act) stipulates that the method of accounting for computation of income under the heads “**Profits and gains of business or profession**” and “**Income from other sources**” can either be cash or mercantile system of accounting.

Section 145(2) of the Act states that the Central Government may notify the (accounting standards) **income computation & disclosure standards w.e.f Finance Act 2014**) to be followed by any class of assesses or in respect of any class of income.



Background of ICDS

31st March, 2015, the Central Govt notified 10 ICDS which was initially **effective from 1st April, 2015.**

Vide announcement dated 6th July 2016, the Applicability of ICDS was deferred to be now applicable from **F.Y. 2016-17**

Vide Notification No. 87/2016, the previous set of ICDS notified was replaced by New Set of said 10 ICDS

First set of clarifications in **FAQ** format was issued on 23rd March 2017



GENERAL PRINCIPLES



General Principles

HEADS COVERED: ICDS are applicable for computation of income chargeable under the head “**profits and gains of business or profession**” and “**income from other sources**”.

ASSEESSES COVERED: ICDS applies to all taxpayers (NO TURNOVER LIMIT). **Exemption now provided for Individual and HUF not Having Tax Audit**

MERCANTILE SYSTEM: ICDS apply to taxpayers following ‘mercantile system’ of accounting.



General Principles

BOOKS OF ACCOUNT ICDS do not provide the manner of maintenance of books of account, they simply provide the income computation and disclosure manner

CONFLICT BETWEEN ACT & ICDS: In case of conflict between the provisions of the Act and ICDS, the provisions of the Act shall prevail to that extent.

CONFLICT BETWEEN RULES & ICDS: In case of conflict between the provisions of the Rules and ICDS, the provisions of the Rules shall prevail to that extent.



General Principles:

ICDS are 'Not Applicable' :

- a. If assessee follows cash system of accounting
- b. Income chargeable to tax under the head other than 'profits and gains of business or profession' or 'income from other sources'.

ICDS apply in case of presumptive taxation?

ICDS are applicable for Provisions of Presumptive Taxation.



General Principles

Whether ICDS have any impact on MAT?

Since ICDS does not apply in maintenance of books of account by an assessee thus ICDS should not have any initial impact on **Minimum Alternate Taxation** computations.



General Principles

- icds & amt computation
- AMT S. 115JC : computed on the basis of income computed under normal provisions of the Act subject to addition of specified tax incentives.
- Hence, ICDS apply to computation of total income which forms starting point for such computation of income liable for AMT



General Principles

What are the consequences of ICDS non-compliance?

ICDS non-compliance, as per the provisions of section 145(3) shall enable the Assessing Officer to make an assessment in the manner provided under section 144 of the Income Tax Act 1961. However there is no specific penal provision inserted in the law regarding non-compliance of ICDS.



General Principles

How disclosures under ICDS are to be made?

All ICDS notified provide for the disclosure requirement and the notified revised format of 3CD as notified on 29th Sept 2016

Penal Consequences of ICDS non-compliance

There are no specific provisions inserted in the income tax law particularly in Chapter – XXI

However any additions in income due to applicability of ICDS may attract penalty



AUDITOR'S RESPONSIBILITY



Form 3CD

13. (d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation
- (e) If answer to (d) above is in the affirmative, give details of such adjustments:



		Increase in Profit (Rs.)	Decrease in Profit (Rs.)	Net Effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			



		Increase in Profit (Rs.)	Decrease in Profit (Rs.)	Net Effect (Rs.)
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
Total				



Form 3CD

13. (f) Disclosure as per ICDS:

i) ICDS-I Accounting Policies

ii) ICDS-II Valuation of Inventories

iii) ICDS-III Construction Contracts

iv) ICDS-IV Revenue Recognition

v) ICDS-V Tangible Fixed Assets

vi) ICDS-VII Governments Grants

vii) ICDS-IX Borrowing Costs

viii) ICDS-X Provisions, Contingent Liabilities and
contingent Assets



Auditor's Responsibility

- Section 44 AB
- Rule 6G



Section 44 AB

- Every person,—

.....

get his accounts of such previous year audited by an accountant before the specified date and furnish by that date the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed :



Rule 6 G

Report of audit of accounts to be furnished under section 44AB.

- **6G.** (1) The report of audit of the accounts of a person required to be furnished under section 44AB shall,— 3CA / 3CB

(2) The particulars which are required to be furnished under section 44AB shall be in Form No. 3CD.



