

PANIPAT BRANCH OF NIRC OF ICAI

INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

Complied By :

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President -BVSS

Inherit power

How do ICDS as notified by the Central Government get their authority from ?

The Income Tax Act is a legislation to impose a liability to tax upon **a person** in respect of **its income**. The total amount of income **for a year** is computed and the **charge of income tax** is created on the total income.

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 2016-17

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 or exemption

Any Residential status

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 source***

Continuegive effect of ICDS

The Income Tax Return Forms ITR-4, ITR-5, ITR-6 notified for the Assessment Year 2016-17 contain a specific Schedule which requires disclosure of the monetary impact of each ICDS.

Whether on other ITR ICDS – Not applicable ?

Yes applicable

continuegive effect of ICDS

Requirement in return of Income

Part A- OI : other information

3. Effect on the profit because of deviation, if any as per Income Computation Disclosure Standards notified under section 145(2) (Column 11(iii) of Schedule ICDS)

Schedule ICDS : Effect of Income computation disclosure standards on Profit

Sl. No	ICDS	Amount
(i)	(ii)	(iii)
I	Accounting Policies	
II	Valuation of Inventories	
III	Construction 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)	

Continuegive 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	

continuegive effect of ICDS

Disclosure

Details and disclosure as are required under ICDS shall **probably** be required to be made in the Tax Audit Report (which may be modified to suit the requirements of ICDS).

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.

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.

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.**

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.

Carried forward of tax credit u/s 115JAA ????

Impact of ICDS under MAT contd....

- Also, accelerated income recognition may also result in duplicate levy of tax (i.e. normal tax in year of recognition as per ICDS and MAT in the year of recognition in books): -

	Contract-Completion Method	Book Profit	Add/ Less	Taxable Income (ICDS)
1 (25% work)	Services contract	0	+ 50,000	50,000
2 (75 % work)	Services contract	0	+1,00,000	1,00,000
3 100 % work	Services contract	2,00,000	-1,50,000	50,000

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)

Conflict between SC/HC rulings and ICDS

The AOs are expected to decide the issues in accordance with the provisions of the statute and also rely on the law laid down by the Hon'ble Supreme Court. Accordingly, to the extent the SC/ HC rulings contain an interpretation of the provisions of the Act, the same should prevail over ICDS.

For instance, various judicial rulings have propounded the real income theory. The Delhi High Court, in the case of CIT vs. Vashisht Chay Vyapar 330 ITR 440 has held, **based on the real income theory, that interest accrued on nonperforming assets of non-banking financial companies cannot be taxed until such time as such interest is actually received.** Would the contrary provisions of ICDS IV on revenue recognition change the position?

It would appear that the ruling will still continue to hold good even after the introduction of ICDS.

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 not notified

Where there is no specific ICDS notified, what is the effect on those transactions ?

- Prior period items
- Events after the Balance Sheet
- Lease
- Services concession arrangement – Build, operate and transfer (BOT) contracts or PPT Projects
- Etc.

ICDS –I

Accounting Polices

Scope
Deals with significant accounting policy

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

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**

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 01-04-2015 or entered into on or after 01-04-2015
- 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 31-03-2015

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

ICDS –II

valuation of inventories

Contd.... ICDS-II

What is the effect of not 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.***

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, 2014-15 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?

Contd.... ICDS-II

What is the value of opening stock?

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

Section 145A

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 ?

❖ **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 15.12.2015.
- 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 15.12.2015 with the firm?

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 01-04-2015,
- **shall be taken** into account for determining cost of such inventory for valuation as on close of previous year beginning on or after 01-04-2015,
- if such inventory **continue to remain** part of inventory as on close of the previous year beginning on or after 01-04-2015,

Contd.... ICDS-II

Disclosures

- The following aspects shall be disclosed:
- The **accounting policies** adopted in measuring inventories
- the **cost of formulae** used
- 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.

Contd.... ICDS-VI

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 assessee;**
- 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 :]

Contd.... ICDS-VI

What is provision relates non integral operations in ICDS which is different from AS ?

Contd.... ICDS-VI

AS-11-

Foreign Exchange Translation of Financial Statements:

- **Integral Foreign Operations** are Translated as if the transactions of foreign Operations are those of Reporting Enterprise itself.
- **Non Integral Foreign Operations:**
 - **Assets & Liabilities items – Closing Rates**
 - **Income & Expense items – Rate at the transaction date**
 - **Resulting Exchange Differences-** Accumulated in Foreign exchange translation Reserve until disposal of Net investment

ICDS : same above except resulting exchange differences

That shall be recognized for the purpose of computation of income

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

Contd.... ICDS-VI

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 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 and exchange gain or loss is recognized in the profit and loss account.

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 are recognized

✓ However, gains if any are ignored

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.

ICDS –VIII

Securities

Contd.... ICDS-VIII

Scope : -

Deal with securities in stock in hand

Not deal :

- held by person engaged in insurance business
- Securities held by mutual fund, venture capital fund banks and public financial institution

contd.... ICDS-VIII

- Securities on acquisition recognized at cost
- Unpaid interest at the time of acquiring of securities –pre-acquisition portion of interest reduced from cost

Contd.... ICDS-VIII

- Year end : Securities should be valued at lower of cost or net realizable value.
- When Securities are not listed or listed but not quoted regularly - **shall value at cost**
- The comparison of cost and NRV shall be done category wise and not for each individual security.
- The major heads of classification are (i) shares (ii) debt securities (iii) convertible securities (iv) any other securities

Contd.... ICDS-VIII - *Example*

Shares	Cost	NRV	Valuation as per AS 13	Valuation as per ICDS
			Lower of cost or NRV - Individual scrip wise	Lower of cost or NRV - Category wise
ABC Ltd.	100	40	40	
XYZ Ltd.	200	140	140	
PQR Ltd.	300	150	150	
EFG Ltd.	400	250	250	
LMN Ltd.	100	500	100	
Total	1100	1080	680	1080

Impact: Category wise valuation results into accelerated taxation since appreciation in the value of certain securities will be set off against diminution in the value of other securities.

Contd.....ICDS –VIII

How to value when securities acquired in exchange ?

ICDS, prescribes that when a security is acquired in exchange for other securities or for another asset, the fair value of the security so acquired shall be its actual cost.

Contd.....ICDS –VIII

Fair value : The amount for which as assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in arm's length transaction

Any Query ?

Thank
you

