Demystifying Revised ICDS

Contents

Background

Journey so far !

1995	▶ Income Tax Act, 1961 (ITA) amended to give power to Central Government (CG) to notify tax accounting standards (s.145(2))
Jan 1996	▶ CG notified two standards comparable to ICAI AS-1 and AS-5 viz. 1. Disclosure of Accounting Policies and 2. Disclosure of Prior Period and Extraordinary Items and Changes in Accounting Policies
Mar 2015	▶ New set of 10 ICDS notified w.e.f. FY 2015-16
May 2015	▶ Amendments to align ITA with ICDS

Journey so far !

Nov 2015	► CG invited public suggestions on implementation issues
Jan 2016	► Justice Easwar Committee recommended deferment
April 2016	► Return forms amended to disclose ICDS impact
July 2016	► CG announced deferment of ICDS by one year; ICDS to be revised and FAQs to be issued
September 2016	► Revised 10 ICDS issued w.e.f FY 2016-17; Tax Audit Report amended to include ICDS disclosures

Distance yet to be covered !!

Issue	Status
▶ FAQs on ICDS	▶ Under consideration of CG
▶ MAT framework for Ind-AS companies	▶ Final Report submitted to CBDT (yet to be considered)
▶ To suggest appropriate amendments to the ITA for Ind-AS companies	▶ No visibility as yet on any proposed changes to ITA

ICDS – General Principles

ICDS – General Principles

- Effective from F.Y. 2016-17 onwards
- Applies only to taxpayers following mercantile method of accounting
  - Applicable for two heads of income viz. Profits & Gains of Business & Profession and Income from other sources
- Does not apply to individuals and HUFs not liable to tax audit
- No separate books of account to be maintained
  - Impact to be given in computation of taxable income

ICDS – General Principles

- ICDS is largely borrowed from IGAAP with carve-outs
- Contains main principles only; no explanations or illustrations provided
- Notified ICDS do not address all IGAAP/Ind-AS items
- MAT continues as per book treatment (IGAAP or Ind-AS)

ICDS – Principles of construction

- Provisions of ITA to prevail in case of conflict with ICDS
- Undefined words/expression take their meaning from ITA
- No clarity as yet on interplay with tax jurisprudence

Hierarchy of ICDS

- Specific statutory provisions (ITA)
- Income tax rules
- Real income theory
- Tax jurisprudence on above
- ***ICDS***
- Commercial principles of accounting

ICDS – Transitional Provisions

- Committee's intent – ICDS should not result in double taxation or escape from taxation
- Complete grandfathering for construction and service contracts commenced prior to 1 April 2016
- No 'grandfathering' for any other items – ICDS to be applied after reckoning incomes/ deductions recognised prior to 1 April 2016

Transitional Provisions – Grandfathering of construction and service contracts

Date of commencement of contract	Book treatment	Tax treatment	Key difference amongst others
► Prior to 1 April 2016	IGAAP/ Ind-AS	IGAAP/Ind-AS	Foreseeable loss on onerous contract can be recognised
► On or after 1 April 2016	IGAAP/ Ind-AS	ICDS III	Foreseeable loss on onerous contract cannot be recognised

Revisions to ICDS II - Valuation of inventory

WIP in case of ‘service provider’

ICAI AS-2	Excluded
2015 ICDS	▶ Ambiguous ▶ ‘Cost of services’ refers to ‘service provider’
2016 ICDS	▶ Ambiguity continues ▶ But ‘service provider’ reference omitted

Standard costing technique

ICAI AS-2	Permissible
2015 ICDS	Ambiguous in view of omission
2016 ICDS	Permitted if standard cost approximates actual cost

Average % for each retail department under retail method

ICAI AS-2	Permissible (‘is often used’)
2015 ICDS	Ambiguous in view of omission
2016 ICDS	Mandatory (‘is to be used’)

Specific provisions of s.145A (which requires inventory to be valued at book value and further increased by tax, duties, etc.) will override ICDS

General spares (not specific to any capital asset)

Revised ICAI AS-2/10	Treated as Property, Plant & Equipment (PPE) if useful life > 12 m Else, treated as Inventory
ICDS II and V	Treated as inventory Charged to revenue as and when consumed

Illustration

X Co purchased general machinery spares with useful life > 12 m on 15th April 2016

Book treatment as per revised ICAI AS-2/10	PPE to be depreciated over useful life
Tax treatment	View 1 – Depreciate over useful life as per books View 2 – Treat it as inventory as per ICDS II/V
Issue	How does s.145A impact conclusion?

