WIRC of ICAI – Nashik Branch

Jhankhana Thakkar Palan

22 September 2018

Contents

Background

Background

Section 145 of Income-tax Act, 1961

Section 145(1)

- Income chargeable under the head "Profits and gains of business or profession" or "Income chargeable from other sources" shall, subject to the provisions of sub-section (2), be computed in accordance with either cash or mercantile system of accounting regularly employed by the assesse

Section 145(2)

- The Central Government may notify in the Official Gazette from time to time income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income

Section 145(3)

- Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assesse, or where the method of accounting provided in sub-section (1) has not been regularly followed by the assesse, or income has not been computed in accordance with the standards notified under subsection (2), the Assessing Officer may make an assessment in the manner provided in section 144

Background

Journey so far

- **Jan 1996** – Central Board of Direct Taxes ('CBDT') notified 2 Accounting Standards ('AS') under section 145(2) of the Income-tax Act, 1961 ('Act') [existing tax AS]
- **Dec 2010** – CBDT constituted Accounting Standards Committee to suggest harmonization of ICAI AS with provisions of the Act and suggest AS to be notified under the Act
- **Oct 2012** – Final report of Committee and 14 draft AS published (comments were invited from public on Draft AS)
- **Jul 2014** – Finance Bill (No 2) 2014 amended section 145 (2) and (3) (ICDS substituted for AS)
- **Jan 2015** – CBDT issued drafts of 12 ICDS (Draft ICDS kept open for comments and suggestions)
- **Mar 2015** – CBDT notified 10 ICDS (excluding standards on 'Leases' and 'Intangible Assets')
- **Sep 2016** – Revised ICDS issued (excluding standards on 'Leases' and 'Intangible Assets') – applicable from AY 2017-18

Background

Timeline of significant events

10 March 2017 – CBDT releases FAQs in Circular No.10/2017

(‘the Circular’)

July 2017 – ICAI issues “Technical Guidance on ICDS” (‘ICAI technical guidance)

8 November 2017 – Delhi High Court Judgement – The Chamber of Tax Consultants – Delhi HC judgement – 400 ITR 178

Finance Act, 2018 – Introduction of certain provisions of ICDS into the Act with retrospective effect from AY 2017-18

Snapshot of retrospective amendments by the Finance Act, 2018:

Section 36(1)(xviii)

Deduction of MTM or other expected loss to be in accordance with ICDS

Section 40A(13)

No deduction in respect of MTM or other expected loss, except as allowable u/s 36(1)(xviii)

Section 43AA

Any foreign exchange gain or loss in respect of specified foreign currency transactions shall be treated as income or loss, if computed as per ICDS

Section 43CB

- Profits from a construction contract or a services contract to be determined as per percentage of completion method
- Retention money to be included
- Incidental income not to be reduced

Section 145A

- Inventory to be valued at lower of actual cost or NRV computed in the manner provided in ICDS
- Inventory being securities to be valued in line with ICDS

Section 145B

Interest received on enhanced compensation, claim for price escalation or export incentives, subsidy, grants, etc. to be taxed in year of receipt/ achieving reasonable certainty of realisation

Background

Notified ICDS – Applicable from AY 2017-18

No.	ICDS	Accounting standard (AS)	Indian Accounting Standard (Ind AS)
I	Accounting Policies	AS 1	Ind AS 1 & Ind AS 8
II	Valuation of Inventories	AS 2	Ind AS 2
III	Construction Contracts	AS 7	Ind AS 115*
IV	Revenue Recognition	AS 9	Ind AS 115*
V	Tangible fixed assets	AS 10	Ind AS 16
VI	Changes in Foreign Exchange Rates	AS 11	Ind AS 21
VII	Government Grants	AS 12	Ind AS 20
VIII	Securities	AS 13 / AS 30	Ind AS 32 & Ind AS 109
IX	Borrowing Costs	AS 16	Ind AS 23
X	Provisions, Contingent Liabilities and Contingent Assets	AS 29	Ind AS 37

* Applicable from FY 2018-19

ICDS on Leases and Intangible assets are not notified

Draft ICDS on Real Estate Transactions (CBDT press release dt. 11 May 2017)

Background

General questions in relation to ICDS (Circular No. 10/2017 dated 23 March 2017)

ICDS are for maintenance of books of account (Q1)

- No

Certain ICDS provisions are inconsistent with judicial precedents (Q2)

- ICDS will prevail

ICDS applicable to assessee covered under presumptive scheme (Q3)

- Yes

If conflict between ICDS and rules (Q4)

- Rules will prevail

Will ICDS apply to company which adopted Ind-AS (Q5)

- ICDS will apply irrespective of accounting standards

Whether ICDS will apply to MAT / AMT (Q6)

- Will not be applicable for MAT but will be relevant for AMT

Will ICDS apply to Banks, NBFC's, Insurance Co., Power Co. etc. (Q7)

- Yes

Disclosure of net effect on the income - Return of Income.

- **Disclosures required under ICDS shall be made in the tax audit report (Form 3CD).**
- **No separate disclosure requirement for persons not liable to tax audit (Q-25)**

Background

What to do ?

- Get the Financial statements prepared complying AS / IND AS
- Check and List out the applicable ICDS
- Note Differences in accounting policy as per AS/IND AS in books and ICDS
- If different, effect on profit/loss to be disclosed in Form 3CD & ITR
- Is there any adjustment required in computation from Profit as per Books and IT ?
- Does any of those relate to any ICDS ?
- If yes, disclosure may be required in 3CD & ITR too

Background

Validity of ICDS

Application of the principles laid down by the Delhi HC

- As held by the Delhi High Court, ICDS cannot override judicial precedents interpreting the provisions of the law.
- Though certain provisions of ICDS which were struck down by the Delhi High Court have been validated by insertion of specific provisions to that effect in the Act, there could still be some judicial precedents which may be in conflict with the provisions of ICDS and have not been plugged.
- In those cases, it may still be possible to apply the principles laid down by the Delhi High Court.
- In the absence of concept of prudence in ICDS I, ICDS I was held to be ultra vires by the Delhi High Court.
- Though section 36(1)(viii) allows deduction for mark to market and expected losses as per ICDS and section 40A(13) disallows all other mark to market and expected losses, concept of prudence is wider than mark to market and expected losses.
- Therefore, it may still be possible to apply the concept of prudence on a case to case basis.

ICDS analysis and its impact

Computation of taxable Income – Impact of ICDS

Particulars	Pre ICDS	Post ICDS
Net profit as per profit and loss account	**XXX**	**XXX**
Add: - Disallowance as per Act	XXX	XXX
Depreciation as per companies Act	XXX	XXX
Provision for gratuity	XXX	XXX
Less: Allowance as per Act	(XXX)	(XXX)
Depreciation as per Income tax Act	(XXX)	(XXX)
Allowance u/s 43B of the Income tax Act	(XXX)	(XXX)
Net profit before tax	**XXX**	**XXX**
Add / less : Adjustment on account of ICDS	NA	XXX
Valuation of Inventory (Standard Costing effect)	NA	XXX
Construction contract (Provision for expected loss)	NA	(XXX)
Foreign Exchange fluctuations (Premium of forward contracts)	NA	XXX
Net Profit before after tax (after considering impact of ICDS)	**XXX**	**XXX**

Disclosures in Form 3CD (Notification no. 88/2016 dated 29 September 2016) (1/2):

Clause 13(d) under Part-B:

(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:

		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			
ICDS VI	Changes in Foreign Exchange rates			
ICDS VII	Government Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
	Total			

Disclosures in Form 3CD (Notification no. 88/2016 dated 29 September 2016) (2/2):

Clause 13(d) under Part-B (Contd..):

(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 -	Government Grants
(vii)ICDS IX -	Borrowing Costs
(viii)ICDS X -	Provisions, Contingent Liabilities and Contingent Assets

