

Income Computation and Disclosure Standards



ANALYSIS BY
CA. TEJAS ANDHARIA
B. COM, F.C.A., D.I.S.A.(ICAI), D.I.R.M.(ICAI)

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About the Author.



- ✚ CA. Tejas K. Andharia is Practicing Chartered Accountant from last 10 years.
- ✚ He is honorary visiting lecturer at some educational institutions to impart knowledge to B. Com, MBA and CA students for last 8 years.
- ✚ He has delivered CPE lectures at Bhavnagar, Ahmedabad, Rajkot and Surat on diversified topics.
- ✚ He was an editor-in-chief of e-newsletter of Bhavnagar Branch of WIRC of Institute of Chartered Accountants of India.
- ✚ He was writing the column “Technology Aspirant” in e-newsletter of Bhavnagar Branch of WIRC of Institute of Chartered Accountants of India.
- ✚ He was an elected managing committee member of Bhavnagar Branch of WIRC of Institute of Chartered Accountants of India.
- ✚ At present, he is President of Bhavnagar Chartered Accountants’ Association (for last two consecutive terms).
- ✚ His articles are published on various national level websites like www.taxguru.in, www.caclubindia.com etc.
- ✚ He has developed many utilities in MS Excel and VBA of general and special use.
- ✚ He has wrote and published “Shayarana” (The Gujarati Ghazals)
- ✚ Links of Articles of Author
 - ❖ Taxguru.in : <https://goo.gl/4Lvhb6>
 - ❖ Caclubindia.com : <https://goo.gl/CUVt97>
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 - ❖ Youtube Channel: <https://goo.gl/sbkJVt>
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 - ❖ Youtube: <https://goo.gl/HN6M5A>

Preface:

It's my pleasure to publish this e-book on Income Computation and Disclosure Standards. This e-book is an attempt to summarize the relevant provisions of Income Computation and Disclosure Standards in comparison with provisions of Accounting Standards. Relevant sections of Income Tax Act, 1961 are also discussed at appropriate places.

My lectures in series of meetings on ICDS (jointly organized by Bhavnagar C. A. Association and Bhavnagar Income Tax Bar Association) inspired me to write this e-book.

I hope this e-book will be helpful not only to practicing CAs and Income Tax Practitioners, but also to students of professional courses like CA/CS/CWA.

Readers may just go to the “contents” page and click on link of relevant chapter, it will automatically redirect the reader to concerned page.

I am thankful to almighty god who gave me the morale to write this e-book.

Suggestions, criticism and guidance are most welcome from readers of this e-book.

CA. Tejas K. Andharia
B. COM, F.C.A., D.I.S.A.(ICAI), D.I.R.M.(ICAI)
103, Eva Surbhi, Opp. Aksharwadi,
Waghawadi Road,
Bhavnagar, Gujarat
Email: tejasinvites@gmail.com

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Chapter – 1 : Background of ICDS and certain general aspects

- Accounting Standards (AS): Roots of ICDS are in accounting standards. An accounting standard is a principle that guides and standardizes accounting practices. Accounting standards are concerned with the preparation, presentation and disclosure requirements regarding books of accounts. These are drafted by ICAI.
- The CBDT had constituted an Accounting Standard Committee in year 2010 and this committee had drafted 14 Tax Accounting Standards (though they were not made applicable).
- First time, ICDS were notified by Central Govt. by issuing **notification no. 32/2015 dated 31/03/2015** (applicable for FY 2015-16 and onwards). Thereafter, The Direct Taxes Committee of ICAI has made Representation to the CBDT for deferment of implementation of ICDS, due to difficulties that would be faced by stakeholders on implementation of ICDS w.e.f. 01/04/2015. The representations made by ICAI were considered positively by the CBDT's Expert Committee on ICDS and the ICAI was asked to prepare FAQs and recommend amendments to ICDS. Thereafter, CBDT had asked for the suggestions / comments from various stakeholders by issuing **press release dated 26/11/2015**. Thereafter, by **press release dated 06/07/2016**, CBDT had clarified – “Some of the tax payers might have filed their return of income and obtained Tax Audit Report without incorporating the compliance with the ICDS and related disclosures in the absence of the revised Tax Audit Report. Considering these facts, it has been decided that the ICDS shall be applicable from 1.4.2016 i.e. previous year 2016-17 (Assessment Year 2017- 18). The notification to this effect will be issued shortly.”
- Finally, ICDS are again notified (**Notification No. 87/2016 dated 29/09/2016**) by Central Government by exercising the powers conferred by section 145(2) of Income-tax Act, 1961.

➤ **Notification No. 87/2016 dated 29/09/2016** says that Income Computation and Disclosure Standards as specified in the Annexure to this notification to be followed by **all assessees** (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB of the said Act) following the **mercantile system of accounting**, for the purposes of computation of income chargeable to income-tax under the head “Profits and gains of business or profession” or “Income from other sources” for A.Y. 2017-18 and onwards.

- ✓ Applicable for A.Y. 2017-18 (FY 2016-17) and onwards
- ✓ To all assessees except.....
- ✓ Who are following mercantile / accrual system of accounting
- ✓ And who have income chargeable to income-tax under the head “Profits and gains of business or profession” or “Income from other sources”

➤ In other words, ICDS are **not applicable** in any of the following cases

- ✓ Cases for A.Y. 2016-17 (FY 2015-16) or earlier years.
- ✓ Individual or a HUF who is not required to get his/its accounts of the previous year audited in accordance with the provisions of section 44AB of the Act
- ✓ Those are following cash system of accounting
- ✓ Those who don't have income chargeable to income-tax under the head “Profits and gains of business or profession” or “Income from other sources”.

➤ By above mentioned notification, central government has notified 10 ICDS. In Preamble to each ICDS, it is clearly mentioned that (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 accounts. (2) In the case of conflict between the provisions of the Income-tax Act, 1961 and the Income Computation and Disclosure Standard, the provisions of the Act shall prevail to that extent.

Further by issuing Circular no. 10/2017 dated 23/03/2017, CBDT has reiterated that ICDS are only for the computation of income and not for the purpose of maintenance of books of accounts.

- Whether inconsistent judicial precedents shall prevail over ICDS?

Answer: CBDT Circular no. 10/2017 dated 23/03/2017 says that The ICDS have been notified after due deliberation and after examining judicial view for bringing certainty on the issues covered by it. Since certainty is now provided by notifying ICDS, the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to AY 2017-18 and subsequent AYs.

In my opinion, in those matters, where the issue will arise as to the contradictions between Act and ICDS, final interpretation of judicial channel will be final and in other matters like methods of computation of income mentioned in ICDS, earlier judicial pronouncements will be superseded by ICDS.

- If there is a conflict between ICDS and other specific provisions of the Income-tax rules, 1962 (the Rules), which provisions shall prevail?

Answer: ICDS provides general provisions of computation of income. So, in case of such conflict, the provisions of Rules, which deal with specific circumstances, shall prevail (CBDT Circular no. 10/2017 dated 23/03/2017)

- In case of assesseees who are covered under the provisions of presumptive taxation (hence not required to maintain books of accounts), whether these ICDS will be applicable?