Auditor's Responsibility

- *Books of Account v. Income Computation*
- *Disclosure – who's responsibility?*
- *Representation Letter*
- *Representation v. Return of Income*



ASSEESSEE'S RESPONSIBILITY



ICDS Impact: Income Tax Return

Particulars	Amount
Profit or loss as per P&L Account	XXX
<u>Add / Less: Adjustments to neutralize specific accounting treatment not aligned with ICDS</u>	
Eg. (1) Capital vs Revenue Expenditure	XXX
(2) Provision for expected losses	XXX
(3) Foreign Exchange Fluctuations	XXX
<u>Add /Less: Specific adjustments under IT Act</u>	
Eg (1) Depreciation /Investment allowance, Tax holiday, etc.	XXX
Taxable Income	XXX

ICDS – A step to harmonize Accounting Standards with IT Act



JUDICIAL ANALYSIS



icds & income computation

- Section 4, 5
- Real Income v. Books of Account
- Substantive v. Machinery provisions
- **Godhra Electricity Co. Ltd.**

v.

Commissioner of Income-tax

[1997] 091 TAXMAN 351 (SC)



icds & income computation

- Entry in books not relevant

Kedarnath Jute

- Accrual

Calcutta Co. Ltd. / Interest

- Objective of the Provision

Anupam Tele Services

- Express provisions of law

Hindusthan Organic Chemicals Ltd.

Ghatge Patil Transports Ltd.



Are ICDS mandatory?

- ICDS X: Provisions, contingent liabilities and contingent assets
- Prescription:
- 8. Where details of a proposed new law have yet to be finalized, an obligation arises only when the legislation is enacted.
- Supreme Court Judgment

Are ICDS mandatory?

- Delegated Legislation
- Binding on the Department
- **COMMISSIONER OF CUSTOMS ETC., ETC. vs. INDIAN OIL CORPORATION LTD. & ANR.**
- 187 CTR (SC) 297 : 267 ITR 272 (SC) : (2004) 136 TAXMAN 491 (SC)

Are ICDS mandatory?

- Cannot override the Act
- Circular falls within the parameters of powers exercisable by the CBDT under s. 119 it is valid
- **UOI vs. AZADI BACHAO ANDOLAN & 263 ITR 706 (SC)**

WRIT PETITION- PETITIONER'S CASE

Petitioner's Case

- Effect of ICDS is to **modify basis of taxation**
- **Basis of taxation can be changed only by Parliament** by amending the Act
 - CG cannot do so through ICDS
- ICDS **contrary to several SC / HC decisions**
- ICDS **not applicable to assesseees following cash system of accounting** – violative of A.14 of Constitution
- ICDS cast **additional compliance burden / restrictions on assesseees** – violative of A.19(1)(g) of Constitution

DELHI HIGH COURT RULING

Key findings of the Delhi High Court

- Power to **enact validation law** vests with the **Parliament** and not the **Central Government** and such enactment can be made by an **amendment** to the statute
- ICDS has the effect of modifying the basis of COI as recognized by Act / courts
- ICDS cannot overrule the provisions of Act, Rules and judicial precedents
- Section 145(2) should be read down to the extent it is ultra vires the Act and Article 141, 144 and 265 of the constitution

DELHI HIGH COURT RULING

Key findings of the Delhi High Court

- Provisions of ICDS struck down / watered down
 - × **ICDS I (Accounting Policies)** – **unsustainable in law**, since it has done away with the concept of ‘**Prudence**’, which is contrary to the Act and judicial precedents
 - × **ICDS II (Valuation of Inventories)** – Court annulled the provision, which eliminated distinction between a continuing partnership and discontinued partnership, after dissolution
 - × **ICDS III (Construction Contracts)**
 - Incidental income not allowed as reduction from borrowing cost, contrary to SC decision in Bokaro Steel and is unsustainable to that extent
 - Taxing retention money which is uncertain/ conditional is contrary to Judicial precedents; hence impermissible

DELHI HIGH COURT RULING

Key findings of the Delhi High Court

- × **ICDS IV (Revenue Recognition)**
 - Impermissibility of completed contract method for revenue recognition held to be ultra vires the Act and struck down
 - Taxation of export incentive upon reasonable certainty of collection contrary to SC decision in Excel Industries; struck down

