CENTRAL INDIA REGIONAL COUNCIL OF ICAI JOINTLY WITH KCAS STUDY CIRCLE OF CIRC OF ICAI

INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

Complied By : cabaldevraj@gmail.com
9312235173

SECTION 145-Method of Accounting

(1) Income chargeable under the head "Profits and gains of business or profession" or "Income 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 assessee.

(2) The Central Government may notify in the Official Gazette from time to time ~~accounting standards~~ (w.e.f. 1.4.2015) **income computation and disclosure standards** to be followed by any *class of assessees* or in respect of *any class of income.*

Income Computation & Disclosure Standards (ICDS)

ICDS NO	NAME	Equivalent AS No
I	Accounting Policies	1 & 5
II	Valuation of Inventories	2
III	Construction Contract	7
IV	Revenue Recognition	9
V	Tangible Fixed Asset	10
VI	Effects of changes in foreign exchange rates	11
VII	Government Grants	12
VIII	Securities	13/ 30
IX	Borrowing Costs	16
X	provisions, contingent liabilities and contingent assets	29

Applicable

To whom and from when these ICDS are applicable ?

ICDS applicable with effect from AY 2017-18

Class of assessee : ***Assessee following mercantile system of accounting***

Class of Income : Income under head :

a) Business and professional and b) other source

No minimum threshold

Exemption to individual and HUF who are not required to get it accounts audit u/s 44AB

Any Residential status

Not Applicable

To whom and from when these ICDS are not applicable ?

1. Cash basis of accounting
2. income other than Income under head :

a) Business and professional and b) other source

3. Individual and HUF who is not required to get its accounts audit u/s 44AB

Structure
How ICDS structure and what are the contents?

ICDS generally modified the bold portion of the AS and omitted the explanatory paragraphs and examples contained in the AS

ICDS are apparently lucid and short

- ✓ Preamble, scope,
- ✓ Contents
- ✓ Transitional provision
- ✓ Disclosure requirement

How to give effect of ICDS ?

As ICDS not for the purpose of maintenance of books of accounts.

Maintain its accounts in accordance with applicable AS issued by ICAI or IND-AS notified under the Companies Act.

In Computation of Income :

When there is difference between the accounting results and the requirements of applicable ICDS ***make adjustments*** while ***computing taxable income under the head of income Business and Profession and Income from*** **other sources**

Tax audit requirement

A.Y 2017-18

Clause no 13. (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).

13(e). If answer to 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 Rate*			
ICDS VII	*Government Grants*			
ICDS VIII	*Securities*			
ICDS IX	*Borrowing Costs*			
ICDS X	*Provision, contingent Liabilities and Contingent Assets*			
	Total			

13.(f) Disclosure as per ICDS:

(I)	*ICDS I-Accounting Policies*
(ii)	*ICDS II- Valuation of Inventories*
(iii)	*ICDS III-Construction Contracts*
(iv)	*ICDS IV-Revenue Recognition*
(v)	*ICDS V-Tangible Fixed Assets*
(vi)	*ICDS VII-Governments Grants*
(vii)	*ICDS IX-Borrowing Costs*
(viii)	*ICDS X-Provisions, Contingent Liabilities and Contingent Assets.*

Income tax return

A.Y 2017-18

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

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]

No Column in income tax return in computation of income

Schedule ICDS : Effect of Income Computation Disclosure Standards on profit

No	ICDS	Amount
(i)	(ii)	(iii)
I	**Accounting Policies**	
II	**Valuation of Inventories**	
III	**Construction Contract**	
IV	**Revenue Recognition**	
V	**Tangible Fixed Asset**	
VI	**Effects of changes in foreign exchange rates**	
VII	**Government Grants**	
VIII	**Securities**	
IX	**Borrowing Costs**	
X	**Provisions, Contingent liabilities and Contingent assets**	
II	**Total Net Effect (I+II+III+IV+V+VI+VII+VIII+IX+X)**	

Consequences of non- Complying of ICDS

What are the consequences of non-complying with ICDS?

By the Assessee :

The Assessing Officer may make an assessment in the manner provided in section 144.

Section 145

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

Contd…….Consequences of non-Compliance

By the professional :

While finalizing the Audit

While preparing the income tax return

Presumptive tax Scheme

Do ICDS apply to a taxpayer who is offering his income to tax under a presumptive tax scheme, such as section 44AD?

The provisions of **Section 44AD** begin with a non-obstante clause and accordingly override the provisions of Section 28 to 43C of the Act. Thus, under the presumptive tax scheme, books of account are not relevant, since **the income is computed on the basis of the presumptive tax rate laid down** under the Act.

It does not involve computation of income on the basis of the method of accounting, or on the basis of adjustments to the accounts. There is **no specific exclusion under the notification for taxpayers** following under presumptive tax schemes from the purview of ICDS

Where the presumptive tax scheme involves computation of tax on the basis of gross receipts, turnover, etc. that **the ICDS on revenue recognition** would apply **to compute the gross receipts or turnover in such cases.**

Non -Resident

Whether the notified ICDS apply to non-residents?

The provisions of Section 90 provide that the provisions of **the Income Tax Act or the DTAA, whichever is more beneficial shall apply to the assessee**.

Hence in case the assessee opts for the provisions of the DTAA, **it can be argued** that DTAA shall override the provisions of Section 145 of the Income Tax Act and hence ICDS notified there under **shall not be applicable**.

But DTAA explained that where income is taxability in India or contracting state ? What is the maximum rate of tax on that income ? If taxable in both state than how to allow double taxation relief ?

However all procedural provisions under income tax Act are applicable. i.e. filing of return, assessment etc

ICDS is computing amount of Income under the Income Tax Act. The ICDS procedural provision ?

Whether two Books of Accounts ?

ICDS for income computation, not for maintenance of books of account

It is not feasible for the assessee to maintain two separate books of accounts with different system of accounting and taxation purpose.

