Deloitte
Haskins & Sells LLP

Income Computation and Disclosure Standards

ICDS 6, 9 and 10

17 December 2016

Contents

ICDS Evolution

1996
CG notified 2 AS under section 145(2)

December 2010
CBDT constitutes AS Committee to suggest Harmonization of ICAI AS with the Act and suggest AS to be notified under the Act . Method to determine book profit for MAT purposes on transition to IND AS Amendments to the Act in view of transition

October 2012
Final report of Committee and 14 ICDS published. Comments invited from public on Draft ICDS

July 2014
Finance Bill (No 2) 2014 amended section 145(2).ICDS to be notified separately. ICDS applicable from FY 2015-16

January 2015
CBDT issued draft of 12 ICDS. Draft ICDS kept open for comments and suggestions till February 8, 2015

March 2015
CBDT vide Notification No. 32/2015 dated March 31, 2015 notified 10 ICDS w.e.f. April 1, 2015

September 2016
The CBDT has rescinded old ICDS notified in 2015 and has issued new notification with some modifications. Applicable from 1 April 2016

ICDS Highlights

1. Applicable to all the assessees (other than an individual or a Hindu undivided family not required to get their accounts audited under section 44AB of Income Tax Act)) following mercantile system of accounting
2. ICDS will not have any impact on computing taxable income under provisions of section 115JB of the Act
3. ICDS shall apply for computation of income chargeable under the Act as Business Income or income from Other Sources
4. No separate books of account required to be maintained for ICDS - Adjustment to be made only to income
5. In case of a conflict between ICDS and the Act, provisions of the Act to prevail
6. Amended ICDS shall apply from financial year 2016-17. Tax Audit Form amended to include impact and disclosure requirements of ICDS

Extract of Notification no. 88 dated 29 September 2016 – Tax Audit Report-Impact/Disclosure of ICDS

In the Income-tax Rules, 1962, in Appendix II , in Form No. 3CD, in Part-B, in clause 13, for sub-clause (d), the following shall be substituted ,namely, — "(d), the following shall be substituted ,namely, —

"(d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)

If answer to (d) above is in the affirmative, give details of such adjustments:

		Increase in profit (Rs.)	Decrease in Profit (Rs.)	Net (Rs.)
ICDS I	Accounting Policies			
ICDS II to ICDS X	Valuation of Inventories and other ICDS			

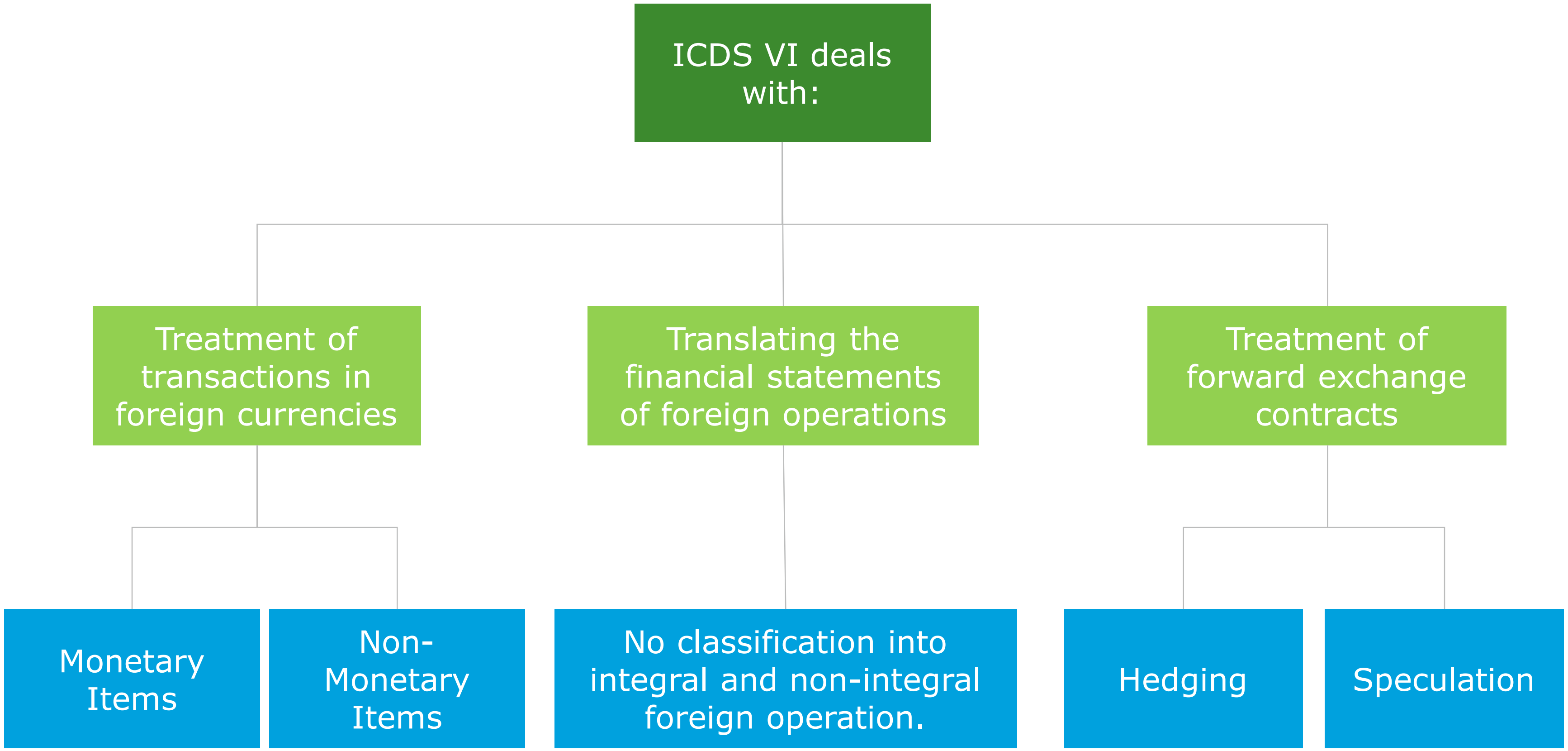
(f) Disclosure as per ICDS:

(i)	ICDS I	Accounting Policies
(ii)	ICDS II to ICDS X	Valuation of Inventories and other ICDS

ICDS VI

Effects of Changes in Foreign Exchange Rates

ICDS VI – Effects of changes in foreign exchange rates



ICDS VI – Effects of Changes in foreign exchange rates
Monetary and Non - monetary Items

Monetary Items

- **Monetary items** are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables and payables are examples of monetary items
- **Initial Recognition:**
  - At the exchange rate between the reporting currency and the foreign currency at the date of the transaction or
  - At an average rate for a week or a month that approximates the actual rate at the date of the transaction

  If there are significant fluctuations then average rate should not be used
- **Conversion at year end**
  - Monetary items shall be converted by applying the closing rate
- **Recognition of exchange differences**
  - Exchange difference on conversion, shall be recognized as income or expense

Non - Monetary items

- **Non monetary items** are assets and liabilities other than monetary items. Fixed assets, inventories and investments in equity shares are examples of non – monetary items
- **Initial Recognition:**
  - At the exchange rate between the reporting currency and the foreign currency at the date of the transaction or
  - At an average rate for a week or a month that approximates the actual rate at the date of the transaction

  If there are significant fluctuations then average rate should not be used
- **Conversion at year end**
  - Non-monetary items to be recorded using exchange rate on date of transaction
  - Inventory carried at net realizable value (NRV)-Exchange rate on the date of determination of NRV should be used
- **Recognition of exchange differences**
  - Not applicable

Initial recognition, conversion and recognition of exchange difference shall be subject to Section 43A of the Income Tax Act, 1961 or Rule 115 of Income-Tax Rules, 1962.
Refer next slide for details

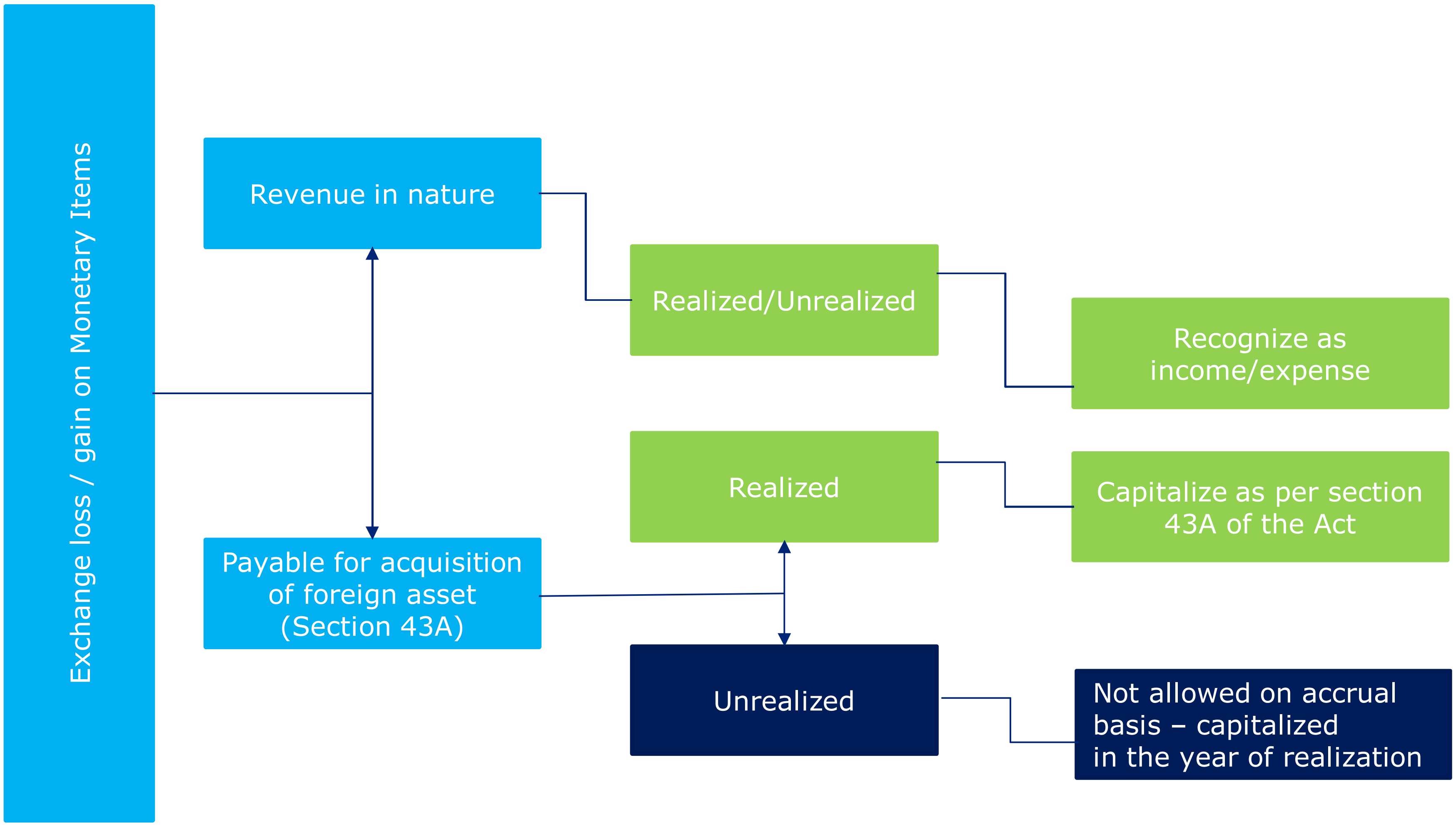
ICDS VI – Effects of changes in foreign exchange rates