- × **ICDS VI (Effects of changes in foreign exchange rates)** – Not allowing **MTM losses** in case of foreign currency derivatives held for trading/speculation and **taxation of opening balance of FCTR on monetary items is ultra vires** the judicial decisions

- × **ICDS VII (Government Grants)** – Taxation of unaccrued subsidy / grant on the date of actual receipt is ultra vires the tax laws

- × **ICDS VIII (Valuation of Securities)** – Part A which prescribes bucket approach for taxpayers not governed by RBI, is ultra vires the tax laws

Interest accrual for NBFC as per ICDS IV held to be valid

RETROSPECTIVE AMENDMENT BY FINANCE ACT, 2018

Snapshot of Amendments by Finance Act, 2018

Sr. No.	Relevant ICDS	Relevant Section	Relevant amendment
1	ICDS I	36(1)(viii)	<ul style="list-style-type: none"> Deduction for Marked to Market Loss or other expected loss to be in accordance with ICDS
2	ICDS II and ICDS VIII	145A	<ul style="list-style-type: none"> Inventory shall be valued at the lower of cost or net realizable value whichever is lower which is in line with the valuation method as provided in ICDS II; Inventory in nature of securities is to be valued in line with ICDS VIII "Securities".
3	ICDS III and ICDS IV	43CB	<ul style="list-style-type: none"> Income from a construction as well as service contracts on the basis of percentage completion method; Contract revenue to include retention money; Incidental income in nature of interest, dividend or capital gains shall not be reduced from the cost

Snapshot of Amendments by Finance Act, 2018

Sr. No.	Relevant ICDS	Relevant Section	Relevant amendment
4	ICDS IV and ICDS VII	145B	<ul style="list-style-type: none">• Interest received on compensation or enhanced compensation – deemed to be the income of the year in which it is received;• Claim for escalation price or export incentives – Year in which a reasonable certainty of realisation is achieved;• Income from a subsidy, grant, cash incentive, duty drawback, waiver, concession – taxable in the year of receipt, if not charged to tax in any earlier previous year.
5	ICDS VI	43AA	<ul style="list-style-type: none">• Any foreign exchange gain or loss in respect of specified foreign currency transactions shall be treated as income or loss, if computed according to ICDS VI

Approach to Revised ICDS



ICDS I accounting policies

Requirements:

1. Disclose Significant Accounting Policies
2. Change in Accounting Policies – Amount of Effect, Subsequent Years
3. Fundamental accounting assumptions
4. Place for disclosure?
5. Prudence
6. Materiality



ICDS I accounting policies

Approach:

1. Responsibility?
2. Significant accounting area - listing
3. Change in accounting policies – Effect
4. Representation letter



MTM Losses (ICDS I and ICDS VI)

- Apex Court ruling in the case of Woodward Governor, Sutlej Cotton
- Section 36(1)(xviii): Deduction of MTM loss / other expected loss will be allowable to the taxpayer if such losses are computed as per the provisions of ICDS.



MTM Losses (ICDS I and ICDS VI)

- Such MTM loss is not dealt with in ICDS [e.g. MTM loss on interest rate swaps, commodity forward contract, Forex Derivative contract (other than forward contracts)], then Section 40A (13), provides that no deduction of such MTM loss shall be allowed if it is not covered within the provision of section 36(1)(xviii).



ICDS II valuation of inventories

Requirements: :

1. Stocks – quantity & valuation
2. Method of valuation – FIFO or Wght Av
3. AS 2 v/s ICDS 2 & matching principle
4. Net realisable value
5. Firm dissolution – SC judgments



ICDS II valuation of inventories

Change:

- The words “in case of service provider” appearing in paragraph 6 have been removed.

Consequence:

- This amendment seems to absolve service providers from maintaining inventory for provision of services.



ICDS II valuation of inventories

Approach:

1. Stock list
2. Valuation method and rate
3. Affirmative reporting



Valuation of Inventories and Securities (ICDS II & VIII)

- Section 145A : while computing the business income, a tax payer is required to follow inclusive method for valuation of inventories, purchase and sales. Further such provision is applicable in respect of goods and not in respect of services.



Valuation of Inventories and Securities (ICDS II & VIII)

- Substituted Section 145A: incorporates the existing provision of aforesaid ICDS under the Act to provides that:
 - (i) Valuation of inventory - To be made at lower of cost or net realisable value computed as per the provisions of ICDS II – Valuation of Inventories.