Answer: As has been said earlier ICDS has nothing to do with maintenance of books of accounts, but only computation of income. Further even in case of presumptive taxation, assessee is required to establish turnover, so it will be governed by ICDS – III on Construction Contracts and/or ICDS – IV on Revenue Recognition as the case may be. (Supported by CBDT Circular no. 10/2017 dated 23/03/2017).

- 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 Income-tax Act, 1961?

Answer: MAT is computed on book profits subject to certain specified adjustments mentioned under the Act. Since the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, provisions of ICDS shall not apply to the computation of MAT.

AMT is computed on adjusted total income, which is derived by making specified adjustment to total income computed as per normal provisions of the Act. Hence, ICDS shall apply to AMT (CBDT Circular no. 10/2017 dated 23/03/2017).

- 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 on securities contains specified provisions for banks and certain financial institutions and Schedule – I of the Act contains specified provisions for the insurance business. (CBDT Circular no. 10/2017 dated 23/03/2017).

➤ Following is the list of ICDS.

- ❖ ICDS I relating to Accounting Policies (corresponding to AS-1)
- ❖ ICDS II relating to Valuation of Inventories (corresponding to AS-2)
- ❖ ICDS III relating to Construction Contracts (corresponding to AS-7)
- ❖ ICDS IV relating to Revenue Recognition (corresponding to AS-9)
- ❖ ICDS V relating to tangible Fixed Assets (corresponding to AS-10)
- ❖ ICDS VI relating to the Effects of Changes in Foreign Exchange Rates (corresponding to AS-11)
- ❖ ICDS VII relating to Government Grants (corresponding to AS-12)
- ❖ ICDS VIII relating to Securities (corresponding to AS-13)
- ❖ ICDS IX relating to Borrowing Costs (corresponding to AS-16)
- ❖ ICDS X relating to Provisions, Contingent Liabilities and Contingent Assets (corresponding to AS-29)

- By notification no. 88/2016 dated 29/09/2016, Form no. 3CD is also modified to incorporate ICDS effects and disclosures.
- Section 145 (on method of accounting) of Income Tax Act, 1961 reads as under.

145. (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 income computation and disclosure standards to be

followed by any class of assessee or in respect of any class of income.

(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.

- Is there any section in Income Tax Act, 1961 which overrides Section 145 as mentioned above?

Answer: Yes. Section **145A** which reads as under.

145A. Notwithstanding anything to the contrary contained in section 145,—

(a) 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—

- (i) in accordance with the method of accounting regularly employed by the assessee; and
- (ii) 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;

(b) interest received by an assessee on compensation or on enhanced compensation, as the case may be, shall be deemed to be the income of the year in which it is received.

- Transitional provisions are given in each ICDS except ICDS VIII on Securities.
- In Tax Audit Report, where to give effect / Disclosures of ICDS?

Answer: Clause no. 13(d) Form No. 3CD: 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)

Clause no. 13(e) Form No. 3CD: If answer to (d) above is in the affirmative, give details of such adjustments as under:

Effect of		Increase in profits (Rs.)	Decrease in profits (Rs.)	Net (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
	Total			

Clause no. 13(f) Form No. 3CD: Disclosure as per ICDS as under:

(i)	ICDS I-Accounting Policies
(ii)	ICDS II-Valuation of inventories

(iii)	ICDS III-Construction Contracts
(iv)	ICDS IV-Revenue Recognition
(v)	ICDS V-Tangible Fixed Assets
(vi)	ICDS VII-Governments Grants
(vii)	ICDS IX Borrowing Costs
(viii)	ICDS X-Provisions, Contingent Liabilities and Contingent Assets”.

[N.B. : ICDS VI on Changes in Foreign Exchange Rates and ICDS VIII on Securities are not mentioned in clause 13(f)]

➤ In ITR, where to give effect / Disclosures of ICDS?

Answer: ICDS related reporting is only in ITR-3, ITR-5 and ITR-6. Though we have noted earlier that even in case of presumptive income, to establish the turnover relevant ICDS will have to be applied, it is omitted to include such reporting in ITR-4 (Sugam). Most likely, from next A.Y., it will be incorporated in it.

In ITR-3, ITR-5 and ITR-6, In part A-OI (other information), point no. 3 reads as “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]”

Further, in all these three ITRs, Schedule – ICDS [After Schedule – UD (unabsorbed depreciation)] is there which is reproduced below.

Sl. No.	ICDS	Amount (+) or (-)
(i)	Accounting Policies	
(ii)	Valuation of inventories	
(iii)	Construction Contracts	
(iv)	Revenue Recognition	
(v)	Tangible Fixed Assets	
(vi)	Changes in Foreign Exchange Rates	

(vii)	Governments Grants	
(viii)	Securities	
(ix)	Borrowing Costs	
(x)	Provisions, Contingent Liabilities and Contingent Assets”.	

There is not any separate disclosure requirements regarding ICDS in ITRs.

Chapter – 2 : ICDS – I Accounting Policies

- This Income Computation and Disclosure Standard deals with significant accounting policies.
- Fundamental Accounting Assumptions: All the three fundamental accounting assumptions of Going Concern, Consistency and Accrual are same as those mentioned in AS-1.
- Considerations in the Selection of Accounting Policies: Accounting policies adopted by a person shall be such so as to represent a **true and fair view** of the state of affairs and income of the business, profession or vocation. For this purpose,
 - ✓ the treatment and presentation of transactions and events shall be governed by their **substance and not merely by the legal form**; and
 - ✓ marked to market loss or an expected loss shall **not** be recognised unless the recognition of such loss is in accordance with the provisions of any other Income Computation and Disclosure Standard.
 - ✓ In same way, marked to market gains or expected profit shall also not be recognized unless the recognition of such gain is in accordance with the provisions of any other Income Computation and Disclosure Standard. (CBDT Circular no. 10/2017 dated 23/03/2017)

Here it is to be noted that “true and fair view and “substance over legal form” are in line with AS-1. But, principle of Prudence / Conservatism is ignored, as expected loss will not be taken into consideration except it is in line with some other ICDS. Prima facie, concept of Materiality seems to have been omitted in ICDS-I which is there in AS-1. But, one thing to be noted is, this ICDS says about “**Significant**” accounting policies in its **scope** para. Hence, Materiality is still there in hidden way. Further on the next page (in

disclosure para) you may note down the usage of word “**material**” for four times.

- Change of Accounting Policies: An accounting policy shall not be changed without **reasonable cause**.

This is not totally in line with AS-5 which says that (para 29 of AS-5) a change in an accounting policy should be made **only if** (1) the adoption of a different accounting policy is required **by statute** or (2) for **compliance with an accounting standard** or (3) if it is considered that the change would result in a **more appropriate presentation of the financial statements** of the enterprise.

As per CBDT clarification (by its Circular no. 10/2017 dated 23/03/2017), 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.

- Disclosure of Accounting Policies:

- ✓ All **significant** accounting policies adopted by a person shall be disclosed.
- ✓ Any change in an accounting policy which has a **material** effect shall be disclosed. The amount by which any item is affected by such change shall also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact shall be indicated. If a change is made in the accounting policies which has no **material** effect for the current previous year but which is reasonably expected to have a **material** effect in later previous years, the fact of such change shall be appropriately disclosed in the previous year in which the change is adopted and also in the previous 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.