Different Methods of Accounting for Different sources of income

Can different methods of accounting be followed for different sources of income?

It is well **settled** that the method of accounting is vis-à-vis each **source of income**.

Where an assessee follows cash method of accounting for certain sources of income and mercantile system of accounting for others, **ICDS would apply only to those sources of income, where mercantile system of accounting is followed** and would not apply to those sources of income, where cash method of accounting is followed.

Impact of ICDS on taxable profits under MAT

What is the impact of ICDS on taxable profits under MAT?

As per the provisions of Section 115JB, the **net profit as shown in the profit and loss account** as adopted and laid before the company in the annual general meeting in accordance with the provisions the Companies Act shall be used as **the starting point** for computing **the book profits** for determining **the Minimum Alternate Tax** (MAT).

However, **the normal tax** shall be **computed** in accordance with **profit and loss account as per the financial statements and further adjusted for items specified in the ICDS**. Accordingly, since computation of MAT does not take into account the provisions of ICDS, the mismatch between MAT and normal computation is likely to be widened further.

Conflict between Act and ICDS

When there is conflict in the provision of Income Tax and ICDS ?

Provisions of Act to prevail in case of conflict with ICDS

- 43B,
- 40(a),(ia)

SC/HC rulings and ICDS

Settled law can not override through notifications :

CIT VS Surpur Paper Mills (1989) 237 ITR 41 (SC)
CIT vs Taj Mahal Hotels (1971) 82 ITR 44 (SC)

What is not an income cannot be income by ICDS?
What is not allowable expense cannot be expenses in ICDS?

FAQ 2: Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?

The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years.

Contrary between ICDS with Income Tax Rules

The Income Tax rules are a form of **delegated legislation,** while ICDS is in the form of a notification, which then becomes a part of the legislation. Accordingly, it appears that **the provisions of ICDS should prevail in such cases**.

ICDS Impact on the financial Statement

Whether ICDS would have any impact on the financial statements of the assessee?

- **Provision for Income tax and**
- **deferred tax**

will be the only two items in the **financial statements which shall be impacted**.

Continue ………….give effect of ICDS

Check list - ICDS

Sl. No	ICDS	Whether Applicable	Effect on profit
(i)	(ii)	(iii)	
I	**Accounting Policies**	Yes	
II	**Valuation of Inventories**		
III	**Construction Contract**		
IV	**Revenue Recognition**	Yes	
V	**Tangible Fixed Asset**		
VI	**Effects of changes in foreign exchange rates**		
VII	**Government Grants**		
VIII	**Securities**		
IX	**Borrowing Costs**		
X	**Provisions, Contingent liabilities and Contingent assets**	Yes	

Amendments made in the Act

What are the amendments made in the Act to comply with the ICDS provisions?

There have been 3 specific amendments made to the Income-tax Act by the Finance Act 2015, to ensure that the provisions of the Act are in line with the provisions of ICDS. These 3 provisions are:

The definition of **"income" u/s. 2(24)** has been amended by insertion of **clause (xviii)** to **include assistance in the form of a subsidy or grant or cash incentive or duty drawback or favour or concession or reimbursement** (by whatever name called) by the Central Government or a State Government or any authority or body or agency **in cash or kind** to the assessee, **other than the subsidy or grant or reimbursement, which is taken into account for determination of the actual cost of the asset** in accordance with the provisions of explanation 10 to clause (1) of section 43. This is to align it with the provisions of ICDS VII on Government Grants.

Amendments made in the Act contd…

The provisions of the **proviso to section 36(1)(iii)** have been modified to delete the words **"for extension of existing business or profession",** after the words "in respect of capital borrowed for acquisition of an asset", to bring the section in line with **ICDS IX on Borrowing Costs,** whereby interest in respect of borrowings for all assets acquired, from the **date of borrowing till the date of first put to use** of the asset, is to be **capitalised.**

A **second proviso has been inserted to section 36(1)(vii),** to provide that where a debt has been taken into account in **computing the income of an assessee** for any year on the basis of ICDS without recording such debt in the books of accounts, **then such debt would be deemed to have been written off in the year in which it becomes irrecoverable.** This is to facilitate the claim for deduction of bad debts, where the debt has been recognised as income in accordance with ICDS, but has not been recognised in t he books of accounts in accordance with AS.

Amendments made in the Act

2(24)(xviii)assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than—

(a)the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43; or

(b)the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be ;

Section 36(1)(iii)

The amount of interest paid in respect of capital borrowed for the purposes of business or profession:

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for the [~~extension of existing business or profession~~] (whether capitalized in the books of accounts or not), for any period beginning from the date on which the capital was borrowed for acquisition of the assets till the date on which such asset was first put to use, shall not be allowed as deduction.]

36(vii)(1)

Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year:

Provided that in the case of an assesse to which clause (viia) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause:

Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.

ICDS –I
Accounting Polices

Scope
Deals with significant accounting policy

Whether ICDS-I ultra vires Section 145 of Income-tax Act, 1961?

The explanatory Memorandum to Finance (No.2) Bill, 2014, clarifies that ICDS is not for the purpose of maintenance of books of accounts. In the same spirit, ICDS-I also provides that it is not for the purpose if maintenance of books of accounts. But the content of ICDS-I deals with fundamental accounting assumptions such as going concern, consistency and accrual. These assumptions are mainly for the purpose of maintenance of books of accounts. Therefore, to this extent is appears to be ultra vires.

Contd…. ICDS-I

What are consideration in the selection of accounting policy in AS ?

1. Prudence
2. Substance over form and
3. Materiality

Contd…. ICDS-I

Prudence :

In view of uncertainty of further events Profits are not anticipated but recognized only when realized in cash, receivables or other wise.

Provision is made for all known liabilities & losses (on best estimates).

Materiality

Financial statements shall disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.

