

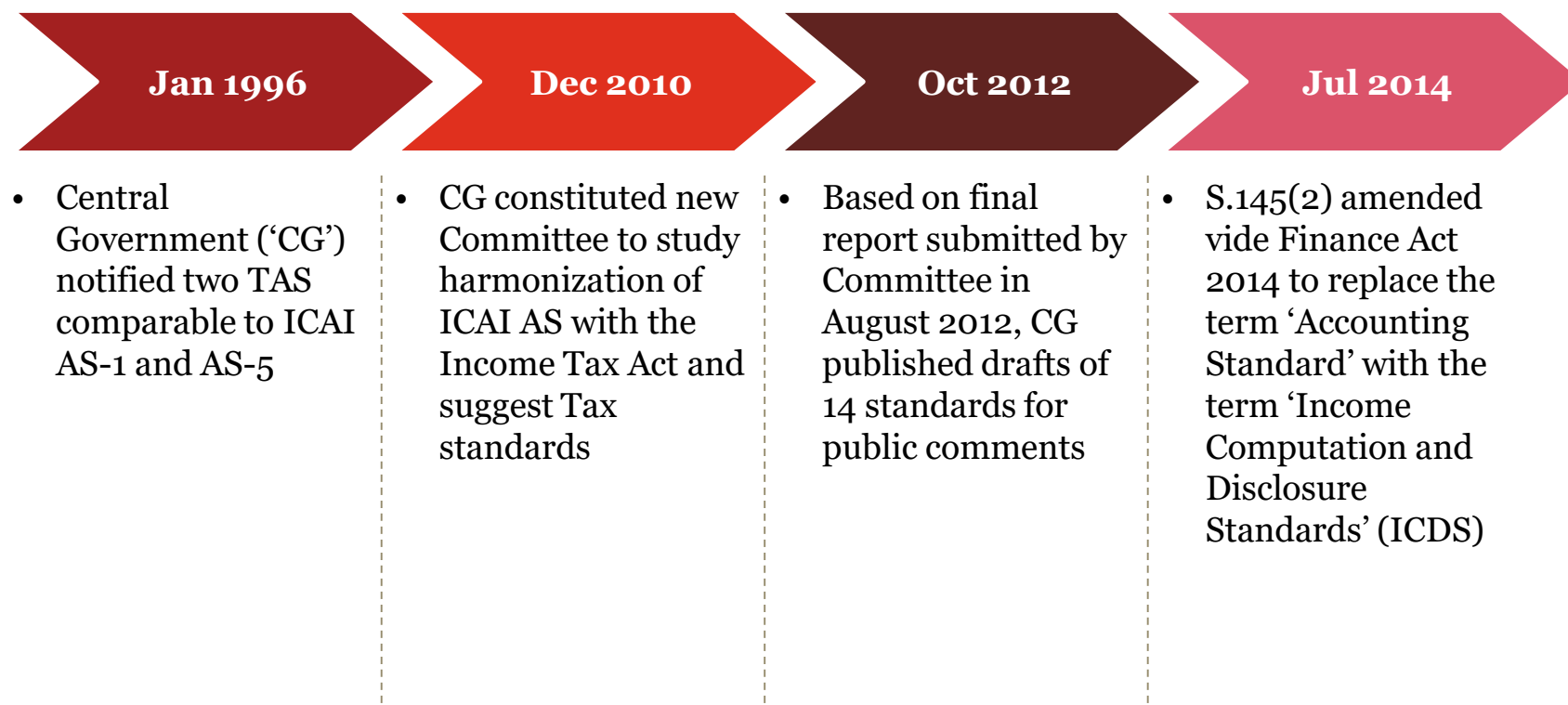
Income Computation and Disclosure Standards – I, IV, VII & VIII