Illustration 1 – Monetary and Non- Monetary Items

Date	Particulars	Amount	Rate
01 January 2017	100 Equity shares purchased on Credit	€5000	1€=Rs. 70
31 March 2017			1€=Rs. 75
01 January 2017	Investment - Balance Sheet(BS)	5000*70	Rs. 350,000
	Payable – BS	5000*70	Rs. 350,000
31st March 2017	Payable – BS	5000*75	Rs. 375,000
31st March 2017	Foreign exchange loss – Statement of Profit and Loss	5000*(75-70)	Rs. 25,000

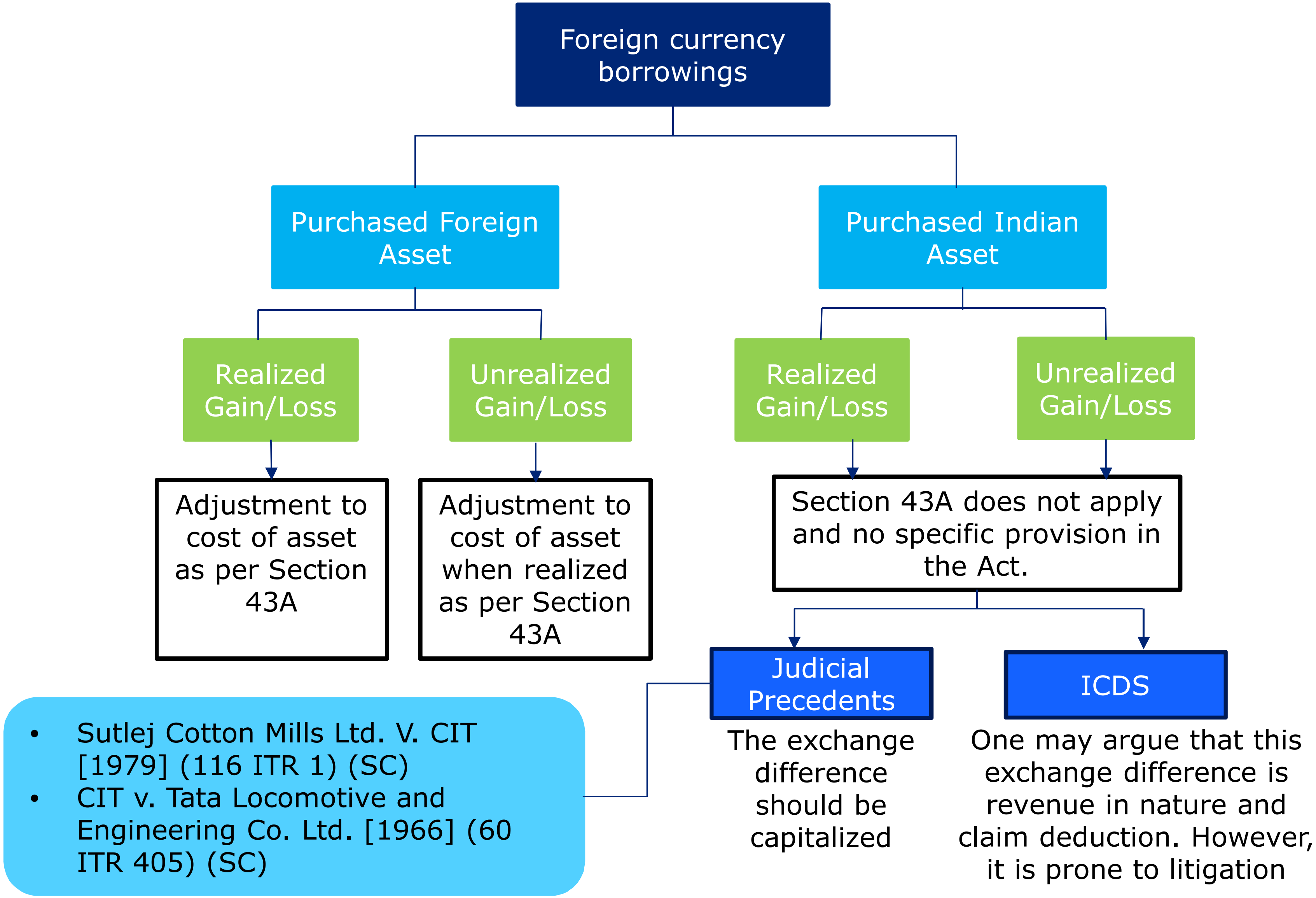
ICDS VI – Effects of changes in foreign exchange rates