Contd…. ICDS-I

What is the effect of not recognized the concept of "prudence" and "Materiality" while selecting accounting policy under ICDS ?

Marked to market loss or an expected loss shall not be recognized

unless such loss is in accordance with the provision of any other ICDS

FAQ 8: Para 4(ii) of ICDS-I provides that Market to Market (MTM) loss or an expected loss shall not be recognized unless the recognition is in accordance with the provisions of any other ICDS. Whether similar consideration applies to recognition of MTM gain or expected incomes?

Answer: Same principle as contained in ICDS-I relating to MTM losses or an expected 'loss shall apply *mutatis mutandis* to MTM gains or an expected profit.

Judicial precedents

I. MARKED TO MARKET, EXPECTED AND PROBABLE LOSSES	
WHAT JUDICIAL PRECEDENTS PROVIDE	**WHAT ICDS PRESCRIBED**
a) Loss incurred on account of **evaluation of contract on last date of accounting period**, (before date of maturity of forward contract) is an allowable deduction - *Dy. CIT (International Taxation) v. Bank of Bahrain & Kuwait* [2010] 41 SOT 290 (Mum.)(SB) b) The losses incurred by assessee due to **revaluation of an un-materialized oil exchange contract were allowable as deductions** - *Addl. DIT (IT) v. British Bank of Middle East* [2011] 44 SOT 109 (Mum.)(URO)	a) No deduction for marked-to-market or expected and probable losses a) Since such mark-to- market gains or losses are unrealized in nature, the ICDS provides that all gains or losses on such contracts shall be recognized on settlement

JUDICIAL PRECEDENTS (contd………..)

MARKED TO MARKET, EXPECTED AND PROBABLE LOSSES	
WHAT JUDICIAL PRECEDENTS PROVIDE	**WHAT ICDS PRESCRIBED**
c) **Possible losses from unsettled contracts could not be** allowed as deductions - *CIT v. Indian Overseas Bank* [1984] 19 Taxman 542 (Mad.) d) **Just because anticipated profits are not assessed to tax, it would not follow as a corollary thereto that anticipated losses cannot be allowed** as deductions in computation of business income - *ABN Amro Securities India (P.) Ltd. v. ITO* [2011] 15 taxmann.com 177 (Mum.)	

JUDICIAL PRECEDENTS (contd...........)

MARKED TO MARKET, EXPECTED AND PROBABLE LOSSES	
WHAT JUDICIAL PRECEDENTS PROVIDE	**WHAT ICDS PRESCRIBED**
e) It was held that any profit arising on account of revaluation of forward contract on the last day of accounting period has to be treated as an income of the assessee - *Addl. DIT(IT) v. Development Bank of Singapore* [2011] 12 taxmann.com 35 (Mum.)(URO) **f)** **Mark-to-market loss on derivatives held as stock-in-trade shall be allowed** as business loss - *Deputy CIT v. Kotak Mahindra* [2013] 35 taxmann.com 225 (Mumbai - Trib.)	

“Materiality”

- Significant accounting policy (para 1)
- True and fair view not true and correct view (para 4)
- Change in accounting policy having material effect are to be disclosed (para 7)

Contd…. ICDS-I

When accounting policy could be change ?

- **As per AS**
  a) Required by the statue or
  b) Compliance with AS
  c) Would result in a more appropriate presentation of financial statement of enterprises

- As per ICDS – When reasonable cause
  Not defined, A wider term

FAQ 9: ICDS-1 provides that an accounting policy shall not be changed without reasonable cause'. The term 'reasonable cause' is not defined. What shall constitute reasonable cause'?

Answer: Under the Act, 'reasonable cause' is an existing concept and has evolved well over a period of time conferring desired flexibility to the tax payer in deserving cases.

Contd…. ICDS-I

Disclosure :

Change in accounting policy

Effect: - ascertainable ……..amount

Not ascertainable….fact should indicate

When no material effect in previous year

Disclosed in previous year when change adopted

and subsequent previous year in when effect first time effect

Contd…. ICDS-I
Transitional Provisions

- All contract or transaction
- existing on 01-04-2016 or entered into on or after 01-04-2016
- shall be dealt with in accordance with the provisions of this standard
- after taking into account the income, expense or loss, if any,
- recognized in respect of the said contract or transaction
- for the previous year ending on or before 31-03-2016

Contd…. ICDS-I

Disclosure:

- All **significant** accounting policies.

- Any **change** in an accounting policy which has a **material effect i**n year of change or likely to effect in subsequently year. The fact of material change should disclosed in the period in which the change is adopted and in the year in which such change has material effect for the first time

- Disclosure of accounting policies or of changes therein **cannot remedy a wrong** or inappropriate treatment of the item.

- **Deviation** from fundamental accounting assumptions. i.e. going concern, consistency and accrual

FAQ 25: ICDS-1 requires disclosure of significant accounting policies and other ICDS requires specific disclosures. Where is the taxpayer required to make such disclosures specified in ICDS?

Answer: Net effect on the income due to application of ICDS is to be disclosed in the Return of income. The disclosures required under ICDS shall be made in the tax audit report in Form 3CD. However, there shall not be any separate disclosure requirements for persons who are not liable to tax audit.

Case study :

"AB LLP" has borrowed funds from various financial institutions, besides owes huge sums of money to the creditors.

For the financial year 2012-13, the LLP has defaulted payments to financial institutions of creditors.

In 2013-14, the financial institution has filed a case in Court for recovery of money.

Sundry creditors, who have not been paid for last 5 years have also filed a petition in the court for recovery.

Under the circumstances, being a Tax Auditors of "AB LLP" whether company can be assumed as a going concern?

Reply

The ICDS-I deals with significant according policies. One of the fundamental accounting assumptions for the purposes of Income computation is ‘going concern’.

‘Going concern’ refers to the assumption that the person has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the business, profession or vocations for the foreseeable future.