Disclosures in return Form ITR-6 for AY 2018-19 (1/2):

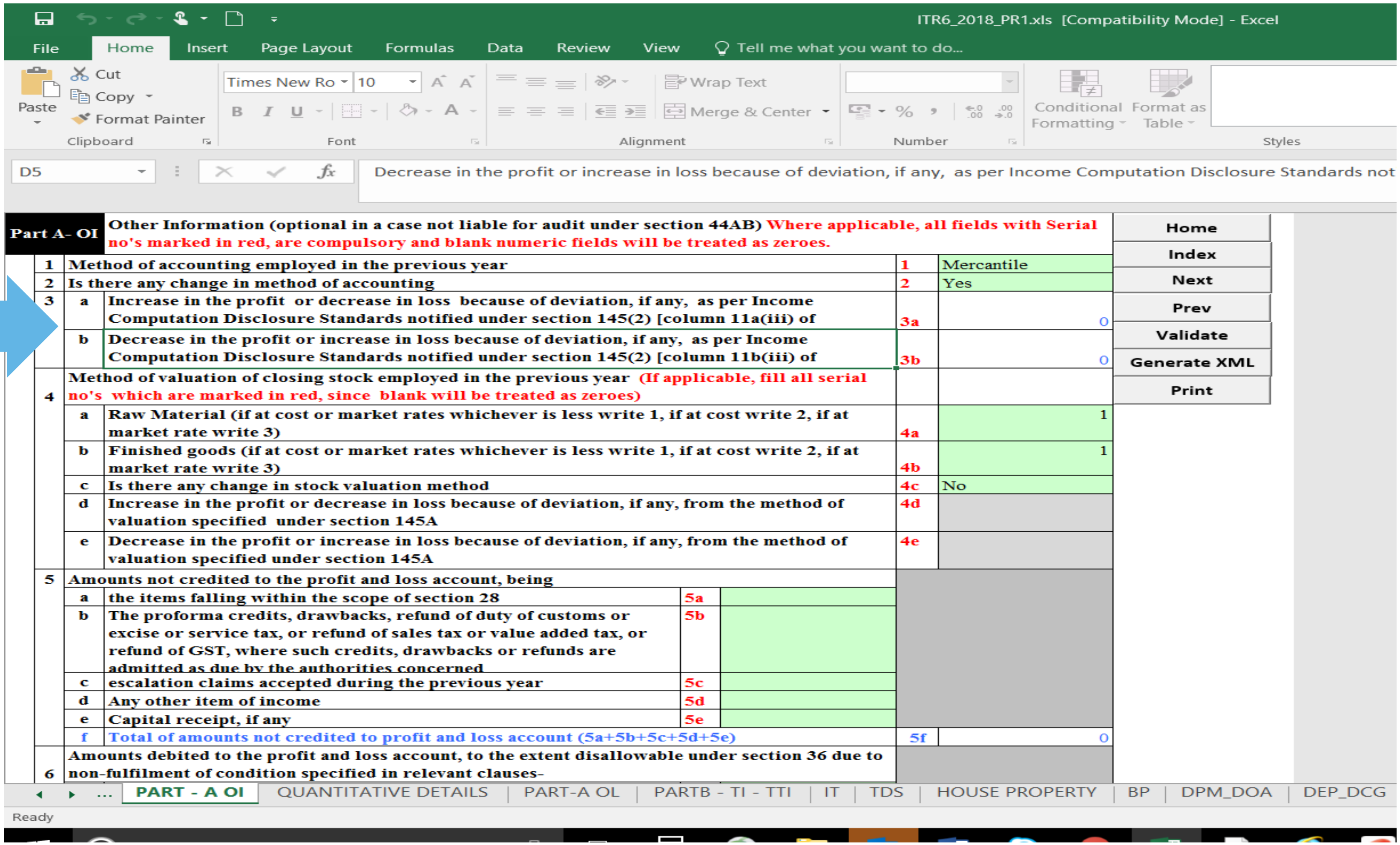
Schedule ICDS:

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	
XI	Total effect of ICDS adjustments on profit (I+II+III+IV+V+VI+VII+VIII+IX+X) (if	0
XI	Total effect of ICDS adjustments on profit (I+II+III+IV+V+VI+VII+VIII+IX+X) (if	0

Home
Index
Next
Prev
Validate
Generate XML
Print

Disclosures in return Form ITR-6 for AY 2018-19 (1/2):

Part A – OI sheet:



Part A- OI	Other Information (optional in a case not liable for audit under section 44AB) Where applicable, all fields with Serial no's marked in red, are compulsory and blank numeric fields will be treated as zeroes.		
1	Method of accounting employed in the previous year	1	Mercantile
2	Is there any change in method of accounting	2	Yes
3 a	Increase in the profit or decrease in loss because of deviation, if any, as per Income Computation Disclosure Standards notified under section 145(2) [column 11a(iii) of	3a	0
b	Decrease in the profit or increase in loss because of deviation, if any, as per Income Computation Disclosure Standards notified under section 145(2) [column 11b(iii) of	3b	0
4	Method of valuation of closing stock employed in the previous year (If applicable, fill all serial no's which are marked in red, since blank will be treated as zeroes)		
a	Raw Material (if at cost or market rates whichever is less write 1, if at cost write 2, if at market rate write 3)	4a	1
b	Finished goods (if at cost or market rates whichever is less write 1, if at cost write 2, if at market rate write 3)	4b	1
c	Is there any change in stock valuation method	4c	No
d	Increase in the profit or decrease in loss because of deviation, if any, from the method of valuation specified under section 145A	4d	
e	Decrease in the profit or increase in loss because of deviation, if any, from the method of valuation specified under section 145A	4e	
5	Amounts not credited to the profit and loss account, being		
a	the items falling within the scope of section 28	5a	
b	The proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, or refund of GST, where such credits, drawbacks or refunds are admitted as due by the authorities concerned	5b	
c	escalation claims accepted during the previous year	5c	
d	Any other item of income	5d	
e	Capital receipt, if any	5e	
f	Total of amounts not credited to profit and loss account (5a+5b+5c+5d+5e)	5f	0
6	Amounts debited to the profit and loss account, to the extent disallowable under section 36 due to non-fulfilment of condition specified in relevant clauses-		

Disclosures in return Form ITR-6 for AY 2018-19 (1/2):

Schedule BP:

A1 | Schedule BP

Schedule BP	Computation of income from business or profession	Home
A	From business or profession other than speculative business and specified business	Index

INCOME FR		f	35ABB	21f		
		g	35AC	21g		
		h	40A(3A)	21h		
		i	33AC	21i		
		j	72A	21j		
		k	80HHD	21k		
		l	80-IA	21l		
	22		Deemed income under section 43CA	22		
	23		Any other item or items of addition under section 28 to 44DA	23		
	24		Any other income not included in profit and loss account/any other expense not allowable (including income from salary, commission, bonus and interest from firms in which company is a partner)	24		
	25		Increase in profit or decrease in loss on account of ICDS adjustments and deviation in method of valuation of stock (Column 3a + 4d of Schedule OI)	25	0	
	26		Total (14 + 15 +16 +17 +18 +19 + 20 +21 + 22 + 23 + 24+25)		26	0
	27		Deduction allowable under section 32(1)(iii)	27		
	28		Deduction allowable under section 32AD	28		
	29		Amount allowable as deduction under section 32AC	29		
	30		Amount of deduction under section 35 or 35CCC or 35CCD in excess of the amount debited to profit and loss account (item X(4) of Schedule ESR) (if amount deductible under section 35 or 35CCC or 35CCD is lower than amount debited to P&L account, it will go to item 24)	30	0	
	31		Any amount disallowed under section 40 in any preceding previous year but allowable during the previous year(8Bof Part A-OI)	31	0	
	32		Any amount disallowed under section 43B in any preceding previous year but allowable during the previous year(10h of Part A-OI)	32	0	
	33		Any other amount allowable as deduction	33		
	34		Decrease in profit or increase in loss on account of ICDS adjustments and deviation in method of valuation of stock (Column 3b + 4e of Schedule OI)	34	0	
	35		Total (27+28+29+30+31+32+33+34)		35	0
	36		Income (13+26-35)		36	0