Interplay between ICDS and Section 43A



ICDS VI – Effects of changes in foreign exchange rates

Foreign Borrowings and Indian Asset



ICDS VI – Effects of changes in foreign exchange rates
Foreign Operations

Foreign Operations - Meaning

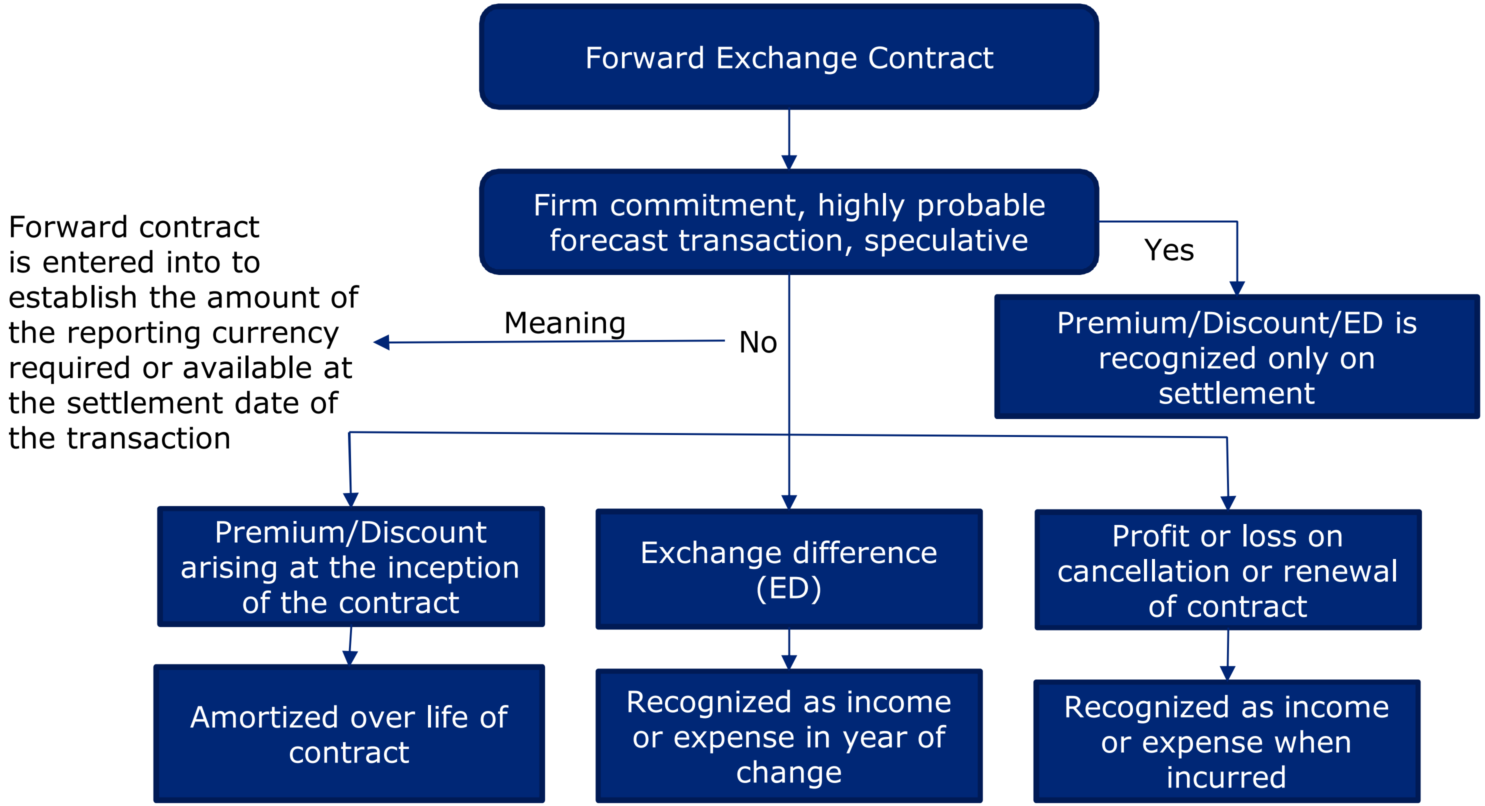
- **“Foreign operations of a person”** is a branch, by whatever name called, of that person, the activities of which are based or conducted in a country other than India

Foreign Operations – Method of Translation

- The financial statements of a foreign operation shall be translated using the same principles and procedures, as if the transactions of the foreign operation had been those of the person himself

ICDS VI – Effects of changes in foreign exchange rates
Forward Exchange Contracts

Forward exchange contract" means an agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature



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ICDS VI – Effects of changes in foreign exchange rates
Transitional Provisions

Impact of Transition to ICDS VI

- All foreign currency transactions undertaken on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard
- The ICDS VI The transition to ICDS VI will have **prospective effect.**

Monetary and Non-monetary items

- Brought forward the balance of monetary and non monetary items as on 31/03/2016
- Apply the provisions as per ICDS from 01/04/2016 onwards

Foreign Operations

- Brought forward the balances of assets and liabilities as on 31/03/2016
- Apply the provisions as per ICDS from 01/04/2016 onwards.

Forward Exchange Contracts

- All forward exchange contracts existing on the 1st day of April, 2016 shall be dealt as per the provisions of ICDS VI after taking into account the income or expenses, if any, recognised in respect of said contracts for the previous year ending on or before the 31st March,2016.

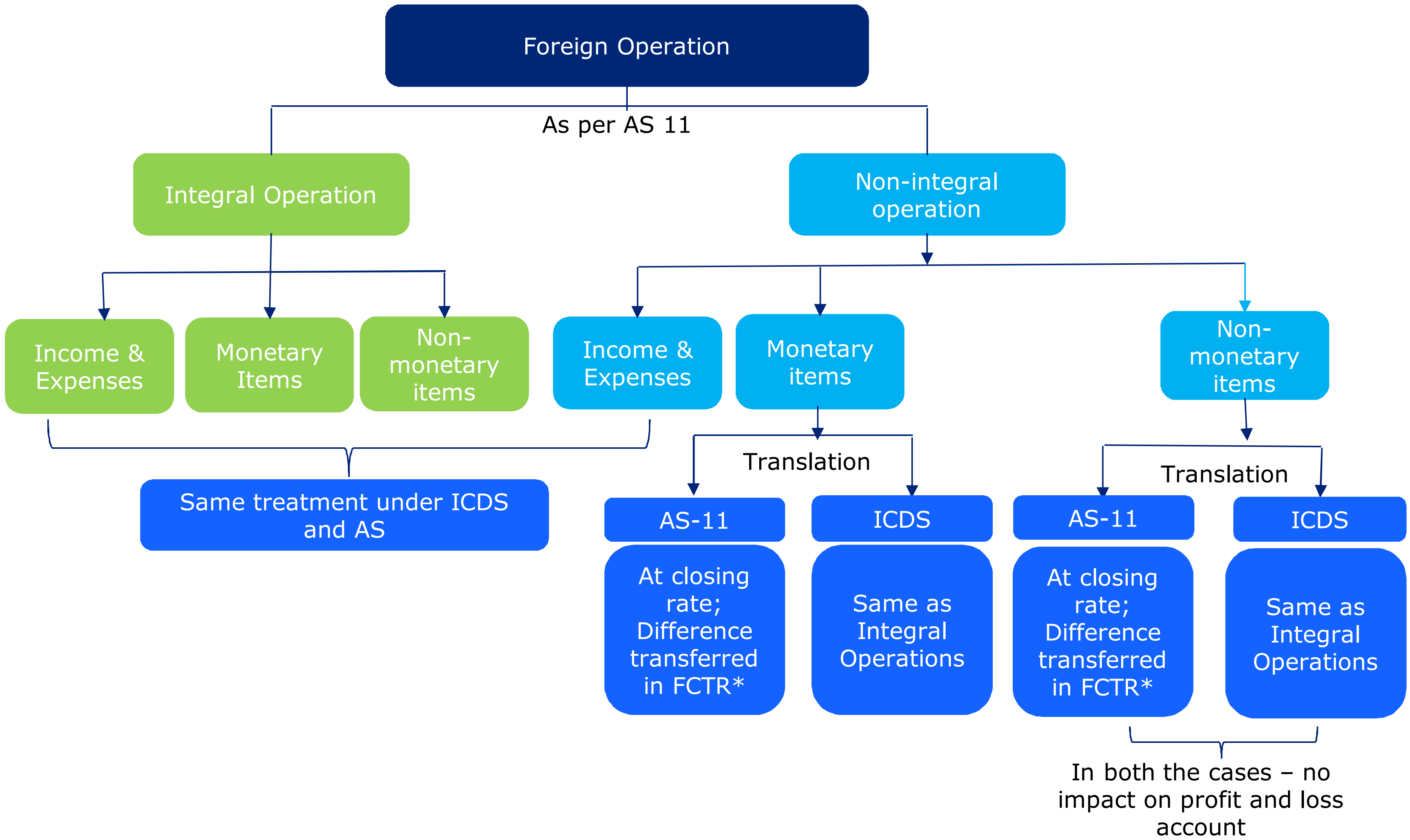
ICDS VI – Key Differences between ICDS and Accounting Standard (1/2)