Valuation of Inventories and Securities (ICDS II & VIII)

- Substituted Section 145A:
- (ii) Valuation of purchase or sale of goods or services and of inventory should be inclusive of tax, duty, cess or fees paid to bring the goods or services to the place of its location and condition on the date of valuation even if the credit of in respect of such taxes is available to the assessee under any law for the time being in force.



Valuation of Inventories and Securities (ICDS II & VIII)

- Substituted Section 145A:
- (iii) Securities not listed/ listed but not quoted on recognised stock exchange – To be valued at actual cost initially recognised in accordance with ICDS VIII.
- (iv) Listed securities - To be valued category-wise at actual cost or net realisable value whichever is low as per ICDS VIII.



ICDS III construction contracts

Requirements:

1. Applicability
2. Paramotors & Builders
3. Completed Contract v/s PoCM



ICDS III construction contracts

- “Construction contract” is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use



ICDS III construction contracts

Approach:

1. Stage of completion
2. Uncertainty v/s write off - T.R.F. LTD. 323 ITR 397
3. Builders – ICAI guidance note
4. BOT Contractors
5. Retention money – para 10



Construction Contracts (ICDS III)

- Section 43CB : Computation of income from construction contracts - mandates use of PoCM be applied as per ICDS III.
- Includes retention money within the purview of “Contract Revenue”. (*No consequential amendment has been proposed to the definition of “income”*)
- Contract costs shall not be reduced by incidental income in the nature of interest, dividends or capital gains



ICDS IV revenue recognition

Requirements:

1. Sale of Goods / Services / Use of Resources
2. Services – percentage of completion
3. Reasonable uncertainty v/s write off
4. Interest accrual – time basis – Due date
5. Disclosure

Note on Bills – about interest charge on delayed payment



ICDS IV revenue recognition

Changes:

- SLM method for recognition of revenue when services are provided by an indeterminate number of acts over a specific period of time (Para 6)
- Service Contracts Revenue with duration of not more than 90 days may be recognised when rendering of services under that contract is completed or substantially completed (Para 7)
- Interest on refund of taxes, duties etc. shall be recorded as income in the year of receipt (Para 8.2)



ICDS IV revenue recognition

Approach:

1. Similar to AS
2. List out revenue streams
3. Disclosures



Service Contract Income (ICDS IV)

- ICDS IV: Apply PoCM for income recognize
- Judicial precedents to hold that PoCM or Completed Contract Method
- Section 43CB : The aforementioned provisions of ICDS IV providing for manner of taxability of service transactions within the Act.



Service Contract Income (ICDS IV)

- * Exceptions continue:
 - (i) Contract for providing services with duration of not more than ninety days shall be determined on the basis of project completion method;
 - (ii) Service transactions wherein services are provided by an indeterminate number of acts over a specified period of time for which revenue could be recognised on a Straight-Line basis.



Price escalation / export incentives (ICDS IV)

- Excel Industries 358 ITR 295 export incentive taxable in the year when claim is accepted by the Govt and the right to receive the payment accrues.
- Section 145B (2): Any claim for escalation of price or export incentive is taxable in the year in which reasonable certainty of its realisation is achieved.
- The term “reasonable certainty” has not been defined.



ICDS V fixed assets

Requirements:

1. Covers 'tangible' fixed assets
2. Spares – para 4 - consumption
3. Improvements and repairs – increase in future benefits
4. Section 43A
5. Section 32
6. disclosure

ICDS V fixed assets

Approach:

1. Opening WDV – basis?
2. Actual cost – para 5

ICDS VI effects of changes in foreign exchange rates

Forex Transactions:

Initial recognition in the reporting currency,
by applying to the foreign currency amount
the exchange rate between the reporting
currency and the foreign currency at the
date of the transaction.

Average rate allowed

Year End - converted into reporting currency
by applying the closing rate

Foreign exchange fluctuation (ICDS VI)

- As per ICDS VI any exchange difference arising on the settlement or restatement of monetary items shall be recognised as income or expenses during the year subject to provision contained in section 43A of the Act. As loan represent monetary items the exchange gain/loss on foreign currency loan (unless covered by section 43A) shall be taxable/deductible in view of ICDS VI.