PART - A OI | QUANTITATIVE DETAILS | PART-A OL | PARTB - TI - TTI | IT | TDS | HOUSE PROPERTY | BP | DPM_DOA | DEP_DCG | ES

Ready

Type here to search

ICDS I: Accounting Policies

ICDS I: Accounting Policies

Highlights

- Deals with fundamental accounting assumptions
  - Going concern
  - Consistency
  - Accrual
- It also covers accounting policies and considerations in selecting accounting policy.
- Mark to Market loss and Expected Loss shall not be recognized unless it is in accordance with the provisions of any other ICDS
- Same principle as applicable to Mark to Market loss or an expected loss shall apply mutatis mutandis to Mark to Market gains or an expected profit (Q-8 of Clarification Circular No. 10/2017)
- Accounting Policy shall not be changed unless reasonable cause. ‘Reasonable cause’ is an existing concept under the Act and has evolved well over the years conferring desired flexibility to the tax payer in deserving cases (Q-9 of Clarification Circular No. 10/2017)
- The principle of Materiality and Prudence not recognized

ICDS I: Accounting Policies

Amendment in Act

Issue	Held by the Delhi HC	Manner of validation
• Expected and marked-to-market losses are not to be recognized/allowed as per ICDS	• ICDS I held unsustainable in law to this extent	• Section 36(1)(xviii) inserted: Mark-to-market loss or other expected loss as computed in the manner provided in ICDS shall be allowed as deduction. • Section 40A(13) inserted: No deduction for losses other than that covered by section 36(1)(xviii)
• Concept of 'Prudence' is done away with in ICDS	• ICDS I is struck down to the extent to which it does not allow prudence	• Nothing specific

ICDS I: Accounting Policies
Disclosure requirements

- All significant accounting policies
- Any change in accounting policy which has a material effect shall be disclosed:
  - Where amount is ascertainable – amount also to be disclosed
  - Where amount is not ascertainable - the fact shall be indicated
- Material effect if not in current year but is expected in future years, such change shall be appropriately disclosed in the year of change and also in the year in which such change has material effect for the first time.
- Cannot remedy a wrong or inappropriate treatment of an item

ICDS I – accounting policies

Case study

Issue

- Oil prices are fluctuating significantly
- Company A, engaged in oil exploration and production, proposes to change inventory valuation from weighted average to FIFO. Other companies in the industry follow FIFO
- Can it change its method of inventory valuation?

ICDS

- **Accounting policy can be changed** if there is **reasonable cause** to do so
- ICDS II **prescribes FIFO and weighted average cost** methods for inventory valuation

ICDS I – accounting policies

Case study

Analysis

- Positive case laws

  - Uniflex Industries (Lucknow ITAT) [15 SOT 246] and Discount & Finance House of India (Mumbai ITAT) [14 SOT 334] – post section 145A

  - Atul Products Ltd. (Gujarat HC) [125 taxmann.com 727]

  - Mopeds (Andhra Pradesh HC) [38 taxmann.com 123]

- Not required to change opening stock – also supported by ICDS

- Negative case laws

  - Ajanta Raj Proteins Ltd (Delhi ITAT) [32 SOT 517] – accounting standards notified u/s 145 are irrelevant for 145A, Act is inflexible regarding valuation of purchase/sale of goods and inventory once a method has been regularly employed

  - Luxor Writing Instruments (Delhi ITAT) [22 taxmann.com 26]

  - Annamalaiar Mill Pvt Ltd (Madras Tribunal) [22 TTJ 204] – the Assessee was not allowed to claim deduction which it was justly entitled to, on account of change in accounting policy

Actual facts of case must be seen – industry practice, statutory requirement, etc.

ICDS II: Inventories

ICDS II: Inventories

Highlights

Inventories defined as assets:

- Held for sale in ordinary course of business
- In the process of production for such sale
- In the form of materials or supplies to be consumed in production process or rendering of services

Exclusions:

- WIP under construction contracts (ICDS III) or dealt with under any other ICDS
- Shares, debentures and Financial instrument held as stock-in-trade covered in ICDS VIII
- Producer's Inventories of livestock, agriculture, etc. to the extent measured at NRV
- Machinery spares which can be used in connection with Tangible Assets – irregular in use, dealt with under ICDS V

Inventories to be valued at cost or NRV whichever is lower

ICDS II: Inventories

Measurement of inventory

NRV: Estimated selling price in the ordinary course of business less estimated costs of completion and the estimated costs necessary for sale

Cost of Purchase + Cost of service + Cost of conversion + Other Cost

Cost of Purchase

Purchase price, duties and taxes, freight, other expenditure directly attributable to purchase; Trade discounts, rebates, other similar items to be deducted

Cost of service

Labour, other costs of personnel directly engaged in providing service, including supervisory personnel and attributable overheads

Cost of conversion

Costs directly related to the units of production and a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods

Other Cost

Included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition

ICDS II: Inventories

Measurement : Cost of inventory

Exclusions from cost of inventories

- Interest and other borrowing costs, unless the inventories require >=12 months to bring them to saleable condition
- Other exclusions (recognized as expenses of the period in which they are incurred)
- Abnormal amount of material/labor cost
- Storage costs, unless necessary in production process prior to a further production stage
- Indirect administration overheads, and
- Selling costs

Techniques for measuring cost of inventory

- Specific Identification Method
- First in First Out Method („FIFO“)
- Weighted Average Cost („WAC“)
- Standard Costing
- Retail method

ICDS II : Valuation of Inventories

Recording of Inventory- Goods and Services

Topic	ICDS		AS	
Inventories – Valuation	**ICDS II relating to valuation of inventories**		**AS 2 – Valuation of Inventories**	
Of goods	Cost of purchase Add: Cost of services Add: Costs of conversion and other costs	XXX XXX XXX ______ XXX	Costs of purchase Add: Costs of conversion and other costs	XXX XXX ______ XXX
Of Services	Cost of Labour Add: Other costs of personnel directly engaged in providing the service Add: Attributable overheads.	XXX XXX XXX ______ XXX	Not prescribed	

Profit and Loss account shall reflect closing inventory of services for all business and impact Profits

ICDS II: Inventories

Recent developments

As per the provisions of erstwhile Section 145A of the Act, valuation of inventory was to be undertaken in accordance with the method of accounting regularly employed by the tax payer

- **Before ICDS**

- Valuation of inventory at cost or NRV whichever is lower
- Methods of determining costs provided

- **ICDS II**

- Section 145A is independent of Section 145(2) under which the ICDS has been notified.
- Where the tax payer regularly follows a certain method for valuation of goods then that will govern irrespective of the ICDS notified

- **Delhi HC Judgement**

Section 145A of the Act has been amended to provide the following:

- Inventory to be valued at the lower of cost or net realizable value, computed in accordance with ICDS II;
- Inventory in nature of securities to be valued in line with ICDS VIII -Securities

- **Retrospective amendments introduced vide Finance Act, 2018**

ICDS II: Inventories

Amendment in Act

Issue	Held by the Delhi HC	Manner of validation
• ICDS prescribes valuation of inventories at NRV on dissolution of firm, when business is not discontinued and is taken over by partners	• SC in Sakhti Trading Co. V. CIT (2001) 250 ITR 871 (SC) held that on the dissolution of a firm, where the business of firm is not discontinued and is taken over by other partners, the stock-in-trade of the firm can be valued at cost or market value, whichever is lower. • ICDS provisions is an attempt to overreach the binding judicial precedents by the device of notifications issued by the CG. It is an exercise of excessive delegation of legislative power which is impermissible in law.	• Section 145A amended to include 'Valuation of inventory at cost or Net Realizable value (NRV) whichever is less as computed under this ICDS' • No specific amendment is made in the Act with respect to valuation of inventory on dissolution of firm. • Therefore, in case of dissolution, one may value the inventory at lower of cost or NRV relying on the decision of Sakhti Trading Co. 250 ITR 871 (SC)
• ICDS states that costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition.	• Nothing specific	• Section 145A amended to include 'Valuation of purchase and sale and of inventory will include allied tax, duty, cess or fee which were incurred to bring the goods or services to the place of its location and condition'

ICDS II: Inventories

Disclosure requirements

- The accounting policies adopted in measuring inventories including the cost formula used
- The total carrying amount of inventories and its classification
- Additional disclosures, where standard costing has been used as a measurement of cost:
  - Details of such inventories; and
  - A confirmation of the fact that standard cost approximates actual cost.