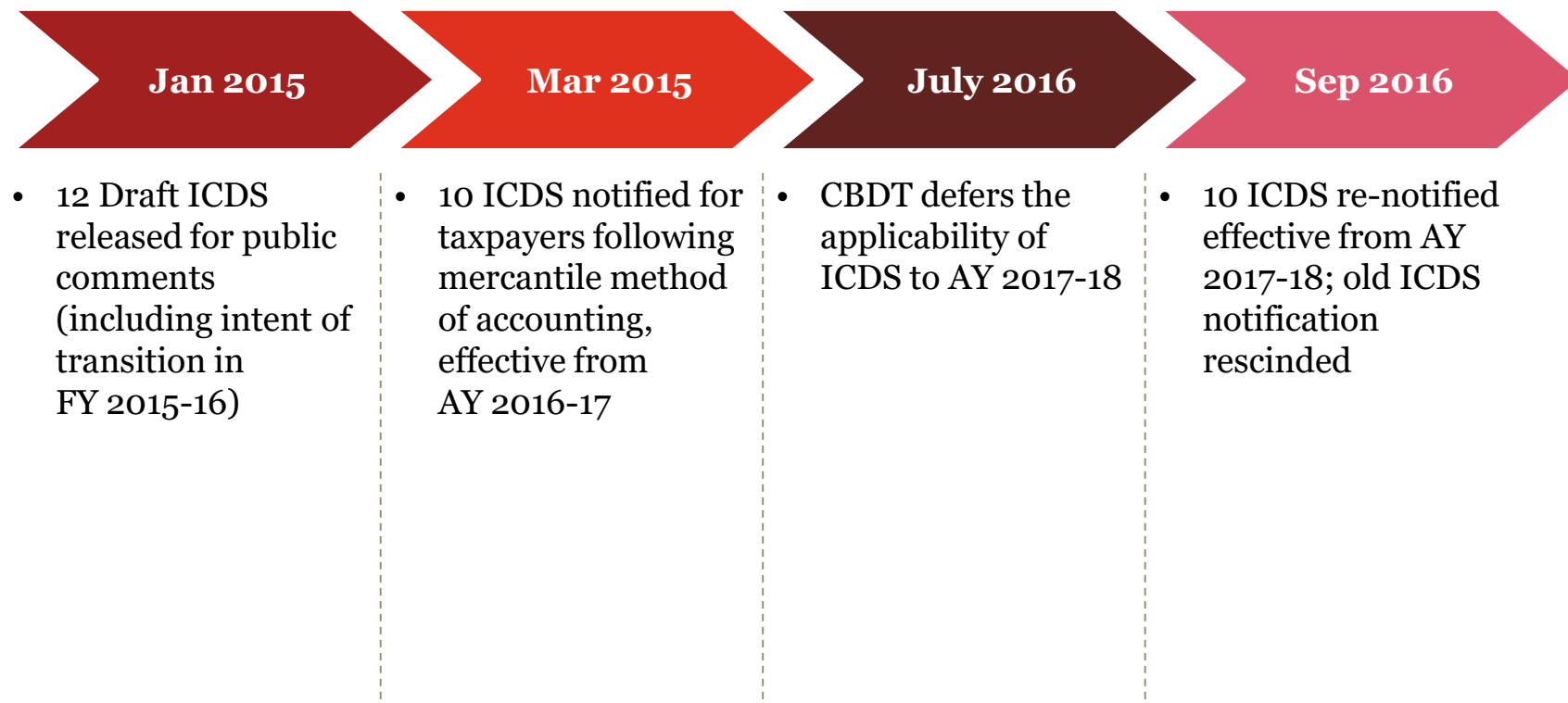
ICAI Nagpur Branch – July 22, 2017

Presented by K Venkatachalam

The story so far...



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Notified ICDS

<i>No.</i>	<i>ICDS on</i>	<i>Corresponding AS</i>
I	Accounting policies	AS 1
II	Valuation of Inventories	AS 2
III	Construction Contracts	AS 7
IV	Revenue Recognition	AS 9
V	Tangible fixed assets	AS 10
VI	Effects of changes in foreign exchange rates	AS 11
VII	Government Grants	AS 12
VIII	Securities	AS 13
IX	Borrowing costs	AS 16
X	Provisions, Contingent Liabilities & Assets	AS 29

**ICDS in respect of 'intangible assets' and 'leases' not yet notified.
Draft ICDS in respect of Real Estate released in May 2017**

Tax Audit Report – ICDS

- Central Government made ICDS applicable from AY 2017-18. As per Notification 88/2016, the impact of ICDS is required to be reported in the Form 3CD and the ITR.
- As a result, in Form No. 3CD, in Part-B, in clause 13, sub-clause (d) is amended to include ICDS.
- Further, sub-clause (e) and (f) are added.
- Sub-clause (e) requires reporting of adjustments required to profit and loss in following format

13. (a) Method of accounting employed in the previous year

(b) Whether there had been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.

(c) If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.