Foreign exchange fluctuation (ICDS VI)

- Section 43AA - subject to section 43A any gain or loss arising on account of any change in forex rates shall be treated as income or loss and shall be computed in accordance with applicable ICDS. In order to bring further clarify under the Act.

Foreign exchange fluctuation (ICDS VI)

- Section 43AA - The section provides that such forex loss/gain shall include the same arising on transaction of financial statement of foreign operations, forward contracts and foreign currency translation reserves. ICDS VI already dealt with treatment of exchange gain/loss arising in respect of such transactions.

Nature of transaction	At the year end (Unrealised or MTM)	On settlement (realisation)
Monetary items (including pertaining to foreign operations)	Gains taxable / Losses tax deductible	Gains taxable /Losses tax deductible
Non-monetary items (including pertaining to foreign operations)	Gains not taxable / Loss not tax deductible	Full gains taxable / full losses tax deductible
Forward exchange contracts (other than for trading / speculative purposes / highly probable transactions)	Gains taxable / Losses tax deductible	Gains taxable / Losses tax deductible
Forward exchange contracts for trading / speculative purposes / highly probable transactions	Gains not taxable / Loss not tax deductible	Full gains taxable / full losses tax deductible



ICDS VI Government Grants

“Government grants” are assistance by Government in cash or kind to a person for past or future compliance with certain conditions. They exclude those forms of Government assistance which cannot have a value placed upon them and the transactions with Government which cannot be distinguished from the normal trading transactions of the person.

Income Recognition

ICDS VI Government Grants

- *“2(24)(xviii) **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 other authority or body or agency in cash or kind to the assessee other than the subsidy or grant or reimbursement which is taken into account for determination of the*
- *actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43.”*

Government Grants (ICDS VII)

- Section 145B(3): Subsidy, grant, cash incentive, duty drawback or other income of similar nature received from central or state Govt or other authority in cash or kind shall be charged to tax in the year in which it is received if it is not charged to tax in earlier years.

Government Grants (ICDS VII)

- Section 145B(3):
- Provisions of section - there is a difference in the way the provisions are worded as compared to ICDS VII which require grants to be recognised on reasonable assurance of conditions being satisfied and grant being received. ICDS VII further provides that grants shall not be postponed beyond the date of actual receipt.

ICDS VIII securities

Change:

- Definition of securities has been amended to include shares of a company in which the public is not substantially interested (Para 3 of Part A).

Consequence:

- Shares of closely held companies would also be governed by ICDS VIII.

ICDS VIII securities

- “Securities” shall have the meaning assigned to it in clause h of Section 2 of the Securities Contract Regulation Act, 1956 42 of 1956 , other than Derivatives referred to in sub-clause 1a of that clause.
- At the end of any previous year, securities held as stock-in-trade shall be valued at actual cost initially recognized or net realizable value at the end of that previous year, whichever is lower

ICDS VIII securities

- securities shall be classified into the following categories, namely:-
 - a shares;
 - b debt securities;
 - c convertible securities; and
 - d any other securities not covered above.

ICDS VIII securities

Change:

- New sub-chapter has been introduced that deals with securities held by a scheduled bank or public financial institutions (Part B).

Consequence:

- The new ICDS has included a separate sub-chapter on securities held by a scheduled bank or public financial institutions.

ICDS IX borrowing cost

1. Qualifying asset means:

* 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.

ICDS IX borrowing cost

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and Disclosure Standard. Other borrowing costs shall be recognised in accordance with the provisions of the Act.

ICDS IX borrowing cost

Quantification of interest:

- (i) specific borrowings
- (ii) general borrowings
- (iii) use of specific borrowings

ICDS IX borrowing cost

Approach:

1. Section 36(1)(iii)
2. Capitalisation
3. Borrowing documents
4. Funds flow

ICDS X provisions, etc.

Requirements:

1. Executory contract – onerous contract
2. Present obligation – para 5(a)
3. Contingent assets – subsidy
4. Para 8 – Events after balance sheet date
5. Para 17 – review v/s section 41
6. Para 19 – use of provision

ICDS X provisions, etc.

Approach:

1. List
2. Review

Approach to ICDS

- Sum Up

1. Auditor's Approach:

- * statutory obligation
- * ICAI

2. Assessee Approach:

- * tax outflow
- * timing v/s permanent
- * litigation



Thank you

