

PATPARGANJ CPE STUDY CIRCLE OF NIRC OF ICAI

INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

Complied By : cabaldevraj@gmail.com
9312235173

ICDSJourney

- CG notified 10 ICDS vide notification no. 32 of 2015 dated 31st March 2015 which were applicable from AY 2016-17 onward
- Due to various issues and representations made referred to Expert committee, ICDS Deferred by 1st year (P. R. Dt. 6th July 2016).
- CBDT rescinded the old ICDS through notification no. 86/2016 dated 29th September 2016 and issued revised ICDS vide notification no. 87/2016 and amended Tax Audit Form 3CD.
- FAQs (25) issued on 25th March 2017

Reduce litigation and bring certainty ?

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

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

Preamble

1. This Income Computation and Disclosure Standard is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of account.
2. In the case of conflict between the provisions of the Income-tax Act, 1961 ('the Act') and this Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Transitional provision

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

Disclosure requirement

- 8 ICDS disclosure requirement
- 2 ICDS not required :
 - a) Relating to the effects of changes in foreign exchange rates
 - b) Relating to securities

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

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

Minimum threshold ?

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

Business cash basis – other source mercantile basis ?

One business on mercantile basis or on cash basis ?

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.

FAQ 7: Whether the provisions of ICDS shall apply to Banks, Non-banking financial institutions, Insurance companies, Power sector, etc.?

Answer: The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. For example, ICDS VIII contains specific provisions for banks and certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business.

FAQ 12: Since there is no specific scope exclusion for real estate developers and Build -Operate- Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether ICDS-111 and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.

Answer: At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

FAQ 14: Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s. 115A of the Act.

Answer: Yes, the provisions of ICDS, shall also apply for computation of these incomes on gross basis for arriving at the amount chargeable to tax.

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 :*

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

13.(f) Disclosure as per ICDS:

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

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]

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	
11	Total Net Effect (+II+III+IV+V+VI+VII+VIII+IX+X)	

Income tax return and computation of income

When no column to give effect of ICDS in computation of income in income tax return ?

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/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***

Conti....how to give effect of ICDS

1. Annalise accounting policy are being followed by the assessee for maintained books of accounts
2. Applicable ICDS to Assessee
3. Note down the variance in the accounting policies and ICDS requirement
4. Quantify the variance in the accounting policies and ICDS requirement for each ICDS and effect of that on books profit
5. Consider variance in computation of Income
6. Compute Income tax provision and DTL/DTA
7. Prepare disclosure requirement for each applicable ICDS

Continuegive effect of ICDS
Check list - ICDS

Sl. No	ICDS	Whether Applicable	AMT IN RETURN AND 3CD	Dis-closure	Remarks
(i)	(ii)	(iii)	(iv)	(v)	(VI)
I	Accounting Policies	Yes			
II	Valuation of Inventories				
III	Construction Contract				
IV	Revenue Recognition	Yes			
V	Tangible Fixed Asset	Yes			
VI	Effects of changes in foreign exchange rates				
VII	Government Grants				
VIII	Securities				
IX	Borrowing Costs				
X	Provisions, Contingent liabilities and Contingent assets	Yes			

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.**

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 finalizing tax 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?

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.**

FAQ 3: Does ICDS apply to non-corporate taxpayers who are not required to maintain books of account and/or those who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 448, 44BB, 44BBA, etc. of the Act?

Answer: ICDS is applicable to specified persons having income chargeable under the head 'Profits and gains of business or profession' or 'Income from other sources'. Therefore, the relevant provisions of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. **For example, for computing presumptive income of a partnership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.**

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 ?

Impact of ICDS on taxable profits under MAT/AMT??

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.

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

Yes .

FAQ 6: Whether ICDS shall apply to computation of Minimum Alternate Tax (MAT) under section 115JB of the Act or Alternate Minimum Tax (AMT) under section 115JC of the Act?

Answer: **MAT under section 115JB** of the Act is computed on 'book profit' that is net profit as shown in the Profit and Loss Account prepared under the Companies Act subject to certain specified adjustments. Since, the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, the provisions of ICDS **shall not apply for computation of MAT.**

AMT under section 115JC of the Act is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act. Hence, the provisions of ICDS shall apply for computation of AMT.

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.

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 real income can 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.

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 the 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(1)(vii)

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 assessee to which clause (vii) 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 of 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 it 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 recognizing 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	
JUDICIAL PRECEDENTS	ICDS
<p>a) Loss incurred on account of <u>evaluation of contract on last date of accounting period</u>, (before date of maturity of forward contract) is an allowable deduction - <i>Dy. CIT (International Taxation) v. Bank of Bahrain & Kuwait</i> [2010] 41 SOT 290 (Mum.)(SB)</p> <p>b) The losses incurred by assessee due to <u>revaluation of an un-materialized oil exchange contract were allowable as deductions</u> - <i>Addl. DIT (IT) v. British Bank of Middle East</i> [2011] 44 SOT 109 (Mum.)(URO)</p>	<p>a) No deduction for marked-to-market or expected and probable losses</p> <p>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</p>

JUDICIAL PRECEDENTS (contd.....)