- ✓ If the fundamental accounting assumptions of Going Concern, Consistency and Accrual are followed, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact shall be disclosed.

All these disclosures are in line with AS-1.

- In case of assessee who is not liable to tax audit, where to make disclosures as per ICDS?

Answer: There shall not be any separate disclosure requirement for persons that are not liable to tax audit. Only fill up Schedule – ICDS in relevant ITR and give its effect in part A-OI (other information). [CBDT Circular no. 10/2017 dated 23/03/2017]

- Transitional Provisions: All contract or transaction existing on the 1st day of April, 2016 or entered into on or after the 1st day of April, 2016 shall be dealt with in accordance with the provisions of this standard after taking into account the income, expense or loss, if any, recognised in respect of the said contract or transaction for the previous year ending on or before the 31st March, 2016.

So, if some loss has already been recognized on expected or on mark to market basis in previous year ending on or before the 31st March, 2016, effect of its reversal will have to be given in Schedule – ICDS in ITR-3 or ITR-5 or ITR-6 and in clause 13 of Form No. 3CD if tax audit is also applicable.

Mind well that no reverse entry shall be passed in books of accounts of such already recognized losses, as books of accounts are still governed by Accounting Standards (AS) / Ind AS and not by ICDS.

Chapter – 3 : ICDS – II Valuation of inventories

- Inventories shall be valued at cost, or net realisable value, whichever is lower. This is totally in line with AS-2. [Surprisingly this option is not given in ITRs. They are continued with three old options namely (1) At cost or market value whichever is lower (2) at cost and (3) at market value.]. Mind well, market value and net realizable value are different. “Net realisable value” is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
- “Inventories” are assets:
 - a. held for sale in the ordinary course of business;
 - b. in the process of production for such sale;
 - c. in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- Specific identification method, First-in First-out method and Weighted Average Cost Formula are same in AS-2 and ICDS – II. Standard cost method and retail cost methods are also same.
- Costs of Purchase: 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. Whereas in AS-2, duties and taxes subsequently recoverable by the enterprise from the taxing authorities do not form part of cost of purchase. This is so because section 145A which overrides section 145 makes it mandatory to value the purchase, sales and stock inclusive of all duties and taxes whether any right arising as a consequence to such tax payment or not.

- Interest and other borrowing costs shall not be included in the costs of inventories, unless they meet the criteria for recognition of interest as a component of the cost as specified in the Income Computation and Disclosure Standard on borrowing costs. But, AS-2 denies to consider interest as a cost of inventory. Though Accounting Standards Interpretation (ASI) – 1, para no. 8 says that it is only in exceptional cases, where time is a major factor in bringing about change in the condition of inventories that borrowing costs are included in the valuation of inventories.
- This Income Computation and Disclosure Standard shall be applied for valuation of inventories, except :
 - a. Work-in-progress arising under ‘construction contract’ including directly related service contract which is dealt with by the Income Computation and Disclosure Standard on construction contracts;
 - b. Work-in-progress which is dealt with by other Income Computation and Disclosure Standard; **[Not in AS-2]**
 - c. Shares, debentures and other financial instruments held as stock-in-trade which are dealt with by the Income Computation and Disclosure Standard on securities;
 - d. Producers’ inventories of livestock, agriculture and forest products, mineral oils, ores and gases to the extent that they are measured at net realizable value;
 - e. Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the Income Computation and Disclosure Standard on tangible fixed assets. **[Not in AS-2]**

Further AS-2 excludes from its scope, work in progress arising in the ordinary course of business of service providers, but in ICDS it is also covered. Therefore ICDS – II, in its para no. 6 says that the costs of services shall consist of labour and other costs of personnel directly

engaged in providing the service including supervisory personnel and attributable overheads.

- Value of Opening Inventory: The value of the inventory as on the beginning of the previous year shall be
 - ✓ 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
 - ✓ the value of the inventory as on the close of the immediately preceding previous year, in any other case.
- Change of Method of Valuation of Inventory: The method of valuation of inventories once adopted by a person in any previous year shall not be changed without **reasonable cause**.
- Valuation of Inventory in Case of Certain Dissolutions: In case of dissolution of a partnership firm or association of person or body of individuals, notwithstanding whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realisable value. **[No such provision in AS-2]**
- Transitional Provisions: Interest and other borrowing costs, which do not meet the criteria for recognition of interest as a component of the cost as per para 11, but included in the cost of the opening inventory as on the 1st day of April, 2016, shall be taken into account for determining cost of such inventory for valuation as on the close of the previous year beginning on or after 1st day of April, 2016 if such inventory continue to remain part of inventory as on the close of the previous year beginning on or after 1st day of April, 2016.
- Disclosure : The following aspects shall be disclosed, namely:—
 - (a) the accounting policies adopted in measuring inventories including the cost formulae used. Where Standard Costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost; and
 - (b) the total carrying amount of inventories and its classification appropriate to a person.

Chapter – 4 : ICDS-III Construction Contracts

- This Income Computation and Disclosure Standard should be applied in **determination of income** for a construction contract **of a contractor**.
- A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:
 - (a) the group of contracts is negotiated as a single package;
 - (b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and
 - (c) the contracts are performed concurrently or in a continuous sequence.

[In line with AS-7]

- Contract revenue shall comprise of:
 - (a) the initial amount of revenue agreed in the contract, **including retentions**; and
 - (b) variations in contract work, claims and incentive payments:
 - I.) to the extent that it is probable that they will result in revenue; and
 - II.) they are capable of being reliably measured.

AS-7 is silent about inclusion of retentions in contract revenue. “**Retentions**” are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.

➤ Contract costs shall comprise of :

- (a) costs that relate directly to the specific contract;
- (b) costs that are attributable to contract activity in general and can be allocated to the contract;
- (c) such other costs as are specifically chargeable to the customer under the terms of the contract; and
- (d) allocated borrowing costs in accordance with the Income Computation and Disclosure Standard on Borrowing Costs.

These costs shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in contract revenue. (This last sentence is not there in AS-7)

➤ Recognition of Contract Revenue and Expenses:

- ✓ **ICDS-III:** Contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. Further **para 20** says during the **early stages** of a contract, where the outcome of the contract **cannot be estimated reliably** contract revenue is recognised **only to the extent of costs incurred**. The early stage of a contract shall not extend beyond 25 % of the stage of completion.
- ✓ **AS-7:** When the outcome of a construction contract can be estimated reliably (qualitative conditions are there for deciding outcome of construction contracts which are laid down under para 22 and para 23), contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction

contract should be recognised as an expense immediately in accordance with paragraph 35. Para 35 says that when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognised as an expense immediately.

- The stage of completion of a contract shall be determined with reference to:
 - ✓ the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or
 - ✓ surveys of work performed; or
 - ✓ completion of a physical proportion of the contract work.

Progress payments and advances received from customers are not determinative of the stage of completion of a contract.

This is in line with AS-7.

➤ **Transitional Provisions:**

- ✓ Contract revenue and contract costs associated with the construction contract, which commenced **on or after** 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.
- ✓ 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 recognised based on the method regularly followed by the person **prior** to the previous year beginning on the 1st day of April, 2016.