ICDS II – valuation of inventories

Case study 1

Issue

- Are service providers required to maintain inventory?

ICDS

- The costs of services **in the case of a service provider shall consist of** labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads
- “Inventories” are assets - held for sale in the ordinary course of business; in the process of production for such sale; **in the form of materials or supplies to be consumed in the production process or in the rendering of services**

Analysis

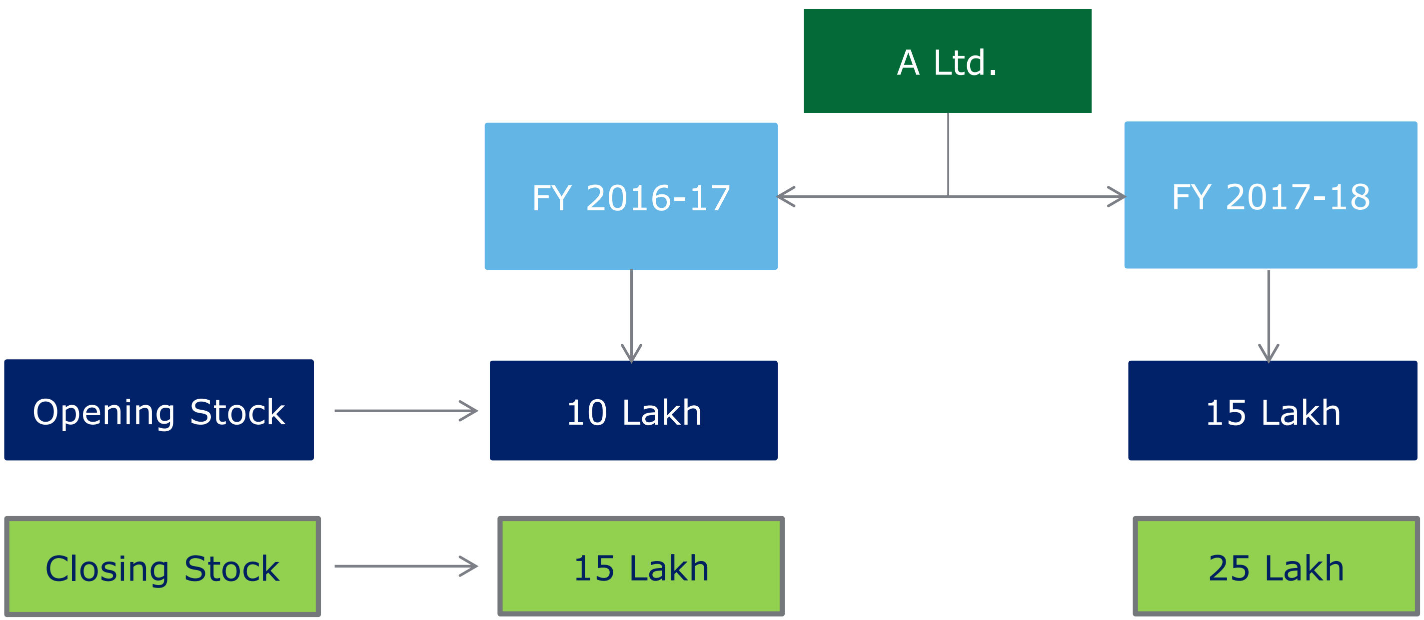
- Definition does not cover WIP of service provider
- Section 37 - cost of services may be claimed as a deduction and may not required to be carried forward to the next year as WIP since the same is not mandatory as per accounting as well

ICDS II : Valuation of Inventories

Case Study-2

Valuation of opening inventory vis-a-vis closing inventory of preceding financial year:

For financial year 2016-17, closing stock of A Ltd. has been valued using Standard Costing Method. From financial year 2017-18 onwards, A Ltd. changed its method for valuation of closing stock to First-in-First-out method at the time of valuation of closing stock.



Issue:

Can the AO adjust the opening stock of the year?

ICDS II : Valuation of Inventories

Case Study-2

Analysis:

As per ICDS II, value of opening inventory shall be the inventory of the business as on the close of the immediately preceding previous year. Relevant extract of ICDS has been reproduced below:

Para 22 of ICDS II :

"The value of inventory as on the beginning of the previous year shall be:

the cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and

the value of the inventory of the business as on the close of the immediately preceding previous year, in any other case"

There have been cases where the AO attempts to change the opening stock of the year, if the method of accounting for the valuation of closing stock is changed.

After introduction of the ICDS, does the AO have the liberty to change the value of opening stock, if the closing stock is revalued?

ICDS II : Valuation of Inventories

Case Study-3

Valuation of inventory in case of conversion of capital asset into Stock in trade

Issue:

If an assessee converts capital asset into stock-in-trade and commences his business during the year. How will the inventory be valued

Analysis:

Under Section 2(47)(iv) of the Act such conversion is to be treated as transfer and under Section 45(2) of the Act capital gain is computed taking the fair value of the asset on the date of conversion as full value of the consideration. ***The Supreme Court in case of CIT vs Bai Shirinbai K. Kooka 46 ITR 86(SC)*** held that for computing the trading profit the fair market value of the asset on the date of conversion into stock-in-trade is cost to the business. Considering the decision of Supreme court ,the fair market value of the asset on the date of conversion shall be regarded as cost of the inventory, although ICDS I provides that the cost of inventory available has to be taken as the value of the inventory as on the beginning date.

ICDS III: Construction Contract

ICDS III: Construction Contract
Highlights

- Contract Revenue = Initial amount of revenue (including retentions) + variations in contract work, claims and incentive payments (to the extent it is probable that it will result in revenue and can be reliably measured)
- Contract Cost = Direct cost + attributable and allocated cost + borrowing cost as per ICDS IX + other cost specifically chargeable to customer) – incidental income not included in contract revenue (not being interest / dividend / capital gains)
- Both revenue and costs are to be recorded in proportion to the stage of completion of contract
- Stage of completion to be determined by :
  - Expenditure approach
  - Work survey approach
  - Physical work completion approach
- During the early stages of a contract, where the outcome of the contract cannot be estimated reliably, contract revenue must be recognized only to the extent of costs incurred. Early stage of a contract shall not extend beyond 25% of the stage of completion
- Contract revenue to be recognized only when there is reasonable certainty of its ultimate collection. Contract revenue once recognized cannot be reversed but needs to be written off as expenses
- Retention money would be a part of contract revenue and the same has to be recognized as revenue subject to reasonable certainty of its ultimate collection. (Q-11 of Clarification Circular No. 10/2017)
- Does not allow provision for foreseeable losses for tax purposes which is in line with non-allowability of expected losses as provided in ICDS-I