MARKED TO MARKET, EXPECTED AND PROBABLE LOSSES	
JUDICIAL PRECEDENTS	ICDS
<p>c) <u>Possible losses from unsettled contracts could not be</u> allowed as deductions - <i>CIT v. Indian Overseas Bank</i> [1984] 19 Taxman 542 (Mad.)</p> <p>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 - <i>ABN Amro Securities India (P.) Ltd. v. ITO</i> [2011] 15 taxmann.com 177 (Mum.)</p>	

JUDICIAL PRECEDENTS (contd.....)

MARKED TO MARKET, EXPECTED AND PROBABLE LOSSES	
JUDICIAL PRECEDENTS	ICDS
<p>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 - <i>Addl. DIT(IT) v. Development Bank of Singapore</i> [2011] 12 taxmann.com 35 (Mum.)(URO)</p> <p>f) <u>Mark-to-market loss on derivatives held as stock-in-trade shall be allowed</u> as business loss - <i>Deputy CIT v. Kotak Mahindra</i> [2013] 35 taxmann.com 225 (Mumbai - Trib.)</p>	

“Materiality”

- Materiality in Income tax ?
- Income/expenses /loss Rs 100 or 1cr
- 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 statute 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: - ascertainableamount

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** in 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

AS-I: Disclosure of Accounting Policies

1. This Standard deals with the disclosure of significant accounting policies followed in preparing and presenting Financial Statements (FS) so as to represent a true and fair view of the enterprise.
2. Accounting policies are specified accounting principles and the methods of applying those principles for the preparation of the FS of an enterprise.
3. Aspects to be kept in mind while selecting accounting policies:
 - a) Prudence: Account for all expected losses/expenses but never account for expected gains/incomes.
 - b) Substance Over Form: Whenever there is a dispute, facts should prevail over law.
 - c) Materiality: Only 'material' information be presented whose knowledge might influence the decision of the users of FS

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.

Comparison at a Glance

	ICDS 1	AS 1
Materiality	Materiality concept is not there	Materiality is one of the key consideration for selection and adoption of accounting policies

	ICDS 1	AS 1
Prudence	Marked to market loss basis or expected losses not to be recognized unless specifically mentioned in any <u>other ICDS</u>	All expected losses are to be recognized and profits to be recognized on actual realization

	ICDS 1	AS 1
Change in Accounting Policy	An accounting policy shall not be changed without a reasonable cause.	A change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of the enterprise.

ICDS –II

valuation of inventories

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

a) What is the value of opening stock?

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

(i) 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

(ii) the value of the inventory as on the close of the immediately preceding previous year, in any other case.

Contd.... ICDS-II

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 (**other than those subsequently recoverable by the enterprise from the taxing authorities**), 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

Method of accounting in certain cases.

145A. Notwithstanding anything to the contrary contained in section 145, the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be-

(a) in accordance with the method of accounting regularly employed by the assessee; and

(b) further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Explanation.- For the purposes of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment.]

Tax Audit requirement

14 (b) Details of deviation, if any, from the method of valuation prescribed under Section 145A, and the effect thereof on the Profit or Loss. Please Furnish:-

Sl. No.	Particulars	Increase in profit (Rs)	Decrease in profit (Rs)
1	Increase in cost of opening stock on inclusion of excise duty on which CEN VAT credit is available/availed		20
2	Increase in purchase cost of raw material on inclusion of excise duty on which CEN VAT credit is available/availed		180
3	Increase in sales of finished goods on inclusion of excise duty	180	
4	Excise duty paid on sale of finished goods as a result of its inclusion in sales	-	180

5	Increase in closing stock of raw material on inclusion of excise duty	40	-
6	Increase in closing stock of finished goods on inclusion of excise duty	60	-
7	Increase in excise duty on closing stock of finished goods as a result of its inclusion in closing stock of finished goods	-	60
8	Accounting of CENVT credit availed and utilised on raw materials consumed in payment of excise duty on finished goods accounted on the basis of raw material consumed	160	-
	Total	440	440

Contd.... ICDS-II

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

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

❖ **A.L.A Firm v. CIT (1991) 189 ITR 285 / 55 Taxman 497 (SC)**

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.

❖ **Sakthi Trading Co. v. CIT (2001) 250 ITR 871 / 118 taxman 301 (SC)**

If on dissolution of the firm the business is not discontinued, then, the ordinary principle of commercial accounting permitting valuation of stock-in-trade at cost or 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

d) Inventories in Services provider ?

Committee report : based on the international best practice

Cost of services

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.