‘In the instant case of “AB Limited”, the business has drastically come down, it has incurred huge losses, there is a continuous default in payment of debt to financial institution. Besides, there is no payment of sundry creditors.

The circumstances would clearly suggest that the LLP cannot be considered as a ‘going concern’. At any point of time, LLP may closed down. Therefore considering these circumstances, fundamental accounting assumption of going concern cannot be made here.

The Tax Auditor considering ICDS-I has to treat the LLP as not a “going concern”.

Case Study :

AB Firm has inappropriately treated certain capitalized expenditure to revenue expenditure. This has also been stated in the accounting policy. What is the position under ICDS?

Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item. This is clear as per pare 8 of ICDS-I.

ICDS –II
valuation of inventories

Scope : ICDS-II applied for valuation of inventories except:

- Work-in-progress arising under 'construction contract' including directly related service contract which is dealt with by the Income Computation and Disclosure Standard on construction contracts;
- Work-in-progress which is dealt with by other Income Computation and Disclosure Standard;
- Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the Income Computation and Disclosure Standard on securities;
- Producers' inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realisable value;
- Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets.

Contd…. ICDS-II

What is the effect of recognized "Standard cost" in techniques for measurement of the cost of inventories in ICDS ?

If the ***results approximate to the actual cost incurred in bringing the items of inventory to their present location and condition.***

Disclosure requirement

Contd…. ICDS-II

The XYZ Company has ERP software for maintaining books of account and as per the software, overhead expenses are allocated to WIP/Finished stock on the basis of parameter decided at the beginning of FY i.e. as on 01st April.

This practice is being followed by the Company for last several years. They review the parameters as per actual cost incurred during last year, 2015-16 and revised the parameter for next year.

Whether this practice will effect valuation of stock under ICDS – II ?

What will be the answer if review is being done at the end of each month/quarter ?

Disclosure

Where standard costing-measurement of cost – detail of such inventory and confirmation that cost is approximates the actual cost

Contd…. ICDS-II

a) What is the value of opening stock?

b) What is the effect of when cost of purchased includes the cenvat, input credit and VAT credit in valuation of stock?

Contd…. ICDS-II

AS: The costs of purchase shall consist of purchase price including duties and taxes (**<u>other than those subsequently recoverable by the enterprise from the taxing authorities</u>**), freight inwards and other expenditure directly attributable to the acquisition. (Exclusive method).

ICDS: The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. (Inclusive method)

Contd…. ICDS-II

Section 145A : Notwithstanding anything to the contrary in section 145

Tax Audit requirement

Provide details of deviation, if any, from the method of valuation (Purchase , sale of goods and inventory)prescribed under section 145A, and the effect thereof on the profit or loss in Form 3CD. –

Guidance note :

The ICAI in the Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961 has explained as follows:

"23.23 The adjustments envisaged by section 145A will not have any impact on the trading account of the assessee. In other words both under exclusive method of accounting and inclusive method of accounting, the gross profit in the trading account will remain the same."

Ruling

The view also confirmed by a decision in the ITAT MUMBAI BENCH 'D' Raj Petro Specialties Private Limited vs. Assistant Commissioner of Income-Tax, 10(2), Mumbai [2013] 34 taxmann.com 76 (Mumbai-Trib.)

Contd.... ICDS-II

How to value inventory in case of dissolution of firm, AOP, BOI ?

- **<u>A.L.A Firm v. CIT (1991) 189 ITR 285 / 55 Taxman 497 (SC)</u>**

  In case of dissolution of firm, the stock-in-trade will have to be valued at the prevailing market price while preparing the accounts if the business of the firm is discontinued.

- **<u>Sakthi Trading Co. v. CIT (2001) 250 ITR 871 / 118 taxman 301 (SC)</u>**

  If on dissolution of the firm the business is not discontinued, then, the ordinary principle of commercial accounting permitting valuation of stock-in-trade at cost or net realisable value, whichever is lower will apply.

As per ICDS – stock at net realizable value

Contd…. ICDS-II

Case study

- Firm three partners
- Partnership deed, no clause relating to status of firm on death of partner partnership is on will.
- One partner out of three expired on 15.12.2016.
- The son of the deceased partner joined as partner on very same date and firm continues.
- What is the position of valuation of stock in hand as on 15.12.2016 with the firm?

Contd…. ICDS-II

- What is the cost of acquisition in the hand over the business ?

- Not clarified but seems to be NRV

Contd…. ICDS-II

Inventories in Services provider

Committee report : based on the international best practice

<u>Cost of services</u>

The costs of services ~~in the case of a service provider~~ shall consists of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.

Contd…. ICDS-II

Inventories are assets

i) Held for sale in the ordinary course of business

ii) In the process of production for such sales

iii) In the form of material or supplies to be consumed in the production process or in the rendering of services

Contd…. ICDS-II

Transitional Provisions

- Interest and other borrowing costs,
- which don't meet criteria for its recognition as a component of cost,
- but included in the cost of opening inventory as on 01-04-2016
- shall be taken into account for determining cost of such inventory for valuation as on close of previous year beginning on or after 01-04-2016,
- if such inventory continue to remain part of inventory as on close of the previous year beginning on or after 01-04-2016,

Contd…. ICDS-II

Disclosures

The following aspects shall be disclosed:

- The **accounting policies** adopted in measuring inventories
- the **cost of formulae** used
- Where **standard costing**-measurement of cost – **detail of such inventory** and **confirmation** that cost is approximates the actual cost
- The **total carrying amount** of inventories , and
- **classification** appropriate to a person.

ICDS-VI
Effect of change in Foreign exchange rates

Contd…. ICDS-VI

Scope :

- Treatment of foreign currency transactions,
- Translation of financial statements of foreign operations and
- Treatment of forward exchange contracts.

Contd…. ICDS-VI

What is treatment of foreign currency transactions in ICDS and different from AS-11 ?