(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)

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

Tax Audit Report – ICDS

- Adjustments required under ICDS are to be disclosed under sub-clause (e) in the following format

		<i>Increase in profit (Rs.)</i>	<i>Decrease in profit (Rs.)</i>	<i>Net Effect (Rs.)</i>
<i>ICDS I</i>	<i>Accounting Policies</i>			
<i>ICDS II</i>	<i>Valuation of Inventories</i>			
<i>ICDS III</i>	<i>Construction Contracts</i>			
<i>ICDS IV</i>	<i>Revenue Recognition</i>			
<i>ICDS V</i>	<i>Tangible Fixed Assets</i>			
<i>ICDS VI</i>	<i>Changes in Foreign Exchange Rates</i>			
<i>ICDS VII</i>	<i>Governments Grants</i>			
<i>ICDS VIII</i>	<i>Securities</i>			
<i>ICDS IX</i>	<i>Borrowing Costs</i>			
<i>ICDS X</i>	<i>Provisions, Contingent Liabilities and Contingent Assets</i>			
	<i>Total</i>			

- Disclosures required under ICDS are to be disclosed under sub-clause (f)

ICDS Disclosure in Return of Income

Part A- OI Other Information (optional in a case not liable for audit under section 44AB)

1	Method of accounting employed in the previous year (Tick) <input checked="" type="checkbox"/> <input type="checkbox"/> mercantile <input type="checkbox"/> cash
2	Is there any change in method of accounting (Tick) <input checked="" type="checkbox"/> <input type="checkbox"/> Yes <input type="checkbox"/> No
3	Effect on the profit because of deviation, if any, as per Income Computation Disclosure Standards notified under section 145(2) [column 11(iii) of Schedule ICDS] 3
4	Method of valuation of closing stock employed in the previous year

Schedule ICDS		Effect of Income Computation Disclosure Standards on profit
Sl. No.	ICDS	Amount
(i)	(ii)	(iii)
I	Accounting Policies	
II	Valuation of Inventories	
III	Construction Contracts	
IV	Revenue Recognition	
V	Tangible Fixed Assets	
VI	Changes in Foreign Exchange Rates	
VII	Government Grants	
VIII	Securities	
IX	Borrowing Costs	
X	Provisions, Contingent Liabilities and Contingent Assets	
11.	Total Net effect (I+II+III+IV+V+VI+VII+VIII+IX+X)	

General Issues

Whether ICDS will prevail over the provisions of the Act/Rules?

- ICDS specifically provide that in case of conflict with the provisions of the Act/Rules, the provisions of the Act/Rules shall prevail

Further clarified by Circular 10/2017

Whether existing 'interpretation of provisions of Act' by Courts will prevail over ICDS?

- Certain judicial precedents were pronounced in absence of authoritative guidance. As guidance is now provided by way of ICDS, it shall override transactional issues dealt in the judicial precedents

ICDS – Judicial precedents overruled

Woodward Governor India (P.)
Ltd. [2009] 179 Taxman 326 (SC)

- Profits for income-tax purposes are to be computed in accordance with ordinary principles of commercial accounting
ICDS I – Accounting Policies

Sakthi Trading Co. v. CIT [2001]
250 ITR 871 (SC)

- 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 NRV whichever is lower will apply –
ICDS II – Valuation of Inventories

Simplex Concrete Piles India (P.)
Ltd [1989] 179 ITR 8 (Cal HC)

- Retention Money set apart in the progressive billings, depending upon the terms of the construction contract, need not be recognised as revenue –
ICDS III – Construction Contract

CIT vs Vashisht Chay Vyapar
[2011] 330 ITR 440 (Delhi HC)

- Interest on NPA taxable only on receipt basis for NBFC's
ICDS IV - Revenue Recognition

ICDS – Judicial precedents overruled

Western India Vegetable Products Ltd v. CIT [1954] 26 ITR 151 (Bom HC)

- Expenses incurred during the gap between set up and commencement are allowable deductions
ICDS V- Tangible Fixed Assets

CIT v. Tata Iron & Steel Co. Ltd. [1998] 231 ITR 285 (SC)

- The cost of an asset and the cost of raising money for purchase of the asset are two different and independent transactions.
ICDS VI- Effects of changes in foreign exchange rates