➤ **Disclosure:**

- ✓ 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.
- ✓ 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) upto the reporting date;
 - the amount of advances received; and
 - the amount of retentions.
- In case of assesseees who are covered under the provisions of presumptive taxation (hence not required to maintain books of accounts), whether these ICDS will be applicable?

Answer: As has been said earlier ICDS has nothing to do with maintenance of books of accounts, but only computation of income. Further even in case of presumptive taxation, assessee is required to establish turnover, so it will be governed by ICDS – III on Construction Contracts and/or ICDS – IV on Revenue Recognition as the case may be. (Supported by CBDT Circular no. 10/2017 dated 23/03/2017).

- Whether the recognition of retention money, the receipt of which is contingent on the satisfaction of certain performance criterion is to be recognised as revenue on billing?

Answer: Retention money, being part of the overall contract revenue, shall be recognised as revenue **subject to reasonable certainty of its ultimate collection** condition contained in para 9 of ICDS-III on construction contracts (CBDT Circular no. 10/2017 dated 23/03/2017).

- Whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. In addition, whether ICDS is applicable for leases?

Answer: At present there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, the relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable. (CBDT Circular no. 10/2017 dated 23/03/2017).

Chapter – 5 : ICDS-IV Revenue Recognition

- This Income Computation and Disclosure Standard deals with the bases for **recognition of revenue** arising in the course of the **ordinary** activities of a person from
 - I.) the sale of goods;
 - II.) the rendering of services;
 - III.) the use by others of the person's resources yielding interest, royalties or dividends.

(This is in line with AS-9)

- “Revenue” is the **gross** inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the **sale of goods**, from the **rendering of services**, or from the use by others of the person's **resources yielding interest, royalties or dividends**. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration. **(This is in line with AS-9)**
- Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.
- **Sale of Goods:** In a transaction involving the sale of goods, the revenue shall be recognised when the seller of goods has transferred to the buyer the property in the goods for a price **or** all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership. In a situation, where transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognised at the time of transfer of significant risks and rewards of ownership to the buyer.

Revenue shall be recognised when there is reasonable certainty of its ultimate collection.

Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved. **(This is in line with AS-9)**

- **Rendering of Services:** Subject to Para 7, revenue from service transactions shall be recognised by the percentage completion method. The requirements ICDS-III “Construction Contracts” shall mutatis mutandis apply to the recognition of revenue and the associated expenses for a service transaction. However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period. Para 7 says that Revenue from service contracts with duration of **not** more than 90 days may be recognised when the rendering of services under that contract is completed or substantially completed. **(Thus completed service contract method can be applied only to the limited extent laid down under para 7 of ICDS-IV)**

Whereas under AS-9, revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

- **The Use of Resources by Others Yielding Interest, Royalties or Dividends:**

✓ **Interest:**

- 1) Subject to sub paragraph (2), interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.
- 2) Interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received. **[On similar line with Section 145A(b) of I T Act, 1961]**

3) Discount or premium on debt securities held is treated as though it were accruing over the period to maturity.

- ✓ **Royalties** shall accrue in accordance with the terms of the relevant agreement and shall be recognised on that basis unless, having regard to the substance of the transaction, it is more appropriate to recognise revenue on some other systematic and rational basis
 - ✓ **Dividends** are recognised in accordance **with the provisions of the Act** (One may refer to section 2(22) for this purpose). But **AS-9** says that dividends from investments in shares are not recognised in the statement of profit and loss until a right to receive payment is established.
- **Transitional Provisions:** The transitional provisions of Income Computation and Disclosure Standard on **construction contract** shall mutatis mutandis apply to the recognition of revenue and the associated costs for a **service** transaction undertaken **on or before** the 31st day of March, 2016 **but not completed by the said date**.

Revenue for a transaction, **other than a service transaction** referred to in Para 10, undertaken **on or before** the 31st day of March, 2016 **but not completed by the said date** shall be recognised in accordance with the provisions of this standard for the previous year commencing on the 1st day of April, 2016 and subsequent previous year. The amount of revenue, if any, recognised for the said transaction for any previous year commencing on or before the 1st day of April, 2015 shall be taken into account for recognising revenue for the said transaction for the previous year commencing on the 1st day of April, 2016 and subsequent previous years.

- **Disclosure:** Following disclosures shall be made in respect of revenue recognition, namely:—
- (a) in a transaction involving **sale of goods**, total amount **not** recognised as revenue during the previous year due to lack of

reasonably certainty of its ultimate collection **along with nature of uncertainty**;

- (b) the amount of revenue **from service** transactions **recognised** as revenue during the previous year;
- (c) the **method used to determine the stage of completion** of **service transactions** in progress; and
- (d) for **service transactions in progress** at the end of previous year:
 - i. amount of costs incurred and recognised profits (less recognised losses) upto end of previous year;
 - ii. the amount of advances received; and
 - iii. the amount of retentions.

[Points (b), (c) and (d) given above are same as laid down under ICDS-III on Construction Contracts]

- The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Is the taxpayer obliged to account for such income even when the collection thereof is uncertain?

Answer: As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non-recovery in either cases can be claimed as deduction in view of section 36 (1) (vii) of the Act (CBDT Circular no. 10/2017 dated 23/03/2017).

- If the contractor gets interest on FDRs (created out of deposit amount received from contractee), will that be considered as contract income and be governed by ICDS-III on Construction Contracts?

Answer: No. Construction contract is clearly defined under ICDS-III. Further, this amount cannot be even deducted from contract costs as para 12 of ICDS-III says “these costs shall be reduced by any incidental income, **not being in the nature of interest, dividends or capital gains**, that is not included in contract revenue.” This income is duly covered under the term “Use of Resources by Others Yielding Interest, Royalties or Dividends” defined under ICDS-IV. This

interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.

Chapter – 6: ICDS-V Tangible Fixed Assets

- This Income Computation and Disclosure Standard deals with the treatment (means recognition and valuation) of tangible fixed assets.
- “Tangible fixed asset” is an asset being land, building, machinery, plant or furniture held with the intention of being used for the purpose of **producing or providing goods or services** and is **not held for sale in the normal course** of business. **(Concept is same as that of AS-10, but wordings are somewhat different).**
- “Fair value” of an asset is the amount for which that asset could be exchanged between **knowledgeable, willing** (means not in compulsion) parties in an **arm’s length transaction** (arm's length “price” is defined under section 92F(ii) of Income Tax Act, 1961).
- Words and expressions used and not defined in this Income Computation and Disclosure Standard but defined in the Act shall have the meanings assigned to them in that Act.
- **Identification of Tangible Fixed Assets:**
 - (e) The definition of Tangible fixed asset given above provides criteria for determining whether an item is to be classified as a tangible fixed asset.
 - (f) Stand-by equipment and servicing equipment are to be capitalised. Machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised.

[This is in line with AS-10]

- **Components of Actual Cost:** The actual cost of an acquired tangible fixed asset shall comprise its purchase price, import duties and other taxes, **excluding those subsequently recoverable**, and any **directly** attributable expenditure on making the asset **ready for its intended use**. Any trade discounts and rebates shall be **deducted** in arriving at the actual cost. The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, shall be **capitalised**. The expenditure incurred **after** the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as **revenue** expenditure. The cost of a tangible fixed asset may undergo changes subsequent to its acquisition or construction on account of price adjustment, changes in duties, exchange fluctuation or similar factors.