ICDS III: Construction Contract

Amendment in Act

Issue	Held by the Delhi HC	Manner of validation
• As per ICDS, Retention money would be a part of contract revenue and the same has to be recognized as revenue subject to reasonable certainty of its ultimate collection.	• There are judicial pronouncements which hold that retention money does not accrue to an assessee until and unless the defect liability period is over and the Engineer-in-Charge certifies that no liability is attached to the assessee • By deploying ICDS-III in a manner that seeks to bring to tax the retention money the receipt of which is uncertain / unconditional, at the earliest possible stage, the Respondents would be acting contrary to the settled position in law • Para 10(a) of ICDS III held to be ultra vires	• New section 43CB inserted • The sub-section (2)(i) states that contract revenue shall include retention money
• ICDS states incidental income in the nature of interest, dividends or capital gains shall not be reduced from contract costs.	• This is contrary to SC decision in Bokaro Steel Limited (1999) 236 ITR 315. • The said provisions contrary to the law settled by the various SC and HC decisions and cannot be sustained • Para 12 of ICDS III struck down	• New section 43CB inserted • The sub-section (2)(ii) states that the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains

ICDS III: Construction Contract

Disclosure requirements

- Contract revenue recognized in the period
- Methods used to determine the stage of completion of contracts in progress
- For contract in progress at the reporting date:-
  - Cost incurred and recognized profits (less recognized losses) upto the reporting date;
  - Advances received; and
  - Retentions

ICDS III – construction contract

Case study 1

Issue

- Company is expecting a loss on an on-going contract and has created a provision for loss.
- Would this provision for loss allowed as a deduction during the current year i.e. FY 2017-18?

ICDS

- ICDS I - **expected loss shall not be recognised** unless specifically provided by other ICDS
- Both revenue and costs are to be recorded in proportion to the stage of completion of contract (percentage completion method)

Act

- Section 36(1)(xviii) : Mark-to-market loss or other expected loss as computed in the manner provided in ICDS shall be allowed as deduction.
- Section 40A(13) : No deduction for losses other than that covered by section 36(1)(xviii)

Analysis

- Though section 36(1)(viii) allows deduction for mark to market and expected losses as per ICDS and section 40A(13) disallows all other mark to market and expected losses, concept of prudence is wider than mark to market and expected losses.
- Therefore, it may still be possible to apply the concept of prudence on a case to case basis.

ICDS III – Construction Contract
Impact

Illustration: disallowance of expected loss

- Contract revenue – 100
- Contract cost originally estimated – 80
- Revised probable estimated contract cost – 130
- Cost incurred during year 1 – 40
- Percentage of completion at end of year 1 – ~30% (40 of 130)
- Cost incurred during year 2 – 90
- Percentage of completion at end of year 2 – 100%

Year 1		Books	ICDS
Revenue	100 x 30%	30	30
Less: Cost incurred during the year		(40)	(40)
Less: Provision for expected loss on construction contracts		(30)	NIL
Net profit		(40)	(10)

Year 2		Books	ICDS
Revenue	100 x 70%	70	70
Less: Cost incurred during the year		(60)	(90)
Net profit		10	(20)

Can upfront provision of expected loss be made based on following Supreme Court cases?

- Metal Box Co. of India Ltd. V. Their Workmen
- Rotork Controls India (P.) Ltd. [180 TAXMAN 422]

Recognition of taxable income at an earlier point in time as compared to book profits

Case Study-2

Retention money

A Ltd. entered into a contract with B Ltd at an agreed contract revenue of INR 100 crore. As per the terms of the contract, an amount of INR 10 crore is to be retained by B Ltd. and would be paid after fulfillment of certain conditions mentioned in the contract.

FY 2017-18

↓

Contract Revenue = INR 100 crore

↓

Retention Money = INR 10 crore

Issue:

- ICDS provides that contract revenue shall include retention money
- Is retention money required to be included in the value of Contract Revenue?

Case Study-2

Analysis:

Income can be held to accrue only when assessee acquires right to receive that income(Section 5 of the Act)

Retention money may not accrue to the assessee if assessee had certain obligations which were linked to the retention payment and right to receive crystalises only on the performance of the obligation.

ICDS provides that contract revenue shall include retention money.

ICDS also states that revenue shall be recognised when there is reasonable certainty of its ultimate collection

Income can be held to accrue only when assessee acquires right to receive that income – SC cases of Ashokbhai [56 ITR 42], Shrivastava [57 ITR 624] ,Excel Industries(2013)(358 ITR 259)

Retention money could not be said to be accrued to the assesse if assessee had no right to receive the same till the completion of work or does not become payable as per the terms of the contract.

The following decisions also support this contention:

- Calcutta HC case of Simplex Concrete Piles India (P) Ltd [79 CTR 71]
- Madras HC case of P & C Constructions (P.) Ltd. [318 ITR 113]

When it can be said that there is reasonable certainty of ultimate collection ?

Case study-3

Early stage of a contract:

For financial year 2017-18, A Ltd. entered into a contract with B Ltd at a agreed contract revenue of Rs. 100 crore. At the end of the financial year, assuming contract has been completed as per the following percentages:

25%

30%

Issue:

At what stage, is revenue to be recognised?

ICDS III : Construction Contracts

Case study- 3

Analysis:

AS does not specify a percentage at which early stage of the contract can be considered to have reached.

Generally, industry practice is to record profits post 25% stage of completion.

Certain companies may not record profits up to 30%

Para 20 of ICDS III:

> "*During the early stages of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25% of the stage of completion.*"

ICDS has specifically provided that early stage of a contract shall not extend beyond 25% of the stage of completion and profits of a contract are required to be booked, once the contract reaches the stage of 25%.

Is it mandatory to book profits post completion of 25%?
Does reasonable certainty of completion of the contract need to be examined?

ICDS IV: Revenue Recognition

ICDS IV: Revenue Recognition

Highlights

- Sale of goods shall be recognized when all significant risks and rewards of ownership are transferred. Claims for escalation of price and export incentives can be postponed to the extent of uncertainty involved
- Revenue from service transactions will be recognized as per percentage completion method similar to ICDS III on Construction Contracts.
- ‘Completed service contract method’, may be followed only in following scenario:
  - When services are provided by an indeterminate number of acts over a period of time,
  - In case of service contracts with duration not more than 90 days i.e. recognition of revenue when rendering of services under that contract is completed or substantially completed
- Interest will be recognized on time basis. Discount or premium on debt securities held should be accrued over the period to maturity
- Dividend will be recognized as per provisions of the Act
- Royalty will be recognized as per terms of the relevant agreement or based on substance, some other systematic and rational basis
- Whether ICDS III and IV should be applied by Real estate developers and Build-Operate-Transfer Operators? (Q-12 of Clarification Circular No. 10/2017)
- Whether the taxpayer is obliged to account for interest, royalty and dividend even when the collection therefor is uncertain? (Q-13 of Clarification Circular No. 10/2017)
- Whether the taxpayer shall be permitted to claim deduction of interest offered to tax but not received? (Q-18 of Clarification Circular No. 10/2017)
- Whether ICDS is applicable to revenues which are liable to be taxed on gross basis like interest, royalty and fees for technical services for non-residents u/s 115A of the Act? (Q-14 of Clarification Circular No. 10/2017)

ICDS IV: Revenue Recognition

Amendment in Act

Issue	Held by the Delhi HC	Manner of validation
• ICDS recognizes export incentive on the basis of reasonable certainty of collection	• SC in Excel Industries (2015) 358 ITR 295 held that it is only in the year in which the claim is accepted by the Government that a right to receive the payment accrues in favour of the assessee and the corresponding obligation to pay arises in the hands of the Government. Only in such year, income from export incentive can be said to have accrued and can be recognized as income. • Para 5 of ICDS IV struck down	• Section 145B(2) inserted: Export incentive shall be deemed to be the income of the previous year in which reasonable certainty of its realization is achieved.
• Recognition of Claim for escalation in price of a contract when collection of such claim is not reasonably certain	• No specific observation/ruling • Above inference may be applicable • Para 5 of ICDS IV struck down	• Section 145B(2) inserted: Claim for escalation of price in a contract shall be deemed to be the income of the previous year in which reasonable certainty of its realization is achieved.
• In case of service contracts, ICDS prescribes only Percentage completion method in case	• The proportionate completion method as well as the contract completion method have been recognized as valid method of accounting under mercantile system of accounting by the SC in various pronouncements. Therefore, the said provisions of ICDS is contrary to the above decisions. • Para 6 of ICDS IV struck down	• New section 43CB inserted • It provides that revenue to be recognized as per percentage completion method as per ICDS except in following service contracts: ○ Contract duration not more than 90 days ○ Involving indeterminate number of acts over a specific period of time shall be determined on the basis of straight line method.