Contd…. ICDS-VI

Treatment of foreign currency transactions

- **Initial recognition –**
  - to be recorded in reporting currency by applying exchange rate of the foreign currency at the date of the transaction.
- **Conversion at the reporting date-**
  - Monetary items to be converted by applying the closing rate
  - Non-monetary item which are carried at historical cost to be converted by applying rate at the date of transaction.
  - **Recognition of exchange differences-**
  - In respect of **monetary items** **only** to be recognised as income or expense in the previous year in which they arise.

The above are subject to section 43 A and rule 115?

Contd…. ICDS-VI

- **Monetary Items-** are money held and assets to be received or liabilities to be paid in fixed or determinable amount of money.
  - Examples: cash, trade receivables, trade payables.

- **Non-monetary items**- are assets and liabilities other than monetary items.
  - Examples: fixed assets, inventories, investments

Contd…. ICDS-VI

Sec 43A- Special provisions consequential to changes in rates of exchange of currency

- in case of acquisition of asset from country outside India for the purpose of his business in any previous year, an increase or decrease in liability at the time of making the payment, irrespective of the method of accounting adopted, shall be added or deducted, as the case may be from the actual cost of the asset.

Rate of exchange for conversion into rupees of income expressed in foreign currency

115. [(1)] The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.

Contd…. ICDS-VI

Explanation : For the purposes of this rule,—

"specified date" means—

a) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears;

b) in respect of income [by way of] "interest on securities", the last day of the month immediately preceding the month in which the income is due;

c) in respect of income chargeable under the heads "Income from house property", "Profits and gains of business or profession" not being income referred to in clause (*d*) and "Income from other sources" not being income by way of dividends and "Interest on securities" *the last day of the previous year of the assesse;*

d) in respect of income chargeable under the head "Profits and gains of business or profession" in the case of a non-resident engaged in the business of operation of ships, the last day of the month immediately preceding the month in which such income is deemed to accrue or arise in India ;

e) in respect of income by way of dividends, the last day of the month immediately preceding the month in which the dividend is declared, distributed or paid by the company;

f) in respect of income chargeable under the head "Capital gains", the last day of the month immediately preceding the month in which the capital asset is transferred :]

Foreign operation

Only branch is considered as foreign operations of a person

Foreign operations translation if foreign operations has been those of persons himself

(As discussed in previous slides)

AS : Covers subsidiary, associate, joint venture or branch of reporting enterprise, the activities of which are based or conducted in a foreign country

Conti….. Foreign operations in AS

Translation depends on :

Foreign operation is integral foreign operation or non-integral foreign operation.

Financial statements of an integral foreign operation of a person are to be translated as if the transactions of the foreign operation had been those of the person himself.

In case of non-integral foreign operations, assets and liabilities are to be translated at closing rate and income and expenses are translated at actual rates or at an average rate if it approximates the actual rate and the resulting exchange differences are accumulated in foreign currency translation reserve.

FAQ 16: What is the taxability of opening balance as on 1st day of April 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognised as per Accounting Standards (AS) 11?

Answer: FCTR balance as on 1st April 2016 pertaining to exchange differences on monetary items for non-integral operations, shall be recognised in the previous year relevant for assessment year 2017-18 to the extent not recognised in the income computation in the past.

Forward Exchange Contract

a) When held for an underlying asset or liability
b) When held for either **speculative or trading purposes**
c) When hedge for firm commitments or highly probable forecast transactions

AS -11
Forward exchange contract

A) Hedge an underlying asset or liability

- The premium/discount is amortized over the life of the contract
- The forward exchange contract is recorded as an asset/liability.
- The exchange difference on both the underlying (Asset and liability) and the forward exchange contract is recognized in the P&L account.
- The exchange gain/loss on the underlying will get offset by exchange loss/gain on the forward exchange contract.
- *The net impact on P&L account will be to the extent of amortization of premium /discount.*

AS -11

Forward exchange contract

b) Speculative or Trading Forward Exchange Contracts

Forward exchange contract is marked to market at each reporting date <u>and exchange gain or loss is recognized in the profit and loss account.</u>

the premium or discount is not recognized

Contd…. ICDS-VI

c) Forward exchange contracts –

Hedge firm commitments or highly probable transactions

✓ *Not covered under AS-11*

✓Covered under AS 30 read with ICAI announcement

✓Mark to market losses and gain are recognized

✓ However, gains if any are ignored till 31.03.2016

Contd…. ICDS-VI

ICDS –

Forward contract –

a) Hedge an underlying asset or liability – No change

b) Trading and speculation
c) Hedge the foreign currency risk of firm commitment, highly probable forecast transaction

Recognized at the ***time of settlement***

Since such mark-to- market gains or losses are unrealized in nature, the ICDS provides that all gains or losses on such contracts shall be recognized on settlement.

FAQ 10: Which ICDS would govern derivative instruments?

Answer: ICDS -VI (subject to para 3 of ICDS-VIII) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts.

For derivatives, not within the scope of ICDS-VI, provisions of ICDS-I would apply.

ICDS VI- Transitional provision

(1) All foreign currency transactions undertaken on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.

(2)Exchange differences arising in respect of monetary items or non-monetary items on the settlement there of during the previous year commencing on the 1st day of April, 2016 or on conversion thereof at the last day or the previous year commencing on the 1st day of April, 2016 , shall be recognised in accordance with the provisions of this standard after toking into account the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item. if any, which is carried forward from said previous year.

Conti….ICDS VI- Transitional provision

(3) The financial statements or foreign operations for the previous year commencing on the 1st day of April, 2016 shall be translated using the principles and procedures specified in this standard after taking into account the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item. if any, which is carried forward from said previous year.

(4) All forward exchange contracts existing on the 1st day of April, 2016 or entered on or after 1st day of April, 2016 shall be dealt with in accordance with the provisions of this standard 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,20I6.