[This is in line with AS-10]

- **Self- constructed Tangible Fixed Assets:** In arriving at the actual cost of self-constructed tangible fixed assets, the same principles shall apply as those described in above para. Cost of construction that relate directly to the specific tangible fixed asset and costs that are attributable to the construction activity in general and can be allocated to the specific tangible fixed asset shall be included in actual cost. **Any internal profits shall be eliminated in arriving at such costs.**

[This is in line with AS-10]

- **Non-monetary Consideration:** ICDS-V says that when a tangible fixed asset is acquired in exchange for another asset, the **fair value** of the tangible fixed asset so **acquired** shall be its actual cost. When a tangible fixed asset is acquired in exchange for shares or other securities, the fair value of the tangible fixed asset so **acquired** shall be its actual cost.

Whereas **AS-10** says that when a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the **fair market value of the consideration given**. It **may be** appropriate to consider also the **fair market value of the asset acquired if this is more clearly evident**. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly **when the assets exchanged are similar**, is to record the asset acquired **at the net book value of the asset given up**; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.

When a fixed asset is acquired in exchange for shares or other securities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, **whichever is more clearly evident**.

Thus in this point, recognition amount differs. But, one thing to remember is ICDS-V does not say about the accounting treatment at all, so effect of changes, if any, will be given in block of asset as defined under I T Act and resultant depreciation.

Suppose, XYZ industries Ltd. has purchased from Maruti Motors, 100 cars for its business use in exchange of equivalent amount in form of listed equity shares of XYZ industries Ltd. Catalogue price of single car is Rs. 5 lakhs but in this deal of 100 cars, shares of total market value of Rs. 4.75 crores are issued to Maruti Motors. As per AS-10, XYZ Industries Ltd. has capitalized Rs. 4.75 crores (value of securities issued) and credited the relevant amounts in accounts of share capital and securities premium account respectively. But, assessing officer may take a stand that as per ICDS, fair value of asset acquired is not Rs. 4.75 crores but Rs. 4.50 crores (it will reduce depreciation consequently). To prove its stand, assessing officer may say that one of the essential component of definition of fair value is parties must be “knowledgeable”. Another dealer(s) was(were) ready to sell those cars at Rs. 4.50 crores, but XYZ Industries Ltd. had not obtained quotation from any other dealer but only from Maruti Motors.

- **Improvements and Repairs:** An Expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance is added to the actual cost. **[This is in line with AS-10]**
- **Valuation of Tangible Fixed Assets in Special Cases:** Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets. Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis. **[This is in line with AS-10]**
- **Transitional Provisions:** The actual cost of tangible fixed assets, acquisition or construction of which **commenced on or before** the 31/03/2016 but **not completed by the said date**, shall be recognised in accordance with the provisions of this standard. The amount of actual cost, if any, recognised for the said assets for any previous year commencing on or before the 01/04/2015 shall be taken into account for recognising actual cost of the said assets for the previous year commencing on the 01/04/2016 and subsequent previous years.
- **Depreciation:** Depreciation on a tangible fixed asset shall be computed in accordance with the provisions of the Act.
- **Transfers:** Income arising on transfer of a tangible fixed asset shall be computed in accordance with the provisions of the Act. **(Which may depend on whether the asset is depreciable or not).**

AS-10 says that items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognised immediately in the profit and loss statement. **(But we have noted that ICDS does not allow any expected loss).**

Even if we assume the non-existence this ICDS, then also we were and we are required to prove that the said amount was/is revenue expense to claim it u/s. 37(1). Thus, it is the difference (between AS and ICDS) with NIL tax effect.

➤ **Disclosures:** Following disclosure shall be made in respect of tangible fixed assets, namely:—

(a) description of asset or block of assets;

(b) rate of depreciation;

(c) actual cost or written down value, as the case may be;

(d) additions or deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—

- Central Value Added Tax credit claimed and allowed under the CENVAT Credit Rules, 2004;
- change in rate of exchange of currency;
- subsidy or grant or reimbursement, by whatever name called;

(e) depreciation Allowable; and

(f) written down value at the end of year.

➤ AS-10 says about upward and downward revaluation of an asset and its accounting treatment, whereas ICDS-V is silent on this topic, because even Income Tax is silent on this aspect and disregards such effects given in the books.

➤ Para 8.1 of AS-10 says an enterprise may decide to expense an item which could otherwise have been included as fixed asset, because the amount of the expenditure is not material.

But ICDS-V is silent on this aspect also.

- What shall be the treatment of expense incurred **after** the conduct of test runs and experimental production but **before** commencement of commercial production?

Answer: It shall be treated as capital expenditure as per para 8 of ICDS –V (CBDT Circular no. 10/2017 dated 23/03/2017).

- **Most of the provisions of this ICDS are similar to those of AS-10 and others have already been laid down under I T Act, so there seems to be mostly NIL tax effect due to this ICDS.**

Chapter – 7: ICDS-VI The Effects of Changes in Foreign Exchange Rates

- This Income Computation and Disclosure Standard deals with:
 - IV.) treatment of **transactions** in foreign currencies;
 - V.) **translating** the financial statements of foreign operations;
 - VI.) treatment of foreign currency transactions in the nature of **forward exchange contracts**.

(This is in line with AS-11)

- Flow Chart of AS-11 is given herewith (at the end of this chapter). Now only points of differentiation and transitional provisions are discussed here.
- As per AS-11, **foreign operation** is a **subsidiary, associate, joint venture or branch** of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

But, ICDS-VI says that **foreign operations** of a person is a **branch**, by whatever name called, of that person, the activities of which are based or conducted in a country other than India. [This is because, AS are concerned with maintenance and presentation of books of accounts, but ICDS is concerned only with computation of income and for the purpose of computation of income, **branch** is part of entity, but **subsidiary, associate, joint venture** are separate assessee having separate PAN]

- As per AS-11, forward exchange contract means an agreement to exchange different currencies at a forward rate.

ICDS-VI says that forward exchange contract means an agreement to exchange different currencies at a forward rate, **and includes a**

foreign currency **option** contract or **another financial instrument of a similar nature**;

Though AS-11 also says in para 36 that a forward exchange contract or **another financial instrument that is in substance a forward exchange contract**, which is.....

- Para 6 of ICDS-VI says that **notwithstanding** anything contained in paragraph 3, 4 and 5; initial recognition, conversion and recognition of exchange difference shall be subject to provisions of **section 43A** of the Act or **Rule 115** of Income-tax Rules, 1962, as the case may be.