Various Judicial Precedents

- Government grants held to be in capital in nature
ICDS VII - Government Grants

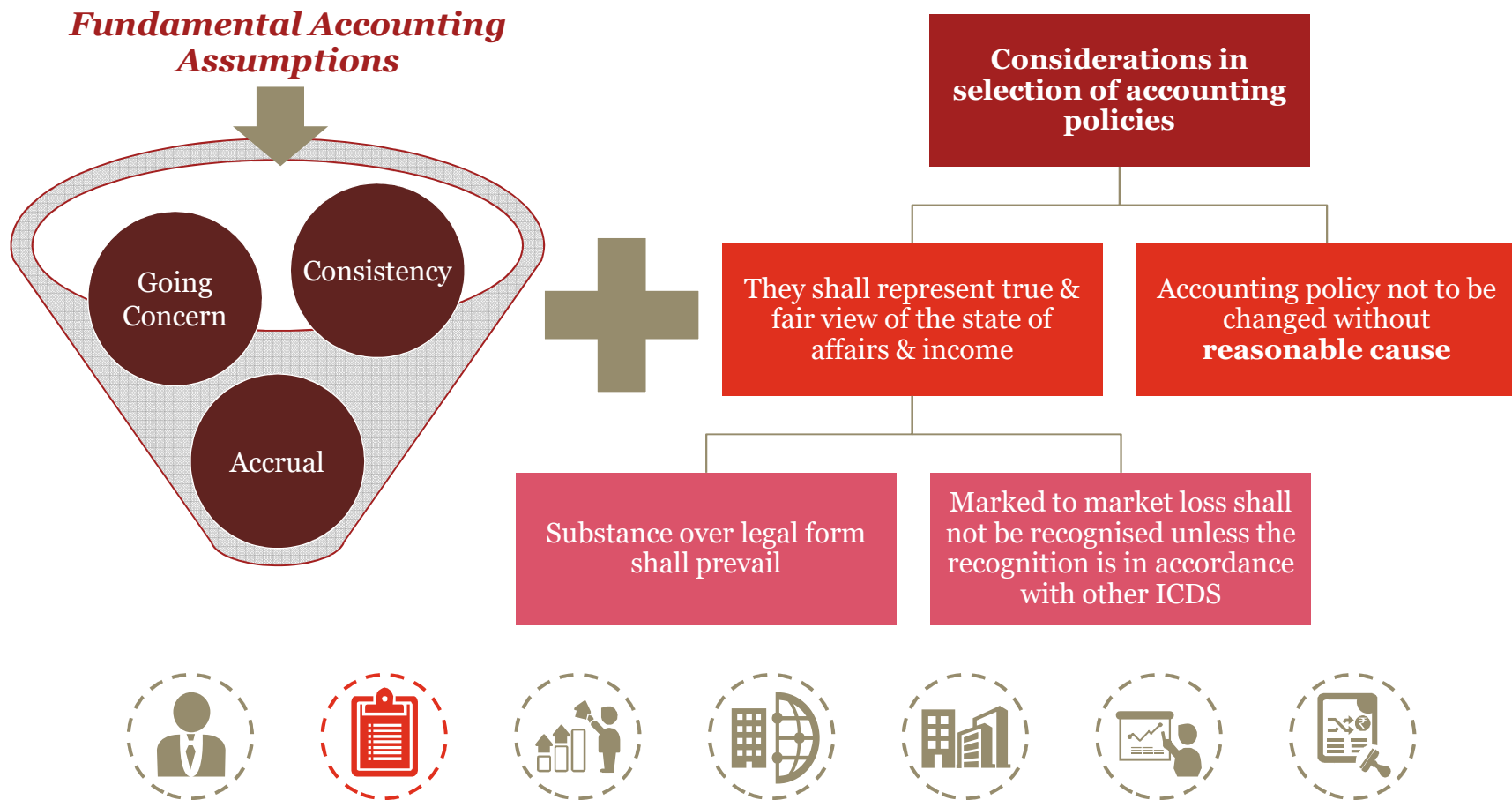
National Thermal Power Corpn. Ltd vs CIT [2013] 357 ITR 253 (Delhi)

- Capital construction equipments kept ready for use, but no actually used are entitled to depreciation
ICDS IX –Borrowing Costs