ICDS IV: Revenue Recognition

Disclosure Requirement

- In a transaction involving sale of goods, revenue not recognized during the previous year due to lack of reasonable certainty of its ultimate collection along with nature of uncertainty;
- Revenue from service transactions recognized as revenue during the previous year;
- Method used to determine the stage of completion of service transactions in progress;
- For service transactions in progress at the end of previous year:
  - costs incurred and recognized profits (less recognized losses) upto end of previous year;
  - Advances received; and
  - Retentions

ICDS IV – revenue recognition

Case study

Issue

- C Ltd entered into a contract with works contractor- Mr. W, the transaction involving both sale of goods and rendering of services
- Mr. W raised an invoice amounting to Rs. 5 lakh, being 50% of the agreed fee on completion on first milestone
- What would be the income to be recognized for the FY 2017-18?

ICDS

Sale of goods

- In a transaction involving the sale of goods, the revenue shall be recognized when the seller of goods has **transferred to the buyer, the property in goods for a price** or **all significant risks and rewards of ownership have been transferred** to the buyer and seller retains no effective control of the goods transferred to a degree usually associated with ownership.
- Revenue shall be recognized when there is reasonable certainty of its ultimate collection

Rendering of services

- … revenue from service transactions shall be recognized by the **percentage completion method**

ICDS IV – revenue recognition

Case study

Analysis

- ICDS IV provides different methods for recognition of revenue in case of sale of goods and rendering of services
- Hence, position needs to be adopted by Mr W for recognition of revenue – either on transfer all significant risk and rewards to C Ltd or under percentage completion method

ICDS V: Tangible Fixed Assets

ICDS V: Tangible Fixed Assets

Highlights

- Tangible fixed asset shall be recorded at actual cost including purchase price, taxes (excluding those that are recoverable) and other expenditure for bringing the asset to workable condition
- Administration and general overheads shall be excluded from actual cost if not relating to specific asset
- Expenditure on start-up and commissioning of a project shall be capitalized while expenditure post commencement of commercial production shall be expensed (Q-15 of Clarification Circular No. 10/2017)
- Subsequent adjustments to cost:
  - Cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of price adjustment, changes in duties or similar factors, or exchange fluctuation as specified in ICDS VI
  - Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost.
  - Cost of an addition or extension to an existing tangible fixed asset of a capital nature and which becomes an integral part of the existing tangible fixed asset is to be added to is actual cost.
- Any addition or extension, which has a separate identity and is capable of being used after the existing tangible fixed asset is disposed of, shall be treated as separate asset
- Tangible asset shall be recorded at its fair value if acquired for non-monetary consideration
- Consolidated price for acquiring group of assets shall be apportioned on fair basis
- Depreciation and income on transfer of asset will be as per the provisions of the Act

ICDS V: Tangible Fixed Assets

Disclosure Requirement

- Description of asset or block of assets;
- Rate of depreciation;
- Actual cost or written down value, as the case may be;
- Additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—
  - Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004;
  - Change in rate of exchange of currency;
  - Subsidy or grant or reimbursement, by whatever name called;
- Depreciation allowable; and
- Written down value at the end of year.

ICDS VI: Effects of changes in foreign exchange rates

ICDS VI: Effects of changes in foreign exchange rates

Highlights

- Foreign currency transaction shall be recorded initially at exchange rate as on the date of transaction or at a weekly / monthly average rate (if rates do not fluctuate significantly from actual)
- Foreign currency monetary items to be reinstated at year end
- Foreign currency non-monetary items to be carried at exchange rate as on date of transaction
- The treatment shall be subject to the provisions of section 43A and Rule 115, as the case may be
- Premium, discount and exchange differences on forward contracts (including foreign currency options) entered for trading, speculation & hedging of firm commitment or a highly probable forecast transaction to be recognized only on settlement
- Premium / discount on other forward exchange contracts shall be amortized over life of the contract
- Derivatives other than forward contracts and other similar contracts, not within the scope of ICDS-VI shall be governed by provisions of ICDS-I (Q-10 of Clarification Circular No. 10/2017)
- Integral foreign operations – financial statements to be translated following the same principles as followed by an Indian company
- Foreign Currency Translation Reserve (FCTR) balance as on 1 April 2016 pertaining to exchange differences on monetary items for non-integral foreign operations, shall be recognized in assessment year 2017-18 to the extent not recognized in the past (Q-16 of Clarification Circular No. 10/2017)

ICDS VI: Effects of changes in foreign exchange rates

Amendment in Act

<table>
<tr><th>Issue</th><th>Held by the Delhi HC</th><th>Manner of validation</th></tr>
<tr><td>• Exchange difference arising in respect of monetary items on translation shall be recognized as income or expense in that previous year.</td><td rowspan="2">• Contrary to the SC decision in Sutlej Cotton Mills Limited (1979) 116 ITR 1 (SC)
• Held ultra vires and struck down</td><td rowspan="3">• Section 43AA inserted for treatment of foreign exchange fluctuation: Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss as the case may be and to be computed as per ICDS-VI. This shall include effects of change in foreign exchange rates in respect of all foreign currency transactions including in respect of-
i. Monetary and non-monetary items
ii. Translation of financial statements of foreign operations
iii. Forward exchange contracts
iv. Foreign currency translation reserve</td></tr>
<tr><td>• Mark-to-market loss/gain on foreign exchange derivatives not allowable (trading or speculation purpose)</td></tr>
<tr><td>• The exchange gain or loss as per foreign currency translation reserve account balance as on 1 April 2016 has to be recognized as income/loss in AY 2017-18. (Q-16 of clarification)</td><td>• Notional or hypothetical income cannot be subject to tax.</td></tr>
</table>

ICDS VI –foreign exchange fluctuations

Case study 1

Issue

- Company A has borrowed overseas loan for purchase of assets in India
- Whether foreign exchange loss is capital or revenue in nature?
- What would be its treatment?

ICDS

- Exchange difference on only monetary items (and **not non-monetary items**) at each year-end shall be recognized as income / expense
- The above is made **subject to section 43A** and rule 115 of the Act

Analysis

- Section 43AA - Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss as the case may be and to be computed as per ICDS-VI. (includes monetary items)
- Capital or revenue
  - Sutlej Cotton Mills Ltd. v. CIT [1979] (116 ITR 1)(SC), Tata Locomotive and Engineering Co. Ltd. [1966] (60 ITR 405)(SC), Canara Bank Ltd. [1967] (63 ITR 328)(SC)
  - India Cements Limited v. CIT [1966] (60 ITR 52)(SC)

ICDS VI –foreign exchange fluctuations

Case study 1

Analysis

- Adjustment to asset cost –
  - Saharanpur Electric Supply Co. Ltd. v. CIT [1992] (60 Taxmann 412)(SC) – cost of an asset may undergo change subsequent
  - Apollo Tyres Ltd. v. ACIT 89 ITD 235 (DELHI)(SB), Essar Steel Ltd. v. DCIT 97 ITD 125 (AHD.) (TM) - Gains earned on cancellation of foreign exchange forward contracts, connected with foreign loans raised for purchase of machinery, should be reduced from cost of plant and machinery
  - Tata Iron & Steel Co [1998] (231 ITR 285)(SC) – post 43A, no adjustment to Indian assets
- Section 43A is an enabling section
- **Section 43(1) – "**actual cost" means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority – Accordingly, intention remains the same, ie adjustment to cost of asset
- Pune ITAT decision in case of Cooper Corporation Pvt Ltd. [2016] 159 ITD 165
  - Foreign loan was taken for refinancing of existing loan (which was used for asset purchase) and the ITAT held that refinancing was done to save interest costs which is revenue in nature

ICDS VI –foreign exchange fluctuations

Case study 2

Issue

- Whether premium on forward contract can be claimed upfront in year 1?