Particulars	ICDS – VI	Accounting Standard 11 (AS-11)
Exchange Difference on Capital Asset	Treatment of realized exchange difference of liability incurred in acquisition of a **foreign** capital asset shall be in accordance with Section 43A of the Act	Option to charge the exchange difference to profit & Loss Account
Forward exchange contract – Speculation/trading purpose/highly probable forecast/firm commitment/hedging	Premium/discount/exchange difference is recognized at the time of settlement.	AS 11 – MTM gain/loss as on the balance sheet date to be recognized as income/expense AS 30 - Forward Exchange Contracts – highly probable forecast/firm commitment/hedging (being outside the scope of AS 11) exchange gain/loss is recorded under Hedge Reserve and transferred to P&L upon actual settlement

ICDS VI – Key Differences between ICDS and Accounting Standard (2/2)

Particulars	ICDS – VI	Accounting Standard 11 (AS-11)
Foreign Operation-Definition	"Foreign operations of a person" is a branch, by whatever name called, of that person, the activities of which are based or conducted in a country other than India	Foreign Operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise
Foreign Operation-Translation	No concept of integral or non-integral foreign operations. The financial statements of a foreign operation shall be translated using the same principles and procedures, as if the transactions of the foreign operation had been those of the person himself	The translation depends on the classification of that operation as integral or non-integral • **Integral Operation -** the translation is done on the same principles as used by the person himself. This is similar to the treatment prescribed under ICDS • **Non-integral Operations -** all the assets and liabilities are translated at the closing rate and profit and loss account items are translated at actual/average rates. The resulting difference is taken to reserve and not to the profit and loss account until disposal of such operations

ICDS VI – Effects of canges in foreign exchange rates
Foreign Operations



*Foreign Currency Translation Reserve

ICDS IX
Borrowing Costs

ICDS IX – Borrowing Costs

Meaning of Borrowing Costs

Borrowing costs 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 does not deal with actual or imputed cost of owner's equity and preference share capital.

ICDS IX – Borrowing Costs
Qualifying Asset

Qualifying Asset

Qualifying asset means:

Tangible Assets

Land, building, machinery, plant or furniture

Intangible Assets

Know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature

Inventories

Inventories that require a period of twelve months or more to bring them to a saleable condition

Note: For the purpose of capitalization of interest on general purpose borrowings, Qualifying asset should be such asset that necessarily require a period of twelve months or more for its acquisition, construction or production

ICDS IX – Borrowing Costs
Types of Borrowings

Particulars	Specific Borrowing	General borrowing
Recognition	Borrowing costs directly attributable to acquisition of qualifying asset - capitalized as part of cost of asset	Provides a specific formula for capitalizing borrowing costs relating to general borrowings based on the ratio of qualifying assets to total Assets
Commencement of Capitalization	Starts from the date when specific borrowings have been taken	When the amount of loan has been actually utilized for construction of Assets
Cessation of Capitalization	Capitalization of borrowing costs shall cease when tangible/intangible asset is first put to use or inventory is ready for sale If the qualifying asset is completed in parts and a completed part is capable of being used, then capitalization shall cease when that part of tangible/intangible asset is put to use or that part of inventory is ready for sale	