Section 43A deals with “Special provisions consequential to changes in rate of exchange of currency.” and **Rule 115** deals with “Rate of exchange for conversion into rupees of **income expressed in foreign currency**. “

- Para 7 of ICDS-VI says that the financial statements of a foreign operation shall be translated using the principles and procedures in paragraphs 3 to 6 **as if the transactions of the foreign operation had been those of the person himself**. This treatment disregards the treatment said by AS-11 which says to accumulate all resulting exchange differences, in relation to non-integral foreign operations, in foreign currency translation reserve until the disposal of the net investment.
- Para 8(5) of ICDS-VI says that premium, discount or exchange difference on contracts that are intended for **trading or speculation** purposes, **or** that are entered into **to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction** shall be recognised **at the time of settlement**. Here the ICDS lays down three categories of forward exchange contracts namely (1) for trading or speculation purposes, (2) to hedge the foreign currency risk of a firm commitment or a highly probable forecast transaction and (3) Other than these two categories. But more clarification must be given by CBDT as to nature of this third category with example.

Whereas AS-11 says in its para 39 that in recording a forward exchange contract intended for **trading or speculation** purposes, the premium or discount on the contract is ignored and at each balance sheet date, the value of the contract is **marked to its current market value** and the gain or loss on the contract is recognised.

➤ **Transitional Provisions:**

- 1) All foreign currency transactions undertaken on or after 1st day of April, 2016 shall be recognised in accordance with the provisions of this standard.
- 2) **Exchange differences** arising in respect of monetary items or non-monetary items, on the settlement thereof during the previous year commencing on the 1st day of April, 2016 or on conversion thereof at the last day of the previous year commencing on the 1st day of April, 2016 , shall be recognised in accordance with the provisions of this standard **after taking into account** the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item, if any, which is carried forward from said previous year.
- 3) The financial statements of **foreign operations** for the previous year commencing on the 1st day of April, 2016 shall be **translated** using the principles and procedures specified in this standard **after taking into account** the amount recognised on the last day of the previous year ending on the 31st March, 2016 for an item, if any, which is carried forward from said previous year.
- 4) All **forward exchange contracts** existing on the 1st day of April, 2016 or entered on or after 1st day of April, 2016 shall be dealt with in accordance with the provisions of this standard **after taking into account** the income or expenses, if any, recognised in respect of said contracts for the previous year ending on or before the 31st March,2016.

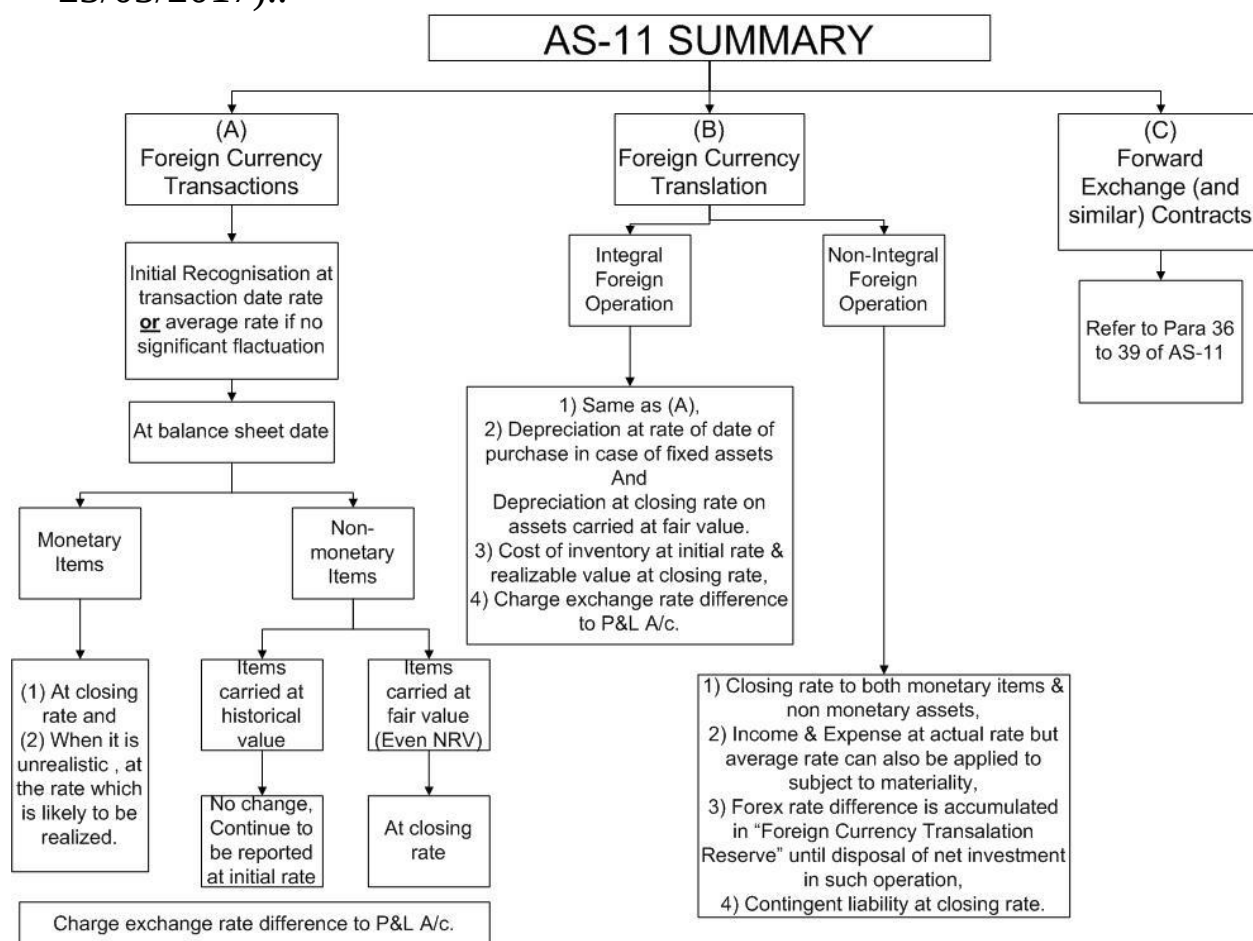
- There is not any disclosure requirement regarding this ICDS in point no. 13(f) of Form No. 3CD.

- Which ICDS would govern derivative instruments?

Answer: ICDS-VI provides guidance on accounting for derivative contracts, such as forward contracts and other similar contracts. For derivatives not within the scope of ICDS-VI, provisions of ICDS-I would apply (CBDT Circular no. 10/2017 dated 23/03/2017).

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

Answer: It shall be recognised in the previous year relevant for assessment year 2017-18 to the extent not recognized in the income computation in the past (CBDT Circular no. 10/2017 dated 23/03/2017)..



Chapter – 8: ICDS-VII Government Grants

- This Income Computation and Disclosure Standard deals with the treatment of Government grants. The Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, waiver, concessions, reimbursements, etc.
- Flow Chart of AS-12 is given herewith (at the end of this chapter). Now only points of differentiation, transitional provisions and disclosure requirements are discussed here.
- **Recognition of Government Grants:** Para 6 of AS-12 says that government grants available to the enterprise are considered for inclusion in accounts:

- I.) Where there is **reasonable assurance** that the enterprise **will** comply with the conditions attached to them; **and**
- II.) Where such benefits have been earned by the enterprise and it is **reasonably certain** that the **ultimate collection** will be made.

Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

Para 4(2) of ICDS-VII says that recognition of Government grant shall not be postponed beyond the date of actual receipt. **(It means it has to be recognized on actual receipt basis even in case where there is not any reasonable assurance that the enterprise will comply with the conditions attached to grant).**

- Para 5 of ICDS-VII says that Where the Government grant relates to a depreciable fixed asset or assets of a person, the grant shall be deducted from the actual cost of the asset or assets concerned or from the written down value of block of assets to which concerned asset or assets belonged to.