I. Accounting policies

ICDS I – Accounting Policies



ICDS I – Impact Areas

<i>Particulars</i>	<i>As per ICDS I</i>	<i>As per AS-1</i>
Materiality	<ul style="list-style-type: none"> Does not consider the concept of 'materiality' 	<ul style="list-style-type: none"> Materiality is one of major consideration
Prudence	<ul style="list-style-type: none"> MTM loss or an expected loss shall not be recognised (unless required by the provisions of any other ICDS) MTM Gain not taxable (Clarified by Circular 10/2017) 	<ul style="list-style-type: none"> Mark to market ('MTM') losses will be provided for in view of prudence concept. Expected losses will be provided for in accordance with relevant Indian GAAP Standards
Changes in Accounting Policy	<ul style="list-style-type: none"> Permitted for any 'reasonable cause' Q 9 of Clarification - 'Reasonable Cause' confers desired flexibility to the tax payer in deserving cases 	<ul style="list-style-type: none"> If required by Statute, or Compliance with AS, or For more appropriate presentation

ICDS I - Mark to Market Loss/ Gain

Facts:

- I Co buys a 3 month futures contract on the stock exchange in Feb 2017 which entitles it to receive 100 shares of B Co at a Price of INR 250 per share;
- Contract will expire in April 2017; On 31 March 2017 there could be two scenarios

Scenario 1 – Price of shares is INR 260

- Notional gain of INR 1,000

Scenario 2 – Price of shares is INR 240

- Notional Loss of INR 1,000

Futures Contract to receive shares of B Co at a price of INR 250 per share	Scenario 1 – MTM Gain of INR 1000	PRE	Not taxable as not recognised in books
		POST	Not taxable as not recognised in books
	Scenario 2 – MTM Loss of INR 1000	PRE	Allowed applying the ratio laid down by SC in Woodward Governor
		POST	Not allowed as the same is not covered by any other ICDS

ICDS I - Disclosure requirements in Clause 13(f) of Tax Audit Report

- All significant accounting policies adopted by a person shall be disclosed.
- Any change in an accounting policy which has a **material effect** shall be disclosed.
- **The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable.** Where such amount is not ascertainable, wholly or in part, the fact shall be indicated.
- If a change is made in the accounting policies which has no material effect for the current previous year but which is **reasonably expected to have a material effect in later previous years**, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted and also in the previous year in which such change has material effect for the first time.
- If the fundamental accounting assumptions of Going Concern, Consistency and accrual are followed, specific disclosure is not required

Disclosure of accounting policies or of changes therein cannot remedy a wrong or in appropriate treatment of the item.



IV. Revenue Recognition

ICDS IV – Revenue Recognition

- ICDS IV deals with the basis for recognition of revenue arising in the course of ordinary activities
- It excludes from its application revenue recognition of items that are dealt by other ICDS

Sale of goods

- Revenue to be recognised when significant risks and rewards are transferred - there is no significant deviation from AS-9 for revenue recognition for sale of goods
- Revenue to be recognized only if there is reasonable certainty of ultimate collection of the revenue; and the revenue can be reliably measured
- Uncertainty with regard to price escalation claims or export incentives, revenue recognition to be postponed

Service income

- Revenue from rendering services to be recognised on POCM basis,
- Straight line method if service provided by the indetermined numbers of acts over a specific period of time
- Revenue from service contracts with duration of not more than 90 days may be recognised when the rendering of services under that contract is completed or substantially completed

ICDS IV – Revenue Recognition

Other income

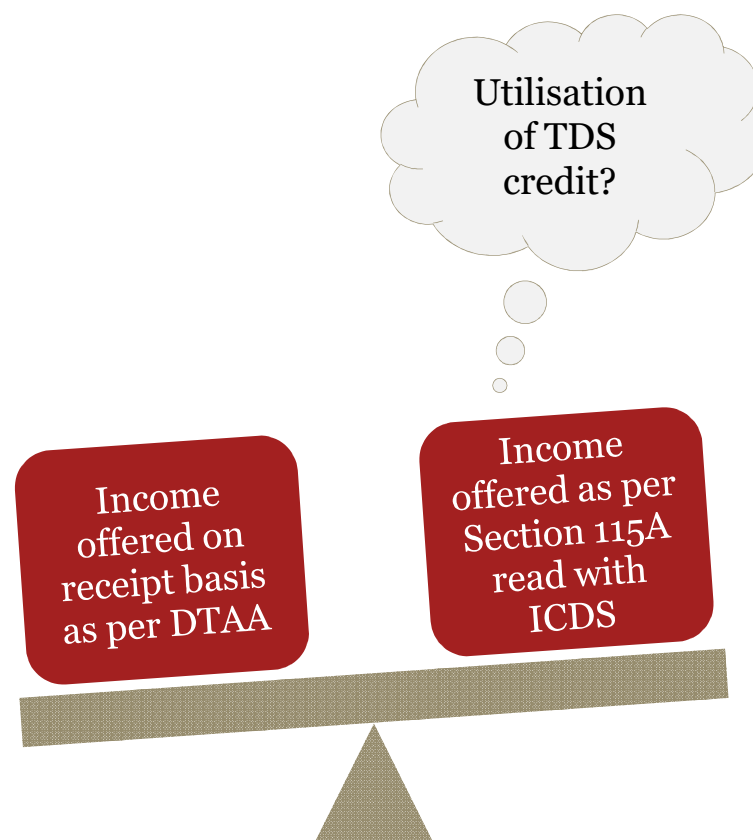
- Interest – Accrual on time basis
- Royalties – in accordance with the terms of the agreement
- Dividend – In accordance with the provisions of the ITA
- Interest on refund of taxes, duties shall be recorded as income in the year of receipt