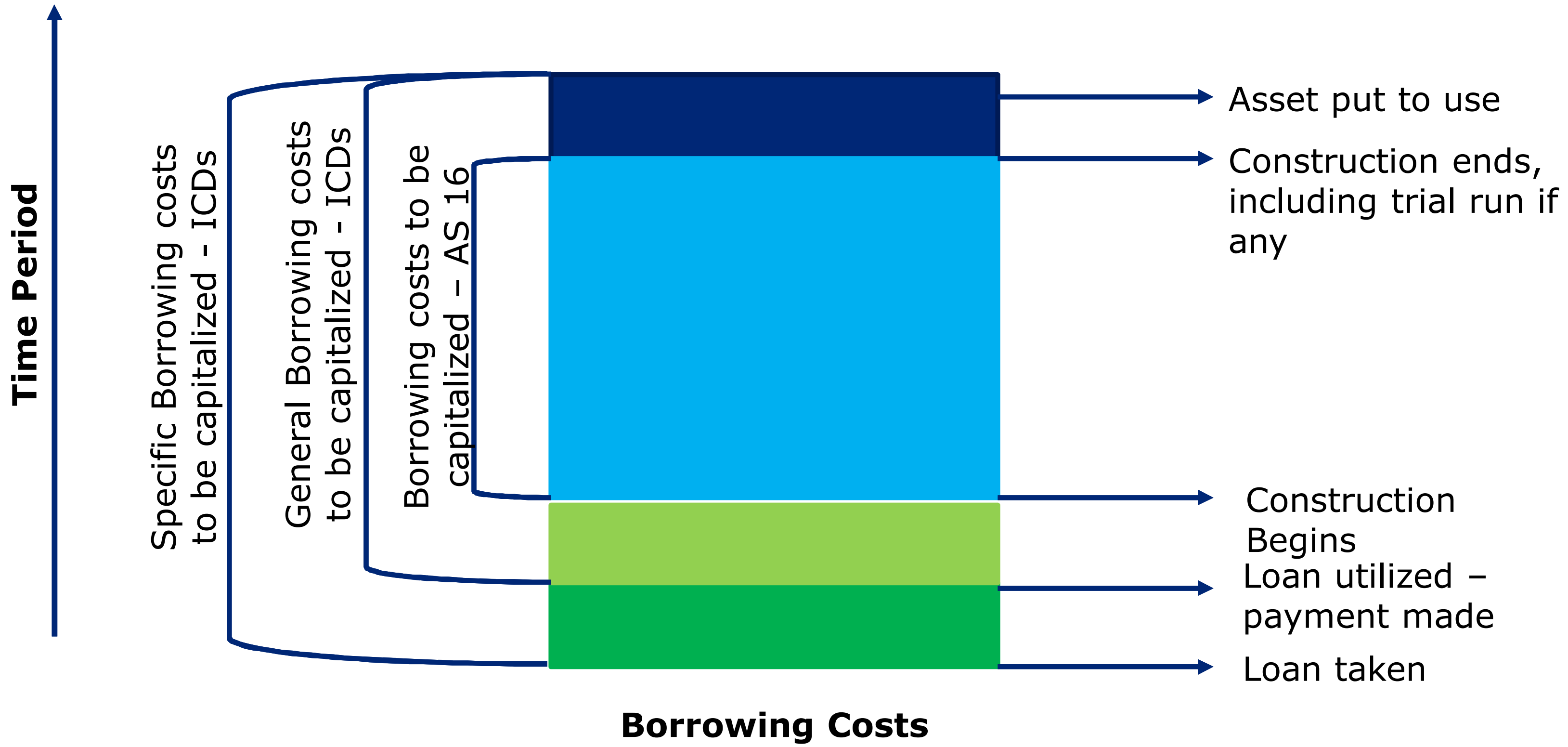
Treatment of borrowing costs other than covered under ICDS IX, will be dealt in accordance with the provisions of Income Tax Act, 1961 (the Act)

As per the provisions of section 36 (1) (iii) of the Act, any interest paid, in respect of capital borrowed for acquisition of an asset (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, is not allowed as deduction.

As per Explanation 8 to Section43(1) of the Act, interest paid or payable after asset is first put to use shall be excluded from its cost.

Provisions of ICDS IX is in line with the said provisions of the Act

ICDS IX – Borrowing Costs
Snapshot – Period of capitalization



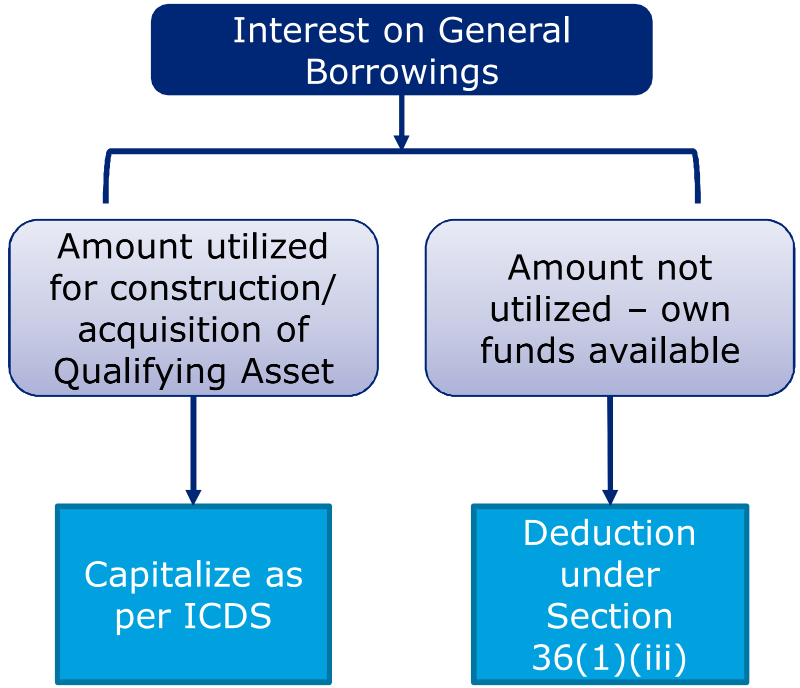
ICDS IX – Borrowing Costs
General borrowings and Owned Funds

It may be argued that capitalization is required only when generally borrowed funds are actually utilized for the purpose of acquisition, construction or production of a qualifying asset, and therefore no capitalization is warranted when the tax payer has sufficient own funds to purchase the qualifying asset.

Reliance can *inter alia* be placed on the following rulings of the Bombay High Court in the context of section 14A -

- o Reliance Utilities & Power Ltd. [2009] 178 Taxman 135
- o HDFC Bank Ltd. [2014] 49 taxmann.com 335
- o Bombay Oil Industries Ltd. [2014] 42 taxmann.com 440

Litigation on this issue cannot be ruled out.