Thus, it does not take into consideration the second method prescribed by AS-12 in its para 8.4 regarding creation of deferred income and recognition in the profit and loss statement on a systematic and rational basis over the useful life of the asset.

But this will not create any tax effect at all, because explanation 10 to Section 43(1) of Income Tax Act, 1961 already provides as under:-

“Explanation 10.—Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.”

As this ICDS doesn't recognize treatment regarding creation of deferred income against such asset, treatment in case of refund of grant obviously differs as per this ICDS as compared to that of AS-12.

- Para 7 of ICDS-VII says that where the Government grant is of such a nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total Government grant, the same proportion as such asset bears to all the assets in respect of or with reference to which the Government grant is so received, shall be deducted from the actual cost of the asset or shall be reduced from the written down value of block of assets to which the asset or assets belonged to. Under AS-12, such grants are considered as grants in the nature of promoters' contribution (para 10) and such grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Again this will not create any tax effect at all, because proviso to explanation 10 to Section 43(1) of Income Tax Act, 1961 already provides as under:-

“Provided that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee.”

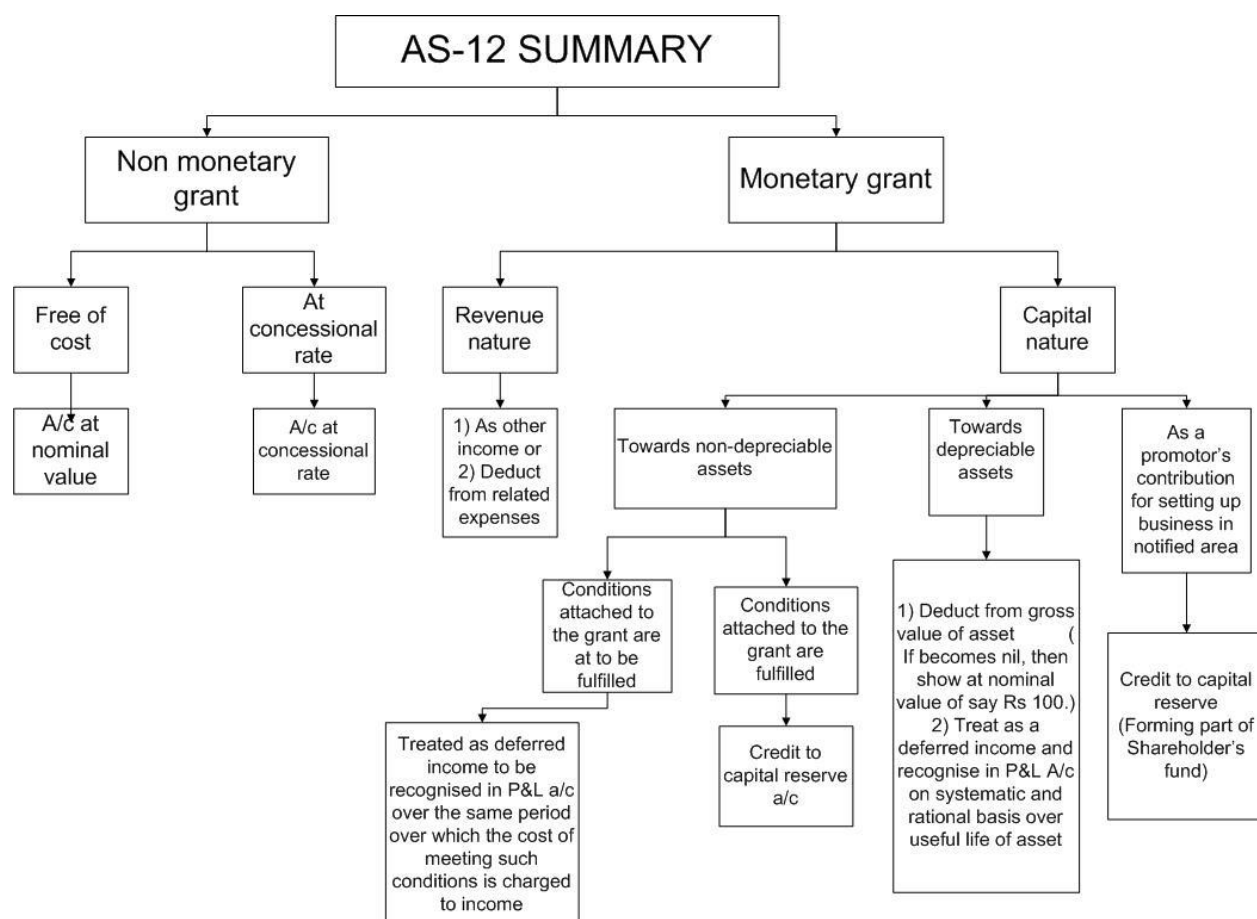
- Para 9 of ICDS-VII says that the Government grants other than covered by paragraph 5, 6, 7, and 8 shall be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate. (Residual category).
- **Transitional Provisions:** All the Government grants which meet the recognition criteria of para 4 on or after 1st day of April, 2016 shall be recognised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard **after taking into account** the amount, if any, of the said Government grant recognised for any previous year ending on or before 31st day of March, 2016.
- **Disclosures:** Following disclosure shall be made in respect of Government grants, namely:—
 - (a) nature and extent of Government grants recognised during the previous year by way of deduction from the actual cost of the asset or assets or from the written down value of block of assets during the previous year;
 - (b) nature and extent of Government grants recognised during the previous year as
 - (c) nature and extent of Government grants not recognised during the previous year by way of deduction from the actual

cost of the asset or assets or from the written down value of block of assets and reasons thereof; and income;

(d) nature and extent of Government grants not recognised during the previous year as income and reasons thereof.

- For subsidy **received prior to 01 April, 2016** but not recognised in the books pending satisfaction of related conditions and achieving reasonable certainty of receipt, how shall the same be recognised under ICDS on or after 01 April, 2016?

Answer: If the subsidy is already received prior to 01 April, 2016, ICDS-VII shall not apply and it shall continue to be recognised as per the law prevailing prior to that date (CBDT Circular no. 10/2017 dated 23/03/2017).



Chapter – 9: ICDS -VIII Securities

- This Income Computation and Disclosure Standard deals with **“securities” held as “stock-in-trade”**.
- AS-13 on “Accounting for Investments” which is compared with this ICDS by many authors does not deal with “stock-in-trade”. AS-13 deals with three elements only (1) current investment, (2) long term investment and (3) investment property. None of these elements is present in ICDS-VIII on Securities. If, at all, we want to compare any AS with this ICDS, then it should be AS-2 on inventories, although AS-2 even does not deal with shares, debentures and other financial instruments held as stock-in-trade, but in principles, it is on similar line. In short, at present, there is not any AS which governs accounting for “securities” held as “stock-in-trade”.
- Part-A of Income Computation and Disclosure Standard does not deal with
 - (a) the bases for recognition of interest and dividends on securities which are covered by the Income Computation and Disclosure Standard on revenue recognition;
 - (b) securities held by a person engaged in the business of insurance;
 - (c) securities held by mutual funds, venture capital funds, banks and public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).
- **“Securities”** shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) **and shall include** share of a company in which public are **not** substantially interested **but shall not include derivatives** referred to in sub-clause (ia) of that clause (h).

