

Income Computation and Disclosure Standards (ICDS)

Respected dignitaries in the dais and my dear friends, a very good evening to all present here.

The topic on which I am going to speak is one of the latest issues in the direct tax field.

It is *Income Computation and Disclosure Standards*.

The knowledge of these standards is vital for any professional working in the field of Income Tax. And every CA student should have a basic understanding of what it is. So sit tight and get ready to absorb all the things that I am going to bombard upon you for the next quarter of an hour.

Introduction

Income Computation and Disclosure Standards (shortly known as the ICDSs) are a set of standards that have been recently notified by the central government. They have come into force from the 1st of April 2015. **Hence they would apply for the assessment year 2016-17.** These standards will have to be followed by all assesses who follow the mercantile system of accounting.

In order to properly understand these standards, we must know where they came from.

Actually, the roots of these standards emerge from the Income Tax Act itself. Section 145 subsection (2) of the act empowers the central government to notify accounting standards that will have to be followed by all assesses for the purpose of income tax. And under this section, 2 accounting standards were notified which were known as the “Tax Accounting Standards”.

But over time, there was much confusion and various disputes arose over treatment of different items. Many court cases were lodged both by the assesseees as well as the income tax department and there was a lack of clarity with regards to various problems.

So to resolve this, the central government formed a committee in 2010. The committee carried out detailed research and in 2012, came up with **14 accounting standards**.

But the committee suggested that these Accounting Standards should be made applicable only for computation of taxable income and NOT for maintaining books of accounts.

They suggested that let the assessee **prepare books of accounts as they normally prepare**. But while they have to compute their income tax, they must first calculate their revised taxable income after applying these standards, and then pay tax and disclose their income accordingly.

The Standards

The government accepted this recommendation and this is the reason why these standards are called the income computation and disclosure standards.

The government has notified 10 ICDS –

ICDS Number	Name	Corresponds to
ICDS I	Accounting Policies	AS-1
ICDS II	Valuation of inventories	AS-2
ICDS III	Construction Contracts	AS-7
ICDS IV	Revenue Recognition	AS-9
ICDS V	Tangible Fixed Assets	AS-10
ICDS VI	The Effects of Changes in Foreign Exchange Rates	AS-11
ICDS VII	Government Grants	AS-12
ICDS VIII	Securities	AS-13
ICDS IX	Borrowing Costs	AS-16
ICDS X	Provisions, Contingent Assets and Contingent Liabilities	AS-29

It is indeed interesting to observe that the names of these standards are similar to the names of the Accounting Standards. But keep in mind that only the names are similar, not the content.

Each of the ten notified ICDSs has a scope paragraph that explains what the ICDS deals with and what it does not deal with. An important point to note is that, in case of any conflict between the Income Tax Act and the ICDSs, the provisions of the act shall prevail.

Unfortunately, we do not have the time to elaborate upon each of these standards separately.

But we will discuss those ICDS that have **some unique and controversial provisions**. There are some provisions that significantly deviate from the accounting

standards as well as many court decisions. We will analyse them and try to understand the implications that they may have in the computation of taxable income.

ICDS I

It is the standard on accounting policies.

ICDS I recognises the accounting assumptions of going concern, consistency and accrual.

Thus,

- You need to value assets at cost.
- Your accounting policies must be applied consistently.
- And you must follow the mercantile system of accounting.

This all is normal.

But ICDS I DOES NOT RECOGNISES the accounting concept of **prudence**.

The age old concept of prudence, which is also known as the concept of **Conservatism**, and which has always been applied as a fundamental accounting assumption, has been omitted from ICDS I.

You will recall that the concept of prudence requires that all known liabilities and losses be recognised immediately, even if the amount cannot be estimated with reasonable certainty. It also states that profits should not be recognised in the books unless it is virtually certain that they shall accrue.

Imagine what would happen if the principle of prudence is not applied.

We will not recognise losses that have not actually accrued. We will also start booking profits a little earlier.

The net effect will be that the overall profit will rise, hence raising the taxable income.

On the other hand, ICDS I also does not recognise the principle of **Materiality**.

Thus, we will have to record transactions of even very small amounts and account for assets of small monetary values, hence increasing compliance burden.

In all, we observe that the provisions of ICDS I are quite radical and challenging.

Now we shall move on to another interesting provision.

ICDS III

The standard on Construction Contracts

The hallmark of the Accounting Standard on construction contracts, that is, AS-7 is that it requires a provision to be made of expected loss.

It requires that if any future loss is expected on a contract, then a provision be made of expected loss irrespective of whether the contract has started or not and irrespective of the stage of completion of the contract.

ICDS I DOES NOT ALLOWS such provisions. It automatically implies that even losses would have to be recognized on the “Percentage of Completion Method” basis. Hence we will have to recognize losses at a later date. Postponement of the recognition of losses would ultimately lead to **Preponement of tax liability**. It can also lead to double taxation in some cases due to application of Minimum Alternate Tax.

This is also against one of the court decisions wherein it was upheld that provision for expected loss should be allowed as tax deduction as long as it is made in compliance of the accounting standards.

ICDS VI

The effects of changes in foreign exchange rates

This standard corresponds to Accounting Standard 11.

You will recall that AS-11 provides the treatment of exchange differences that arise during consolidation of the accounts of foreign branches.

It classifies foreign branches into two –

1. An Integral Foreign Operation (IFO)
2. A Non-Integral Foreign Operation (NIFO)

The area where ICDS VI deviates from AS-11 is in case of a non-integral foreign operation.

AS-11 requires that exchange difference from a NIFO be accumulated in a **“foreign currency translation difference account”**.

Whereas ICDS VI requires that even such exchange difference should be recognized as income or expense in that previous year.

The effect of this provision can be guessed easily.

Due to currency fluctuations, it will lead to volatility in income and hence income tax liability.

ICDS IX vis-à-vis AS-16

As per AS-16, interest on funds borrowed for the purchase, acquisition or construction of a qualified asset should be capitalized.

But if the funds are temporarily invested elsewhere, the income so earned is to be deducted from the borrowing costs and the remaining borrowing cost is to be capitalized.

ICDS IX, however, does not permit such treatment.

It requires that the interest earned on the temporary investment be recognized as income.

This will ultimately result in the increase of taxable income.

Conclusion

So we have observed various deviations between the accounting standards and the ICDS. But there are many more that have not been discussed. I have described only a few of them.

We also observe that the overall impact of most ICDSs is the advancement of income recognition and postponement of the recognition of losses.

The ICDSs, in many areas, also **deviate significantly from various court decisions**, thus it is probable that it will lead to more disputes and litigations instead of reducing them.

Some provisions of ICDS are so cumbersome, for example the absence of materiality concept, that it would necessitate maintenance of separate records, and hence increase in compliance costs.

It is hoped that the various problems that are arising would be solved and the transition towards ICDS would be a smooth one.