ICDS IX – Borrowing Costs
Transitional Provisions and Disclosures

Impact of Transition to ICDS IX

- All the borrowing costs incurred on or after 1st day of April, 2016 shall be capitalised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard.
- The ICDS VI The transition to ICDS IX will have prospective effect
- Treatment of borrowing costs before 1st April 2016 will remain unaffected

Disclosure Requirements

The following disclosure shall be made in respect of borrowing costs, namely:—
(a) the accounting policy adopted for borrowing costs; and

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

ICDS IX – Key Differences between ICDS and Accounting Standard (1/3)

Particulars	ICDS – IX	Accounting Standard 16 (AS-16)
Meaning of Borrowing cost	Exchange difference arising from foreign currency borrowings to the extent it is regarded as an adjustment to the interest cost not covered	Exchange difference arising from foreign currency borrowings to the extent it is regarded as an adjustment to the interest cost covered
Specific Borrowing Cost	Capitalization of interest starts irrespective of stage of completion of the qualifying asset	Capitalization of interest starts only when necessary construction activities are started
Cessation of capitalization	Interest ceased to be capitalized at the time when asset is put to use	Interest ceased to be capitalized at the time when asset is ready to use
Qualifying Asset	• For Specific borrowings - All tangible and intangible assets. • For Other Borrowings – tangible, and intangible assets requiring a period of 12 months or more for its acquisition, construction or production • In both the above cases - Inventories that require 12 months or more to be brought into the saleable condition	Qualifying asset is an asset which takes substantial period of time for its preparation i.e. generally 12 months irrespective of type of borrowings

ICDS IX – Key Differences between ICDS and Accounting Standard (2/3)

Particulars	ICDS – IX	Accounting Standard 16 (AS-16)
Rate of capitalization of interest on general purpose Borrowings	Costs determined by following formula; $A * \frac{B}{C}$ (The formula is explained below)	Costs determined by applying capitalisation rate to the expenditure incurred on the asset. The rate is weighted average of borrowing costs applicable to the borrowings during the period other than specific borrowings.

<u>Formula as per ICDS for capitalization of borrowing costs related to general borrowings</u>

A = Borrowing costs incurred during previous year except on specific borrowings

B = a. Average cost of QA appearing in balance sheet on first and last day of the previous year

b. Half of the cost of QA, if it does not appear in balance sheet on the first day or both first and last day of the previous year

c. Average cost of QA as on first day of previous year and date of completion, if it does not appear in balance sheet on the last day of the previous year

C = Average of total assets, other than those funded by specific borrowings, as appearing in balance sheet as on first and last day of previous year

QA = Qualifying Assets other than those funded by specific borrowings.

ICDS IX – Borrowing Costs
Illustration

The capitalisation of general borrowing cost under the ICDS and Accounting Standard differs as explained below:

- Total assets appearing in balance sheet – INR 1000
- Total tangible and intangible assets acquired, constructed, produced – INR 700
- General borrowings – INR 500 (interest @ 10% i.e. INR 50)
- Specific borrowings – INR 200 (interest @ 10% i.e. INR 20)
- Cost of assets constructed using general borrowings – INR 450
- Cost of assets constructed using specific borrowings – INR 250

Capitalisation of general borrowing costs under AS-16

Weighted average borrowing cost is 10%. The said borrowing cost is 450 X 10% = 45

Capitalisation of general borrowing costs under ICDS-IX*

$$50 \times \frac{700-250}{1000-250} = \text{Rs.}30$$

*(Averaging is ignored in the above illustration)

ICDS IX – Key Differences between ICDS and Accounting Standard (2/3)

Particulars	ICDS – IX	Accounting Standard 16 (AS-16)
Interest income on temporary deposits made, pending utilization of borrowed funds	ICDS does not deal with the issue. One may need to refer relevant case laws in order to determine the treatment of such interest income	Such interest income to be reduced from total borrowing costs

One may have to refer judicial precedents

SC ruling in **Tuticorin Alkali Chemicals (227 ITR 172)** requires that interest income earned frominterest earned on short-term investment of funds borrowed for setting-up of factory during construction of factory before commencement of business has to be offered to tax as income from Other Sources

Delhi HC ruling **in Indian Oil Panipat Power Consortium Ltd (TS-62-HC-2009(Del)** held that since the interest income on temporary deposits was earned in a period prior to commencement of business it was in the nature of capital receipt and hence was required to be set off against pre-operative expenses.

ICDS X
Provisions, Contingent Liabilities and Contingent Assets

ICDS X – Provisions, Contingent Liability and Contingent Asset

Provision

- **Provision”** is a liability which can be measured only by using a substantial degree of estimation

Contingent Liability

a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the person; or

a present obligation that arises from past events but is not recognised because:
(A) it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or
(B) a reliable estimate of the amount of the obligation cannot be made

Contingent Asset

- **Contingent asset”** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the person.

Scope

This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:

a) resulting from financial instruments;
b) resulting from executory contracts;
c) arising in insurance business from contracts with policyholders; and
d) covered by another Income Computation and Disclosure Standard

ICDS X – Provisions, Contingent Liability and Contingent Asset

Recognition of Provision as per ICDS

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

Recognition of Contingent Liability as per ICDS

- Recognition of contingent liability is not allowed

Recognition of Contingent asset as per ICDS

- Recognition of contingent asset is not allowed generally
- Contingent asset must be assessed continually and if it becomes 'reasonably certain' that inflow of economic benefit will arise, the asset and the income are recognized in previous year in which the change occurs
- This is departure from AS which requires recognition of contingent asset only if there is "virtual certainty"

The term 'Reasonably Certain' has not been defined in ICDS, Act or Rules.

Where details of a proposed new law have yet to be finalized, an obligation arises only when the legislation is enacted

ICDS X – Provisions, Contingent Liability and Contingent Asset

Provisions
Contingent Assets and related income

Discounting

- Calculation of Present Value by way of discounting is not required

Review and Reversal

- Review at each balance sheet to reflect the best estimate
- Excess amount not required is to be reversed

ICDS X – Provisions, Contingent Liability and Contingent Asset
Transitional Provisions

Impact of Transition to ICDS X

- All the provisions or assets and related income shall be recognised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard

- The transition to ICDS X will have prospective effect

ICDS X – Provisions, Contingent Liability and Contingent Asset Disclosures

Provisions

- a brief description of the nature of the obligation;
- the carrying amount at the beginning and end of the previous year;
- additional provisions made during the previous year, including increases to existing provisions;
- amounts used, that is incurred and charged against the provision, during the previous year;
- unused amounts reversed during the previous year; and
- the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Contingent Assets and elated income

- a brief description of the nature of the asset and related income;
- the carrying amount of asset at the beginning and end of the previous year;
- additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and
- amount of asset and related income reversed during the previous year.