ICDS

- Any premium or discount arising at the inception of a forward exchange contract shall be **amortized as expense or income over the life of the contract**

Analysis

- Madras Industrial Investment Corpn. Ltd. (SC) [1997] (225 ITR 802) / (91 Taxman 340) - discount on debentures is allowed as amortization over life of debenture in view of continuing benefit to business

- Taparia Tools Ltd [2003] 260 ITR 102 (SC) - upfront interest payment is allowed in year 1. Supreme Court further attempted to distinguished its own decision in above case of Madras Industrial Investment stating that there, assessee had chosen to amortize

ICDS VII: Government Grants

ICDS VII: Government grants
Highlights

- Government grants will be recognized when there is reasonable certainty that related conditions will be complied with and it is reasonably certain that ultimate collection will be made
- Recognition cannot be postponed beyond the date of actual receipt.
- Grants relating to depreciable asset must be reduced from actual cost or written down value. Grants received for a group of assets will be apportioned
- Grants for compensation of expense / loss or for giving immediate financial support with no further related costs will be recognized as income in year in which it is receivable
- Grants relating to non-depreciable assets and other grants will be recognized as income over the period over which related cost is charged to income
- Non-monetary asset given at concessional rate shall be accounted for on the basis of their acquisition cost
- Amount refundable in respect of a government grant:
  - Related to a depreciable asset – Increase the actual cost or WDV of block of assets. Depreciation on the revised actual cost or WDV shall be provided prospectively at the prescribed date.
  - Related to Non-depreciable asset, immediate financial support or other grant – apply first against any unamortized deferred credit remaining in respect of government grant. Excess amount shall be charged to Profit and loss statement.

ICDS VII: Government grants

Amendment in Act

Issue	Held by the Delhi HC	Manner of validation
• Government grants to be recognized on receipt basis which may not have accrued	• Contrary to and in conflict with the accrual system of accounting. • It cannot be said that there is any accrual of government grant although the money has been received in advance, considering that the conditions are attached to the receipt of government grant, non-fulfillment of which may lead to return of such amount.	• Insertion of section 145B(3) which states that income referred to in 2(24)(xviii) ('government grant') should be recognized in the year of receipt if not charged to income-tax in any earlier previous year

ICDS VII: Government grants

Disclosure Requirement

- Nature and extent of government grant recognized during the previous year by way of deduction from the actual cost of the asset or assets or from WDV of block of assets during the previous year;
- Nature and extent of government grant recognized as income during the previous year;
- Nature and extent of government grant not recognized during the previous year by way of deduction from the actual cost of the asset or assets or from WDV of block of assets during the previous year and reasons thereof; and
- Nature and extent of government grant not recognized as income during the previous year and reasons thereof

ICDS VII – Government Grants

Case study

- During financial year 2017-18, the ABC Ltd. has received Government Grant for 30% of the cost of land. The grant is subject to fulfilment of conditions regarding achievement of a particular minimum level of production for five years.

- The company seeks your advice as to the treatment of the grant in its tax computation for AY 2018-19.

ICDS

- Government grants 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.

- Recognition of Government grant shall not be postponed beyond the date of actual receipt.

- Grants relating to non-depreciable assets and other grants will be recognized as income over the period over which related cost is charged to income.

Act

- **Section - 145B(3)** - Income referred to in 2(24)(xviii) (‘government grant’) should be recognized in the year of receipt if not charged to income-tax in any earlier previous year

ICDS VIII: Securities

ICDS VIII: Securities
Highlights

- ICDS deals with securities held as stock-in-trade
- Meaning of Securities – Section 2(h) of Securities Contracts (Regulation) Act, 1956 (42 of 1956) and shall include share of a company in which public are not substantially interested but shall not include derivatives
- Recognition of securities:
  - Securities not listed or not quoted regularly will be recognized at actual cost
  - Other securities shall be carried at actual cost (including purchase price, brokerage, cess, tax, etc.) or NRV, whichever is lower at year-end
- Cost of security shall be determined on FIFO basis or weighted average cost if the actual cost initially recognized cannot be ascertained by reference to specified identification
- Securities shall be recorded at their fair value if acquired in exchange of other asset/securities
- Pre-acquisition interest shall be reduced from the actual cost
- Does not deal with:
  - The bases for recognition of interest and dividend on securities covered by ICDS-IV;
  - Securities held by a person engaged in Insurance business;
  - Securities held by Mutual funds, VCF, banks and public financial institutions formed under a Central or a State Act or so declared under Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013). (dealt by Part B)
  - Derivatives excluded from the definition of securities

ICDS VIII: Securities

Highlights

- Comparison of actual cost and NRV shall be done category-wise and not for each individual security. For this purpose, securities shall be classified into following categories:
  - Shares;
  - Debt securities;
  - Convertible securities; and
  - Any other security not covered above.

- Reference to Q-19 of Clarification Circular:

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	
D	Share	200	190	190	
	Total	560	**535**	505	**535**
E	Debenture	150	160	150	
F	Debenture	105	**90**	**90**	
G	Debenture	125	135	125	
H	Debenture	220	230	220	
	Total	**600**	615	585	**600**
Securities	**Total**	1160	1150	1090	**1135**

ICDS VIII: Securities

Amendment in Act

Issue	Held by the Delhi HC	Manner of validation
• ICDS states comparison of Cost or NRV to be done category wise and not for individual security. • Securities not listed or not quoted regularly will be recognized at actual cost • Other securities held as stock-in-trade shall be valued at cost or NRV at the end of the previous year, whichever is lower.	• Valuation of securities not governed by RBI etc., the accounting prescribed by the AS is different from ICDS. Thereby, valuation of securities as per accounts and for tax purposes will differ. Therefore, part A of ICDS - VIII is ultra vires the Act and is to be struck down.	• Section 145A(iii) and (iv) inserted to provide: a. Securities not listed or not quoted regularly will be recognized at actual cost in accordance with ICDS b. Other securities shall be valued at actual cost or NRV, whichever is lower in accordance with ICDS

ICDS IX: Borrowing Costs

ICDS IX: Borrowing costs
Highlights

- 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.
- Borrowing costs shall be capitalized in case of tangible and intangible assets *(requires a period of 12 months or more for its acquisition, construction or production)* to the extent provided in the standard. With respect to inventory, they shall be added to cost only if inventory takes 12 months or more for bringing to saleable condition.
- The period of capitalization commences:
  - In the case of specific borrowings : funds have been taken
  - In the case of general borrowings : funds have been utilized
- The capitalization ends on the date when asset is first put to use (in case of inventory, capitalization ends when substantially all the activities necessary to prepare such inventory for its intended sale are complete)
- ICDS provides a specific formula for capitalizing borrowing costs relating to general borrowings based on the ratio of qualifying assets to total assets. Also, the capitalization will begin from date of utilization of funds.
- In case of time gap between asset being ready for use and being put to use, capitalization under ICDS will be higher than that under AS-16, since AS-16 stops capitalization when all activities to prepare asset for its use are complete
- Borrowing cost that can be capitalized shall be that portion of the cost which is otherwise allowable as deduction under the Act (Q-20 of Clarification Circular)

ICDS IX: Borrowing costs

Disclosure Requirement

- The accounting policy adopted for borrowing costs; and
- The amount of borrowing costs capitalized during the previous year

ICDS IX – borrowing costs

Case study 1

Issue

- Company A has 3 kinds of borrowings:
  - Loan 1 – borrowed for construction of project X
  - Loan 2 – borrowed for general capital expenditure
  - Loan 3 – borrowed for working capital purpose such as purchase of raw material, etc.