Issues

- Determination of Percentage of Completion;
- Interest on NPA's
- Taxation of Royalties, FTS received by Non-residents under 115A

ICDS IV – Income under Section 115A

- B Inc. is a Foreign company; Resident of USA and in receipt of FTS, Royalty income from Indian customers;
- Customers withhold tax on remittance at the rate under the Act; Royalty and FTS are taxable under Act at 10% plus surcharge and Education cess and 15% under DTAA between India and USA
- Currently, B Inc. offers income to taxation on a receipt basis; Income offered in year when taxes are withheld.
- Q 14 of Circular 10/2017 clarifies that income under Section 115A would be covered by ICDS;
- Can B Ltd offer Royalty/FTS income on receipt basis as per DTAA and still claim rate as per Sec 115A of the Act?



ICDS IV – Disclosure requirements in Clause 13(f) of Tax Audit Report

- **In case of Sale of Goods:** Revenue not recognized during the year due to uncertainty in collection to be disclosed
- **In case of Services:** Method to compute the stage of completion, Amount of revenue recognized,

In respect of service transactions in progress at the end of the year:

- Amount of costs incurred and recognized profits (less recognized losses) upto the reporting date;
- Amount of advances received; and
- Amount of retentions.

[Back](#)



VII. Government Grants

ICDS VII – Government grants

Government

- Government,
- Government agencies and
- Similar bodies whether local, national or international.

Government Grants

- Assistance by government in cash or kind to an enterprise for past or future compliance.

Exclusions

- Assistance other than in the form of Government grants.
- Government participation in the ownership of the enterprise.

ICDS VII – Government grants

<i>ICDS VII - Recognition</i>	<i>AS 12- Recognition</i>
<p><i>Reasonable assurance required for</i></p> <ul style="list-style-type: none">a) conditions of grant to be met and :b) Grant shall be received: <p>or</p> <ul style="list-style-type: none">c) Grant is received <p>Recognition cannot be postponed beyond actual receipt</p>	<p><i>Reasonable assurance required for</i></p> <ul style="list-style-type: none">a) conditions of grant to be met andb) Grant shall be received

ICDS VII – Government grants Key differences

<i>Concept</i>	<i>As per ICDS VII</i>	<i>As per AS-12</i>
Monetary grants related to depreciable assets	<ul style="list-style-type: none">• Shall be deducted from the cost of assets/ WDV of the block of assets (No option to recognize as deferred revenue)	<ul style="list-style-type: none">• Either deducted from gross value of the asset or treated as deferred income and recognised in P&L on a systematic basis over the useful life of assets

ICDS VII – Grant relatable to fixed asset

Attributable to specific asset

- Reduce cost or block WDV

Not attributable to specific asset but to the block of assets

- Reduce cost or WDV in proportion.

Grant at Concessional rate

- Account on basis of acquisition cost

Refund to Government on non-fulfillment of obligations

- To be added to the cost of the asset
- Depreciation allowance to be claimed prospectively.