ICDS –IX
Borrowing Cost

Scope:-

(1) This Income Computation and Disclosure Standard deals with treatment of borrowing costs.

(2) This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.

AS-16 – Borrowing Cost

- Borrowing costs that are directly attributable to the acquisition, construction or production of any qualifying asset
  - Assets that takes a substantial period of time to get ready for its intended use or sale
  - However ordinarily a period of 12 months is considered as substantial period of time
- Borrowing costs that can be capitalized are interest and other costs that are directly attributable to the acquisition, construction and production of a qualifying asset.
- Income on the temporary investment of the borrowed funds to be deducted from borrowing costs.

AS-16 – Borrowing Cost

- Capitalization of borrowing costs should be suspended during extended periods in which development is interrupted.
- Capitalization should cease when completed substantially or if completed in parts, in respect of that part, all the activities for its intended use or sale are complete.
- Financial statements to disclose accounting policy adopted for borrowing cost and also the amount of borrowing costs capitalized during the period.

Qualifying assets?

- Tangible assets
- Intangible assets
- Inventory which require period of 12 months or more for saleable condition

Takes a substantial period of time to get ready in tangible and intangible assets as in AS is missing

Qualifying assets for the purpose of general borrowings formula : which requires a period of 12 months or more.

What are 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.

Section 2(28B)

Interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation)

and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or

in respect of any credit facility which has not been utilized.

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 such specific provisions?

Answer: 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.

Question 21: Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost?

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

Section 36(1)(iii)

- The amount of interest paid in respect of capital borrowed for the purposes of business or profession:

- [Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for the [~~extension of existing business or profession~~] (whether capitalized in the books of accounts or not), for any period beginning from the date on which the capital was borrowed for acquisition of the assets till the date on which such asset was first put to use, shall not be allowed as deduction.]

Foreign exchange difference held as interest cost as per AS-16.

Whether borrowing cost capitalization includes foreign exchange difference held as interest cost as per AS-16. ?

ICDS - not a part of borrowing

Example

XYZ Ltd. has taken a loan of USD 10,000 on April 1, 2016, for a specific project @5% p.a., payable annually.

On April 1, 2016, the exchange rate Rs. 45/USD.

The exchange rate, as at March 31, 2017, is Rs. 48/USD.

The corresponding amount could have been borrowed by XYZ Ltd. in local currency @11% p.a. on April 1, 2016.

- Interest - USD 10,000 × 5% × Rs. 48/USD = Rs. 24,000.
- Increase in the liability towards the principal amount = USD 10,000 × (48-45) = Rs. 30,000.
- Interest had the loan been taken in Indian currency = USD 10000 × 45 × 11% = Rs. 49,500.

Borrowing Costs

	Accounting		Income Tax	
Particulars	**No para 46A**	**Para 46A**	**Pre-ICDS**	**Post ICDS**
Exchange differences as per AS-11	4,500 (P&L)	30,000 (Capital)	4,500 / 30,000 Not allowed except u/s 43A	30,000 P&L except u/s 43A
Borrowing Cost	49,500 (Capital)	24,000 (Capital)	49,500/24,000 – Capital	24,000 – Capital

Issues on borrowing cost

1. Annual renewal charges for CC and Overdraft limit
2. Professional charges paid for syndication of loan and arrangement of loan
3. Guarantee fee charged by the Guarantor to get loan i.e. director or holding company
4. Stock Audit fee charged by the Bank.
5. Finance charges of finance lease .
6. Loan after the acquisition of assets and charges paid
7. Loan shift from one bank to other for lower rate of interest and processing charges paid
8. Bank charges

Two types of Borrowing costs

1. Specific Borrowing cost
2. General Borrowing cost

Borrowing cost for specific purpose?

Borrowing cost to be capitalized from the date of funds borrowed to the date first put to use

and

in case of inventory of the date of inventory intended for sales completed.

Generally borrowing

Generally borrowing and utilized for the purpose of acquisition, construction or production

Qualifying assets : which requires a period of 12 months or more.

Capitalized as per formula given

From the date of fund utilized to the date of first put to use or in case of inventory up to date of intended sales are completed

General borrowings

Formula of generally borrowing prescribed –

A x B/C

A – Borrowing cost other than specific borrowings

B – average cost of qualifying assets excluded qualified asseets funded out of specific borrowings