ICDS

- Provisions for capitalisation of specific and general borrowing costs

Analysis

Loan 1: Capitalise from date of borrowing till asset is put to use

Loan 2: Capitalise from date of borrowing till asset is put to use

ICDS IX – borrowing costs

Case study 1

Analysis

Loan 3:

- Proviso to Section 36(1)(iii) - 'interest paid in respect of capital **borrowed for** acquisition of an asset' will not be allowed as a tax deduction. Thus, funds borrowed for working capital purpose and not for assets should not be covered

- Para 6 of ICDS IX deals with borrowings that are not specifically borrowed for any asset but are borrowed generally **and** are utilised for acquisition of assets

- Thus, as a corollary, in case funds have been borrowed as well as utilised for working capital purpose and not for acquisition of capital assets, borrowing costs in relation to the same should not be required to be capitalised. However, one-to-one nexus must be proved to show that funds were actually utilised towards working capital

- Working capital loans are primarily for inventory - does not take more than 12 months to bring to saleable condition and hence, capitalisation will not be required

ICDS IX – borrowing costs

Case study 2

Issue

- Can borrowing cost pertaining to 'land' which has not been put to use be capitalized?

ICDS

- ICDS IX includes land in its definition of 'qualifying asset'

Analysis

- Unlike AS 1 and Ind AS 23, ICDS on borrowing cost includes 'land' in its definition of a qualifying asset
- The borrowing cost pertaining to land which is not put to use will be capitalized for tax purposes. 'Land' is a non-depreciable asset. Hence, the depreciation on capitalized borrowing cost would not be available
- When the land is sold, deduction for cost of land and borrowing cost capitalized will be allowed as a deduction

ICDS IX : Borrowing Costs

Analysis

- **Capitalization of general borrowings**

  Para 6 of ICDS - *To the extent the funds are borrowed generally and utilised for the purposes of acquisition, construction or production of a qualifying asset, the amount of borrowing costs to be capitalised shall be computed in accordance with the following formula namely:*

$$\textbf{General borrowing cost} \times \frac{\text{average cost of qualifying asset as appearing in the balance sheet on first and last day of the previous year}}{\text{average of total assets appearing in the balance sheet on first and last day of the previous year (other than those assets which are directly funded out of specific borrowings)}}$$

- **AS 16 on Borrowing Costs -** *To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period*

ICDS IX – Borrowing costs

Impact

Calculation of interest expense in respect of general borrowings (refer formula of earlier slide)

Particulars	Amount (Rs.)
Total assets appearing in balance sheet as on 31.3.18*	1,000
Total tangible assets acquired during year 2017-2018	700
General borrowings	500
Interest on general borrowings	50
Specific borrowings	200
Interest on specific borrowings	20
Cost of assets constructed using general borrowings	450
Cost of assets constructed using specific borrowings	200
Under – construction assets value	300

Particulars	ICDS	AS 16
Capitalization of general borrowing cost	= **22.73** **Working:** 50 X [(700 - 200) / 2] [(300+1000-200) / 2]	= **45** (450 X 10%) **Working:** Weighted average borrowing cost is 10% i.e. (50/500)

- Does not consist of under-construction assets at beginning or end of the year

Capitalization of general borrowing cost under ICDS and AS differs

ICDS IX – Borrowing costs

FAQs issued by CBDT on 23 March 2017

Question 20 :

There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a)(i), 40(a)(ia), 40A(2)(b) etc of the Act. Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under which specific provisions ?

Ans: Since specific provisions of the Act override the provisions of ICDS, it is clarified that borrowing costs to be considered for capitalization under ICDS IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act.

ICDS IX – Borrowing costs

FAQs issued by CBDT on 23 March 2017

Question 21 :

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

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

Question 22 :

How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS – IX to different qualifying assets?

Ans: The capitalization of general borrowing cost under ICDS-IX shall be done on asset-by-asset basis.

ICDS X: Provisions, Contingent asset and liabilities

ICDS X: Provisions, contingent liabilities and contingent assets

Highlights

- A provision should be recognized when
  - 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; and
  - a **reliable estimate** can be made of the obligation amount
- 'Probable' (AS 29 and Ind-AS 37) vs. 'Reasonably certain' (ICDS X)
- 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.
- 'Virtually certain' (AS 29) vs. 'Reasonably certain' (ICDS X and Ind-AS 37)
- Provisions and contingent assets will be reviewed at each year-end and reversed if they do not meet recognition criteria
- Recognition in accordance with this standard from 1 April 2016 after taking into account amount recognized for any previous year ending 31 March 2016. Intention of transitional provision is neither double taxation of income nor escapement of income. (Q-23 of Clarification Circular)

Particulars	Amount
Provision required as per ICDS on 31 March 2017 for items brought forward from 31 March 2016 (A)	INR 3 crores
Provision as per ICDS for FY2016-17 (B)	INR 5 crores
Total gross provision (C) = (A) + (B)	INR 8 crores
Less: Provision already recognized for computation of taxable income in FY2015-16 or earlier (D)	INR 2 crores
Net provision as per ICDS in FY2016-17 to be recognized as per transition provision (E) = (C) – (D)	INR 6 crores

ICDS X: Provisions
Disclosure Requirement

- In respect of each class of provision
  - A brief description of the nature of the obligation;
  - Carrying amount at the beginning and end of the previous year;
  - Additional provisions made, including the increase to existing provisions during the previous year;
  - Amounts incurred and charged against the provision during the previous year;
  - Unused amounts reversed during the previous year; and
  - Amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.

- In respect of each class of asset and related
  - A brief description of the nature of the asset and related income;
  - Carrying amount of asset at the beginning and end of the previous year;
  - Additional amount of asset and related income recognized during the year, including increase to assets and related income already recognized;
  - Amount of asset and related income reversed during the previous year.

ICDS X – Provisions, Contingent Liabilities and Contingent Assets

Case study

Issue

- Company Y creates provision for asset retirement obligation, i.e. it provides for contractual/ statutory liability of decommissioning of an asset
- Since the liability is created in the current year, being revenue in nature, can it be claimed as deduction?

ICDS

- A provision shall be recognized when:
  - **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; and**
  - **a reliable estimate can be made of the amount the obligation**

Case study

Analysis

- Above conditions would be satisfied for decommissioning liability. Though an actual outflow of cash could not be determined at the time of provisioning, a reliable estimate can be made and hence, it should be possible to claim a deduction
- Various courts have also held that provision for decommissioning liability is deductible under section 37(1) of the Act

Key Concerns

Key Concerns

- **Revenue/expenses on which there is no ICDS will continue to be governed by AS ?**
- **Unlike ICAI AS, ICDS contains only main principles; ICDS has no Explanations or illustrations**
- **Undefined words/expression can take their meaning from ITA ?**

Questions

Thank You

The information contained in this document is intended to provide general information on a particular subject or subjects and are not exhaustive treatment of such subject(s).
The contents of this document are for general information and the presenter by means of this document is not rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your finances or your business. Before making any decision or taking any action that may affect your finances or business, you should consult a qualified professional advisor.
The presenter shall not be responsible for any loss whatsoever sustained by any person who relies on this document.