ICDS VII – Grant other than fixed asset

Non- depreciable
fixed assets

- Income in the period over which cost of meeting such obligation is charged to income

Grant received as
compensation for
expenses or losses or as
financial support

- Income in the period when it is receivable

All other grants other than
impacting cost of asset

- Income over the period to match them with related costs which they are intended to compensate

Refunds

- Adjusted against an unamortised deferred credit
- Balance debited to Profit & Loss account

ICDS VII – Points to Ponder

Past year treatment as Capital / Revenue; in the books/ Transfer pricing

ICDS provisions in line with the amended provisions of the Act

Subsidy, grant, etc., (other than reduced from actual cost) to be treated as **income under Section 2(24)**

Relevance of “Purpose” test ignored (i.e. capital v revenue in nature)

Carbon credits from other agencies – Treatment in FY 2016-17; Covered by Section 115BBG w.e.f. FY 2017-18

Promoter contribution by Government

ICDS VII – Points to Ponder

Balance of incentives under IPS accrued before 1 April 2015. How do you determine accrual? When does the refund under IPS accrue? On investment in eligible assets or upon payment of VAT?

Explanation 10 to Section 43(1)

Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee :

Provided that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee.

ICDS VII – Judicial precedents overruled

Sahney steel & press
works Ltd/ Ponni Sugars
& Chemicals Ltd.

- Subsidy granted for setting up new unit/expansion of existing business is a capital receipt.

Reliance Industries Ltd.
(339 ITR 632) (Bom)

- Subsidy to setup a new unit in a backward area – Capital receipt.

Chaphalkar Brothers
(351 ITR 309) (Bom)

- Subsidy for construction of multiplex theatre complexes – Capital receipt

Kisan Sahkari
Chini Mills Ltd.
(2 taxmann.com 274)
(Allahabad)

- Incentive by way of additional quota for free sale of sugar for setting up a new sugar factory/expansion – Capital receipt

India Telephone
(215 Taxman 82)
(Karnataka)

- Grant given for research in the field of telecommunications, which in turn would benefit the Nation and public at large, has been held as capital receipt.

ICDS VII – Government grants

Disclosure Requirements

- Nature and extent of Government grants recognized by way of deduction from the actual cost of the asset (s) or from the WDV of block of assets;
- Nature and extent of Government grants recognized as income during the year;
- Nature and extent of Government grants not recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets and reasons thereof; and
- Nature and extent of Government grants not recognized as income and reasons thereof.

[Back](#)



VIII. *Securities*

ICDS VIII – Securities – Part A

Covers only those securities held as stock-in-trade.

Businesses to whom ICDS – VIII is applicable – Indicative list

- Stock brokers
- Traders
- NBFC's

Specifically excludes

- Recognition of interest and dividend on securities.
- Securities in the business of insurance.
- Securities of Mutual fund, Venture capital funds, Banks and Public financial institutions.

Fair Value means

- Amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

Securities means

- Securities as defined in section 2(h) of the Securities Contract (Regulation) Act, 1956 and shall include share of a company in which public are not substantially interested, but shall not include derivatives.

ICDS VIII – Securities – Part B

Covers securities held by:

- Banks and Public Financial Institutions

Classification, Recognition and Measurement

- In accordance with the guidelines issued by the RBI
- Any claim for deduction in excess of the guidelines shall not be taken into account

ICDS VIII - Securities

Criteria	ICDS	AS –13
Scope	<ul style="list-style-type: none"> Only securities held as stock in trade fall within the scope of ICDS 8 and long term investments do not fall under this standard. 	<ul style="list-style-type: none"> AS 13 deals with accounting for investments. Stock-in-trade is outside the scope.
Measurement	<ul style="list-style-type: none"> Cost should be determined either on actual cost or based on FIFO / WAC method and not on specific identification method. 	<ul style="list-style-type: none"> In respect of shares, debentures and other securities held as stock-in-trade, the cost of stocks disposed of is determined by applying an appropriate cost formula.
Valuation	<ul style="list-style-type: none"> Treated as one group each and the total gain / loss of the category is considered: <ul style="list-style-type: none"> - Shares - Debt - Convertible - Any other 	<ul style="list-style-type: none"> Valuation done scrip wise – cost or NRV whichever is less

Case Study - Portfolio Approach

- Portfolio wise valuation results in accelerated taxation with reference to securities which appreciates in values

<i>Company</i>	<i>Cost (INR)</i>	<i>NRV (INR)</i>	<i>AS 13</i>	<i>ICDS VIII</i>
			<i>Lower of Cost / NRV (INR)</i>	<i>Lower of Cost / NRV Portfolio wise (INR)</i>
A	200	250	200	-
B	400	300	300	-
C	600	500	500	-
D	500	600	500	-
E	700	400	400	-
Total	2400	2050	1900	2050

Thank You