i) first day and last day of P.Y i.e (01.04.2016 + 31.3.17)/2

ii) NIL on first day of P.Y - Half of qualifying assets

iii) Nil on last day of P.Y – (First day + date of put to used or completion)/2

C – average cost of total assets

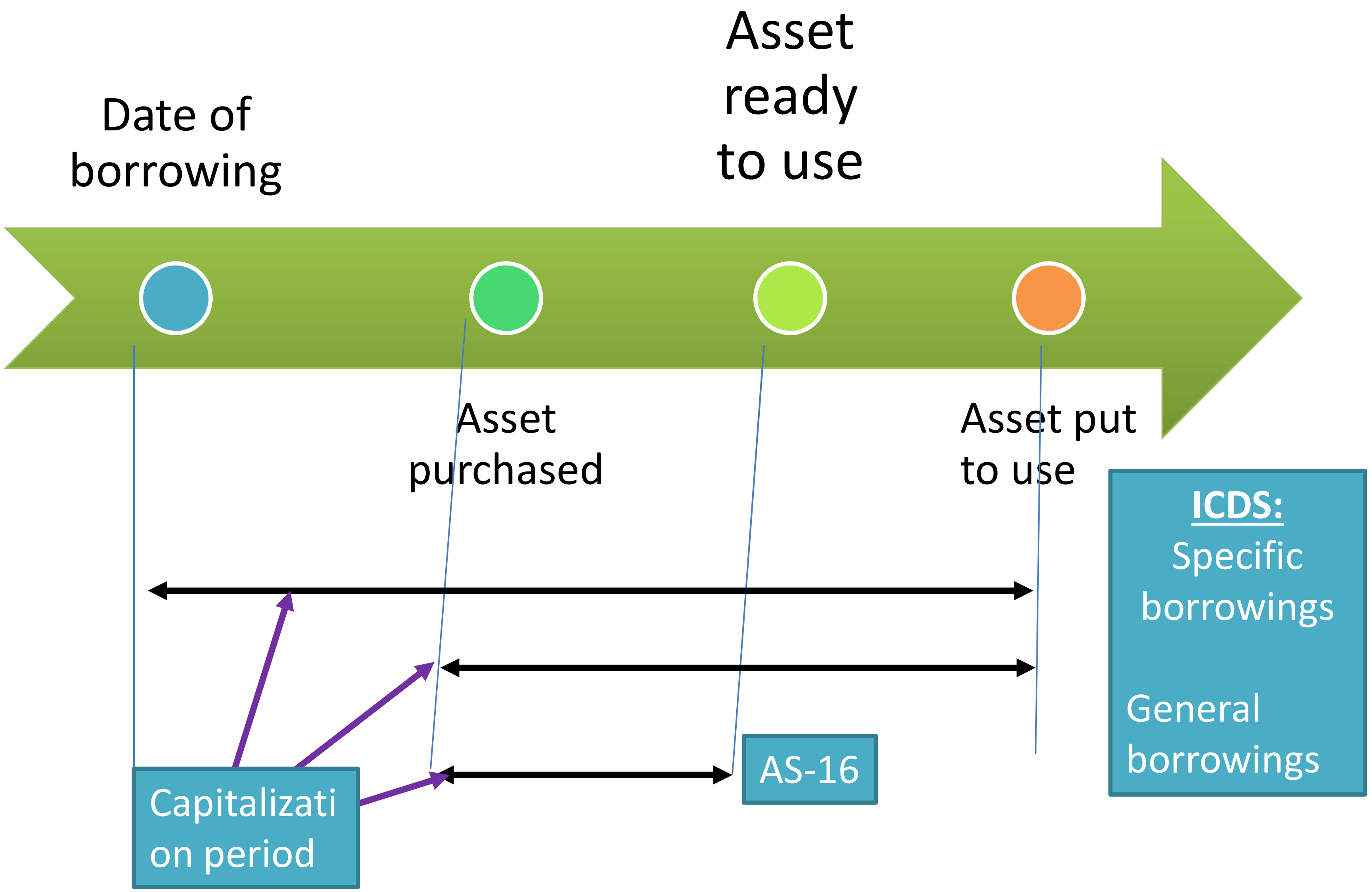
(cost of total assets as on 31.3.16) + (cost of total assets as on 31.3.17)/2

(other than assets directly funded out of specific borrowing)

Qualifying assets : which requires a period of 12 months or more

FAQ 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?

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


Date of borrowing
Asset ready to use
Asset purchased
Asset put to use
ICDS:
Specific borrowings
General borrowings
AS-16
Capitalization period

Income on temporary investment of borrowed funds which are specifically borrowed for obtaining a qualifying asset

ICDS :

- No netting off from cost of asset.
- Will be taxed as income

Suspension of capitalization

AS 16 :

Capitalization suspended during extended periods in which active development is interrupted.

ICDS :

No suspension of capitalization under any circumstances

Transitional Provision

All the borrowing costs incurred on or after 1st day April, 2016 shall be capitalized for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard after taking into account the amount of borrowing costs capitalized, if any, for the same borrowing for any previous year ending on or before 31st day of March, 2016

ICDS IX- Borrowing Costs

Disclosure

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

ICDS –III
CONSTRUCTION CONTRACTS

Scope

Determines the income for a construction contact of a contractor

AS-7 CONSTRUCATION CONTRACTS

- Applied in accounting of construction contracts
- Contract revenue : initial amount agreed in contract and variation in contract work, claims and incentive etc
- Contract cost : directly relate to specific contract , cost attributable, other cost specifically chargeable to customer
- incident income reduced from cost
- Recognition of contract revenue and expenses : when can be estimated reliable : as stage of completion of the contract activity at reporting date
- When can't estimated reliable – revenue to the extend of cost incurred
- Method to determined percentage of completion of contract : proportion of contract cost incurred , survey of work performed , completion of physical proportion of the contract work

Contd…… AS-7 CONSTRUCATION CONTRACTS

- All expected loss should recognized immediately
- Change in estimates
- Disclosure :

  a) contract revenue recognized, method used to determined contract revenue, method used to determined stage of completion

  b) aggregate cost incurred and recognized profit up to reporting date, advance received , retention

  c) Gross amount due from customer –as an assets and Gross amount due to customer – as a liability

Taxability of Retention Money

Various judicial pronouncements have held that retention money accrues to the contractor only when there is a right to receive such income which generally accrues at a later point of time upon completion of the prescribed conditions as per the contract. **Refer following cases:-**

1.) In the case of **CIT v. Simplex Concrete Tiles P.Ltd. 179 ITR 8 (Cal.),** it has been held that the payment of retention money is deferred and is contingent on the satisfactory completion of the work. Till then there is no admission of liability and no right to receive any part of the retention money accrues to the assessee, even if assessee follows mercantile system of accounting.

2.) In the case of **Anup Engineering Ltd. v. CIT (2001) 247 ITR 457 (Guj.) (HC)**, it has been held that for the purpose of ascertaining whether income had accrued to the assessee, one has to find out whether the assessee had a vested right to receive the income by looking at the terms and conditions of the contract in pursuance of which the assessee was to receive the amount.

3.) In the case of CIT v. Shoorji Vallabhdas &Co. (1962) 46 ITR 144 (SC), it has been held that where the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to the effect might, in certain circumstances, have been made in the books of accounts.