ICDS X – Key Differences between ICDS and Accounting Standard

Particulars	ICDS – X	Accounting Standard 29 (AS-29)
Recognition of Provision	A provision shall be recognized /created when outflow of resources is **reasonably certain**	A provision shall be recognized /created when outflow of resources is **probable (i.e. more likely than not)**
Contingent Assets – Assessment	Contingent assets are assessed continually and when it becomes **reasonably certain** that inflow of economic benefit will arise, the asset and related income are recognised in the year in which the change occurs	Contingent assets are assessed continually and if it has become **virtually certain** that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs

Reasonably certain is not defined in ICDS, Act or Rules.
Revenue authorities may contest that 'reasonably certain' is a lower threshold than *'virtually certain'*

ICDS X – Key Differences between ICDS and Accounting Standard

Recognition of Provision

Deviation from Judicial Pronouncements

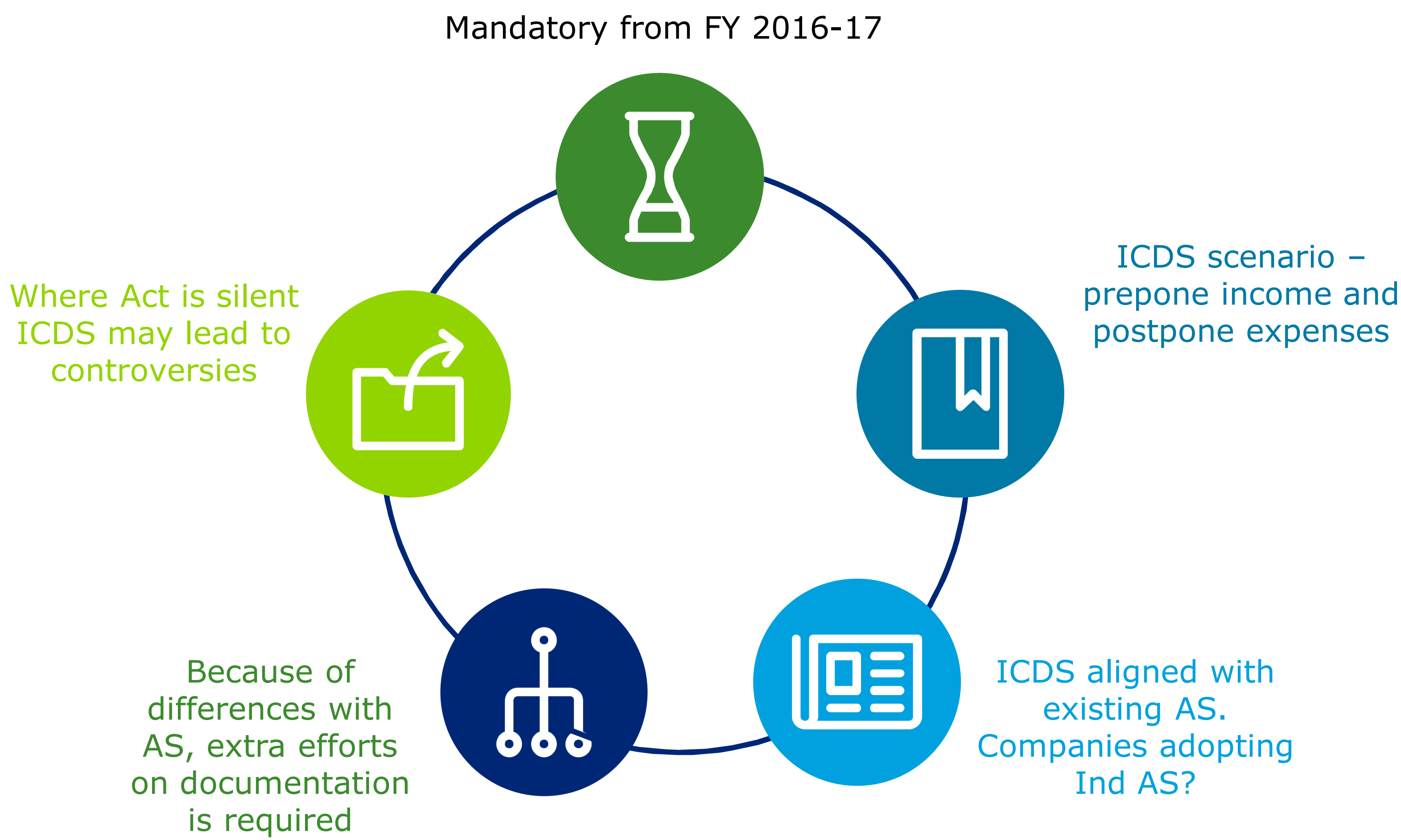
Provision for Warranty is allowed as an expenditure upholding the test of ***'probable'*** warranty obligation in the following judgments. However, ICDS recognizes provision only if the outflow is reasonably certain.

- Rotork Controls India P. Ltd. (2009) 314 ITR 62 (SC) (extract on next slide)
- Himalaya Machinery (P) Limited v DCIT 334 ITR 64
- CIT vs. Luk India P. Ltd. 52 DTR 117.
- Siemens Public communication Networks Limited v CIT
- CIT v Indian Transformer Limited. 270 ITR 259

ICDS X – Key Differences between ICDS and Accounting Standard

Particulars	ICDS – X	Accounting Standard 29 (AS-29)
Onerous Contract	ICDS is silent on the recognition or measurement of provision in respect of such onerous contract	If an enterprise has a contract that is onerous, the present obligation under the contract is recognised and measured as a provision
Reimbursements	Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is **reasonably certain** that reimbursement will be received if the entity settles the obligation	Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is **virtually certain** that reimbursement will be received if the enterprise settles the obligation

Key Takeaways



Questions

Deloitte.