Revisions to ICDS IV – Revenue Recognition

Service Contracts

ICAI AS-9	Provides choice between Percentage of Completion Method (POCM) and Completed contract method
2015 ICDS	► Mandatory to follow POCM without any time or value threshold ► Stage of completion to be determined w.r.t Cost incurred or Survey or Physical proportion
2016 ICDS	► Mandatory to follow POCM only if contract duration > 90 days ► Permits straight line method (SLM) for time based contracts (like AMC)

Illustration – Service Contracts

Particular	Service contracts ≤ 90 days	Service contracts > 90 days
Book treatment (assumed)	Completed contract method	Completed contract method
Tax treatment (2016 ICDS)	► As per books ► WIP to be recognised at year end?	► POCM is mandatory ► No WIP since revenue is recognised on POCM basis ► Revenue for work completed till 31 March 2016 but unbilled?

Interest on tax refunds

ICAI AS-9	No special treatment; Time basis
2015 ICDS	► Same as ICAI AS-9
2016 ICDS	► Receipt basis

Revisions to ICDS VI – Foreign exchange fluctuations

Distinction between integral & non-integral foreign operations

ICAI AS-11	Yes
2015 ICDS	Yes
2016 ICDS	No (Non-integral FO to be treated as integral FO)

Illustration – Independent foreign branch

Independent Foreign Branch

ICAI AS-11

- Translated at year end rate and accumulated in FCTR

ICDS 2016

Capital Items like building, furniture, fixtures etc.

- No translation
- Related loan liability translation covered by s.43A – to be capitalised on settlement basis

Working capital items like Drs, Crs, Bank balances etc

- Translated at year end rate and recognised as income/expense
- Recognition of opening FCTR balance as on 1 April 2016?

Exchange rate for converting non-monetary items valued at cost/ NRV

ICAI AS-11	Rate which existed when cost or NRV was determined
2015 ICDS	No translation
2016 ICDS	Rate which existed when cost or NRV was determined

Revisions to ICDS VIII – Securities (held as stock in trade)

Shares of closely held company

ICAI AS	No specific standard
2015 ICDS	No specific inclusion in the definition of 'Securities'
2016 ICDS	Specifically included in the definition of 'Securities'

Conflict with CBDT Instruction dt. 2 May 2016 which directs Tax Authorities to treat unlisted shares as Capital asset

Weighted average method for valuation of securities

ICAI AS	No specific standard
2015 ICDS	Not permitted
2016 ICDS	Permissible

Securities held by Banks/PFIs (including derivatives)

ICAI AS	Governed by RBI Guidelines
2015 ICDS	Scope exclusion
2016 ICDS	► Valuation as per RBI Guidelines to be recognised for tax purposes ► Overrides ICDS VI (to the extent relating to forward exchange contracts) ► By implication, permits recognition of MTM loss on forward contracts offered to constituents, cross currency swaps, interest rate swaps etc. if permitted by RBI Guidelines

Revisions to ICDS IX - Borrowing Cost

Qualifying capital asset for the purposes of capitalisation of general borrowing costs

ICAI AS-16	Which takes 'substantial period' of time (generally > 1 year) to get ready for use/ sale
2015 ICDS	No threshold period
2016 ICDS	► Which takes > 12 m to get ready for use/ sale (relevant for general purpose borrowing only) ► But no threshold for specific borrowings

Cessation of capitalisation of general borrowing costs

ICAI AS	When asset is ready for use/ sale
2015 ICDS	Ambiguity existed on interpretation of normative formula whether period multiplier to be considered
2016 ICDS	▶ When asset is put to use/ ready for sale ▶ Clarifies applicability of period multiplier

Concluding thoughts

Other issues

- Mismatch of effective date for taxation of capital subsidies
  - Amendment in ITA – F.Y. 2015-16 onwards
  - ICDS VII – F.Y. 2016-17 onwards
- Omission of 'materiality' as a consideration for selection & application of accounting policy
- MTM loss on derivatives not permitted (except for scheduled banks/PFIs)
- Mismatch with MAT due to timing differences between book profit and tax profit

Way forward for Taxpayers

- Revisions in ICDS do not adequately address all concerns of taxpayers
- FAQs on implementation issues are still awaited
- Evaluate impact on F.Y. 2015-16 returns already filed/to be filed – whether any revision required?
- Revision in advance tax estimates for F.Y. 2016-17

Thank you