4.) In the case of CIT v. Ignified Boilers (I) Ltd. (2006) 283 ITR 295 (Mad.) (HC), As per a specific clause in the agreement 10% of the contact price was retained by the principal contractor which is to be paid to the assessee-contractor after one month subject to successful completion of work. The same has not been received in respect of relevant A.Y. though work has been completed. It cannot be said that the said retention money accrued to the assessee merely because bills have been raised on completion of work and the assessee is following mercantile system of accounting. Therefore, the same cannot be treated as income.

Similar view has been expressed by the high courts in the following judgments also:

- CIT v. Associated Cables P. Ltd. (2006) 286 ITR 596 (Bom.) (HC)
- CIT v. East Coast Construction & Industries Ltd. (2006) 283 ITR 297 (Mad.) (HC)

Provision for Foreseeable / Anticipated losses

- There are contradictory decisions of different courts regarding allowability of forseeable / anticipated losses:

  - **Following are the several decisions which <u>"allows" </u>foresseable losses as business expenses:**

    1.) CIT v. Woodward Governor India (P.) Ltd. (2009) 312 ITR 254 (SC)
    2.) Asstt. CIT v. ITD Cementation India Ltd. (2013) 146 ITD 59 (Mum. –Trib.)
    3.) Jacobs Engineering India (P.) Ltd. v. Asstt. CIT (2011) 146 taxmann.com 186 (Mum. – Trib.)
    4.) Rotork Controls India (P.) Ltd. v. CIT (2009) 314 ITR 62 (SC)
    5.) CIT v. Triveni Engineering and Industries Ltd. (2011) 336 ITR 374 (Del.) (HC)

  - **Following are the several decisions which <u>" does not allow"</u> foresseable losses as business expenses:**

    1.) EDAC Engineering Ltd. v. Dy. CIT (2013) 141 ITD 231 (Chennai – Trib.)
    2.) CIT v. Secit Spa Societa Ecologica (2009) 316 ITR 378 (Mad.)

Retentions

ICDS :

Retentions shall be included in contract revenue

AS-7 silent on inclusion of retentions in contract revenue.

FAQ 11: Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?

Answer: Retention money, being part of overall contract revenue, shall be recognized as revenue subject to reasonable certainty of its ultimate collection condition contained in para 9 of I CDS-III on Construction contracts.

Para no 9 ICDS –III

" Contract revenue shall be recognized when there is reasonable certainty of its ultimate collection.

Recognition of contract costs and contract revenues with reference to stage of completion of the contract activity at the reporting date

AS : When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date

ICDS : does not recognize that the possibility that outcome of a construction contract cannot estimated reliably

Early stages of completion of contract

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

AS :

no definition as to upto what % of completion it can be considered that contract is at early stage.

Netting off costs by incidental income

ICDS : Netting off allowed for all types of costs. However, such netting off not allowed if incidental income is in the nature of interest, dividends or capital gains

AS : Costs that relate directly to the specific contract shall be reduced by any incidental income that is not included in contract revenue.

Reversal of contract revenue recognized

ICDS :

Contract revenue which is recognised as income subsequently uncollectable – Recognised as an expenses not to adjusted against revenue.

AS :

No reversal of contract revenue on account of uncertainty arising on realizability of contract revenue which was already recognized as income.

Recognition of expected losses from contract

ICDS : In proportion to percentage of completion.

AS: To be recognized in full

FAQ 11: Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?

Answer: Retention money, being part of overall contract revenue, shall be recognized as revenue subject to reasonable certainty of its ultimate collection condition contained in para 9 of I CDS-III on Construction contracts.

Transitional Provision

1. Contract revenue and contract cost associated with the construction contract, which commenced on or after 1st day of April, 2016 shall be recognized in accordance with the provisions of this standard.

2. Contract revenue and contract costs associated with the construction contract, which commenced on or before the 31st day of March, 2016 but no completed by the said date, shall be recognized based on the method regularly followed by the person prior to the previous year beginning on the 1st day of April, 2016.

Disclosure

1. A person shall disclose:

- the amount of contract revenue recognised as revenue in the period; and
- the methods used to determine the stage of completion of contracts in progress.

2. A person shall disclose the following for contracts in progress at the reporting date, namely:—

- amount of costs incurred and recognised profits (less recognised losses) up to the reporting date;
- the amount of advances received; and
- the amount of retentions.

Case study

A construction contract has been awarded to ABC Contractors for Rs. 10 Crores and as per terms of agreement, 10% of the amount shall be retained by the party as retention money/security. That security/retention will be disbursed at the satisfactory completion of contract. The person incurred cost/expenses of Rs. 2 crores till 31.03.2017 and as per survey, the construction work is completed upto 30% stage but the cost incurred is 24% of total estimated cost of the entire contract. ABC has raised the bill of Rs. 3 crores as on 15.03.2017 and the party has paid Rs. 2.7 crores after deducting 10% as retention. The cost of contract is Rs. 8.34 crores and margin is Rs. 1.67 crores. What is the treatment as per AS-7 and ICDS – III on the transactions for the FY 2016-17?

Case study

2) In continuation of the above question, if ABC has taken a loan of Rs. 2 crores @14% on 15.12.2016 and deployed Rs. 50 Lacs in FDR @ 8% from 01.01.2017 as security deposit for performance guarantee with bank and earned interest of Rs. 1 lac, what would be the treatment under ICDS of Rs. 1 lac of income?

Case study

3) In continuation of the above question, if this is fixed price contract and as on 31.03.2017 the person came to know that due to additional levy of tax imposed by the government on one of the item being imported and used in this contract. Due to this levy, it is certain that there shall be additional contract cost of Rs. 2 Lacs and contract period to complete the job is 2 years. What would be the effect of this Rs. 2 Lacs as per ICDS – III in computation of income and how it is different from AS – 7?

Any Query ?


Thank you