AS-2

DISCLOSURE REQUIREMENTS:

1. All accounting policies adopted in measuring inventories.
2. Cost formula used in measuring inventories.
3. Total carrying amount of inventories and its classification

Comparison at a Glance

	ICDS II	AS 2
Scope	<p>Not applicable for:</p> <ul style="list-style-type: none"> a. Construction contracts b. WIP dealt in other ICDS c. Financial instruments held as stock-in-trade d. Products relating to agriculture e. Machinery spares held as stock in trade 	<p>Not applicable for:</p> <ul style="list-style-type: none"> a. Construction contracts b. Financial instruments held as stock-in trade c. Products relating to Agriculture

	ICDS II	AS 2
Cost of Services	Inclusion of cost of services in cost of inventories to bring inventories to their present location and condition	Cost of Services were not included in cost of inventories as per AS 2 issued by ICAI

	ICDS II	AS 2
Methods of valuation	<ol style="list-style-type: none"> 1. Specific Identification Method 2. FIFO 3. Weight Average Cost 4. Retail method 5. Standard Cost 	<ol style="list-style-type: none"> 1. Specific Identification Method 2. FIFO 3. Weight Average Cost 4. Retail method 5. Standard Cost

	ICDS II	AS 2
Change in the method	Not permitted without a “reasonable cause”	Change in method will amount to change in Accounting Policy

	ICDS II	AS 2
Interest Cost	Excluded unless they meet the criteria as specified in the ICDS on borrowing costs.	Usually excluded.

	ICDS II	AS 2
Valuation of inventory in case of dissolutions	In the case of dissolution of a partnership firm or association of persons or body of individuals irrespective of whether the business continues or not, the inventories on the date of dissolution shall be valued at net realizable value.	As 2 does not specifically mention the valuation of inventory in the case of dissolution.

	ICDS II	AS 2
Cost of Purchase	<p>The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates and other similar items shall be deducted in determining the costs of purchase</p>	<p>The costs of purchase consist of the purchase price including duties and taxes (other than those subsequently recoverable by the enterprise from the taxing authorities), freight inwards and other expenditure directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks and other similar items are deducted in determining the costs of purchase.</p>

	ICDS II	AS 2
Value of Opening Inventory	<p>The value of the inventory as on the beginning of the previous year shall be:</p> <ul style="list-style-type: none"> • Value of inventory on the day of commencement in case of new business and • Value of the inventory as on the close of the preceding PY, in case of existing business. 	Value of opening inventory is not discussed in AS 2
26.05.2017	Baldev Raj & Co	91

ICDS –III

CONSTRUCTION CONTRACTS

Scope

Determines the income for a construction contract of a contractor

Retentions

ICDS :

Retentions shall be included in contract revenue

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

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 contract 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)

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

Provision for Foreseeable / Anticipated losses

- ❖ There are contradictory decisions of different courts regarding allowability of foreseeable / anticipated losses:
 - **Following are the several decisions which “allows” foreseeable 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 “ does not allow” foreseeable 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.)

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 not 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 (no change)

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?

ICDS III – CONSTRUCTION CONTRACTS

ICDS-III Vs. (AS) 7		
Points of comparison	ICDS III: Construction Contracts	(AS) 7 : Construction Contracts
<p>1. Recognition of contract costs and contract revenues with reference to stage of completion of the contract activity at the reporting date (percentage of completion method)</p>	<p>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.</p> <p>ICDS-III does not recognize that the possibility that outcome of a construction contract cannot be estimated reliably except during early stages of contract i.e. upto 25% stage of completion.</p>	<p>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. (AS) 7 specifies criteria as to when the outcome of a construction contract can be estimated reliably for fixed price contracts and cost plus contracts.</p>

ICDS-III Vs. (AS) 7

Points of comparison	ICDS III: Construction Contracts	(AS) 7 : Construction Contracts
<p>2. Early stages of completion of contract</p>	<p>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.</p>	<p>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. However, no definition as to upto what% of completion it can be considered that contract s at early stage.</p>

ICDS-III Vs. (AS) 7

Points of comparison	ICDS III: Construction Contracts	(AS) 7 : Construction Contracts
<p>3. Netting of costs by incidental income</p>	<p>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.</p>	<p>Costs that relate directly to the specific contract shall be reduced by any incidental income that is not included in contract revenue.</p> <p>Such netting off not allowed from –</p> <ul style="list-style-type: none"> (i) Costs that are attributable to contract activity in general and can be allocated to the contract; (ii) Such other costs as are specifically chargeable to the customer under the terms of the contract.

ICDS III – CONSTRUCTION CONTRACTS (Contd..)

ICDS-III Vs. (AS) 7		
Points of comparison	ICDS III: Construction Contracts	(AS) 7 : Construction Contracts
<p>4. Recognition of expected losses from contract</p> <p>Probable that total contract revenue will exceed contract cost</p>	<p>In proportion to percentage completion</p>	<p>To be recognized in immediately.</p>

ICDS-III Vs. (AS) 7

Points of comparison	ICDS III: Construction Contracts	(AS) 7 : Construction Contracts
5. Retentions	Retentions shall be included in contract revenue	(AS) 7 silent on retentions

ICDS-III Vs. (AS) 7

Points of comparison	ICDS III: Construction Contracts	(AS) 7 : Construction Contracts
6. Incentive payments & claims	If reliably measurable	✓ If reliably measurable ✓ Specified performance standards are met

Any Query ?

Thank
you