- As this ICDS deals with only those securities which are held as “stock-in-trade”, it is of utmost importance to classify the portfolio into (1) securities which are held as “stock-in-trade” and (2) securities which are held as “investments”. For this one can take guidance from CBDT Circular No. 06/2016 dated 29/02/2016 link of which is as under.

<http://www.incometaxindia.gov.in/communications/circular/circular-no-6.pdf>

- **Recognition and Initial Measurement of Securities :**

- ✓ A security on acquisition shall be recognised at actual cost.
- ✓ The actual cost of a security shall comprise of its purchase price and include acquisition charges such as brokerage, fees, tax, duty or cess.
- ✓ Where a security is acquired in exchange for other securities, the **fair value** of the security so **acquired** shall be its actual cost.
- ✓ Where a security is acquired in exchange for another asset, the **fair value** of the security so **acquired** shall be its actual cost.
- ✓ Where unpaid interest has accrued before the acquisition of an interest-bearing security **and** is included in the price paid for the security, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion of the interest is deducted from the actual cost.

[almost all of these provisions are adopted from AS-13]

- **Subsequent Measurement of Securities:**

- ✓ At the end of any previous year, securities held as stock-in-trade shall be valued at actual cost initially recognized or net realisable value at the end of that previous year, whichever is lower. [In line with AS-2 and ICDS-2]

- ✓ For the purpose of preceding para, the comparison of actual cost initially recognised and net realisable value shall be done categorywise and not for each individual security. For this purpose, securities shall be classified into the following categories, namely:-
 - shares;
 - debt securities;
 - convertible securities; and
 - any other securities not covered above.
- How the securities held as stock in trade shall be valued “category wise” under ICDS-VIII?

Answer: For the measurement of securities held as stock in trade, the securities are to be first aggregated category wise. The aggregate cost and net realizable value (NRV) of each category of security is compared and the lower of the two is to be taken as carrying value as per ICDS-VIII (CBDT Circular no. 10/2017 dated 23/03/2017).
- Opening Stock: The value of securities held as stock-in-trade of a business as on the beginning of the previous year shall be -
 - ✓ the cost of securities available, if any, on the day of the commencement of the business when the business has commenced during the previous year; and
 - ✓ the value of the securities of the business as on the close of the immediately preceding previous year, in any other case.
- Para 12 of this ICDS says that notwithstanding anything contained in para 9, 10 and 11, at the end of any previous year, securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised.

- For the purposes of para 9, 10 and 11 where the actual cost initially recognised cannot be ascertained by reference to specific identification, the cost of such security shall be determined on the basis of first-in-first-out method or weighted average cost formula.
[In line with AS-2]

- Part-B of this Income Computation and Disclosure Standard deals with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013).
 - ✓ “Scheduled Bank” shall have the meaning assigned to it in clause (ii) of the Explanation to clause (viia) of sub-section (1) of section 36 of the Act.
 - ✓ “Securities” shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contract (Regulation) Act, 1956 (42 of 1956) **and shall include** share of a company in which public are not substantially interested;
[Thus even derivatives are covered in this Part-B]

 - ✓ **Classification, Recognition and Measurement of Securities** : Securities shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account. To this extent, the provisions of Income Computation and Disclosure Standard VI on the effect of changes in foreign exchange rates relating to forward exchange contracts shall not apply.”

- There is not any disclosure requirement regarding this ICDS in point no. 13(f) of Form No. 3CD.

Chapter – 10: ICDS - IX Borrowing Costs

- This Income Computation and Disclosure Standard deals with treatment of borrowing costs. This Income Computation and Disclosure Standard does not deal with the actual or imputed cost of owners' equity and preference share capital.
- “Borrowing costs” are **interest and other costs** incurred by a person in connection with the borrowing of funds and **include**:
 - a) commitment charges on borrowings;
 - b) amortised amount of discounts or premiums relating to borrowings;
 - c) amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
 - d) finance charges in respect of assets acquired under finance leases or under other similar arrangements.

Here all points of borrowing costs mentioned above are similar to those mentioned in AS-16, but only one point “exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.” mentioned in AS-16 is not taken, because that point takes notional parameters into consideration and Income Tax must be based on actual parameters instead of notational parameters.

- Whether borrowing costs to be capitalised under ICDS-IX should exclude portion of borrowing costs that is disallowed under specific provisions such as 14A, 43B, 40(a) and 40A(2)(b)?

Answer: Borrowing costs shall exclude those borrowing costs that are otherwise not allowable under the specific provisions of the Act (CBDT Circular no. 10/2017 dated 23/03/2017).

[CBDT could have also incorporated section 40A(3) here]

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

Answer: Yes, as the definition of “borrowing cost” is an inclusive definition (CBDT Circular no. 10/2017 dated 23/03/2017).

[In same way, we can say that loan prepayment charges can also be part of this inclusive definition.]

- “Qualifying asset” means:
 - a) land, building, machinery, plant or furniture, being tangible assets;
 - b) know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
 - c) inventories that require a **period of twelve months or more** to bring them to a saleable condition.

AS-16 says that a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use **or sale**. Further it explains that what constitutes a substantial period of time primarily depends on the facts and circumstances of each case. However, **ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case.** In estimating the period, time which an asset takes, technologically and commercially, to get it ready for its intended use or sale is considered.

So, both these ICDS and AS are on similar line regarding qualifying asset.

- **Capitalization of specific borrowing costs:** Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation shall be determined in accordance with this Income Computation and

Disclosure Standard. **Other borrowing costs shall be recognised in accordance with the provisions of the Act.**

AS-16 says to deduct any income on the temporary investment of those borrowings also, but ICDS does not say that.

- **Capitalization of general borrowing costs:** AS-16 says (in para 12) that to the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalization rate should be the **weighted average** of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, **other than** borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

ICDS goes in detail for this capitalization by prescribing the following formula.

Borrowing Costs: $A * B / C$

A = borrowing costs incurred during the previous year except on borrowings referred to in Para 5 above (means other than specific purpose borrowings);

B = (i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year; (ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day, half of the cost of qualifying asset; or (iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of the previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be, **excluding** the extent to which the qualifying assets are directly funded out of specific borrowings

C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than assets to the extent they are directly funded out of specific borrowings;

Explanation — For the purpose of this paragraph, a qualifying asset shall be such asset that necessarily require a period of twelve months or more for its acquisition, construction or production.

[Though this explanation is not put after para regarding specific purpose borrowing, it should be equally applicable to it also]

- Commencement of Capitalisation: The capitalisation of borrowing costs shall commence:
- a) in a case referred to in paragraph 5, from the date on which funds were **borrowed**; (Specific purpose borrowing)
 - b) in a case referred to in paragraph 6, from the date on which funds were **utilised**. (General purpose borrowing)

Whereas AS-16 in its para 14 says that the capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when **all** the following conditions are satisfied:

- ✓ **expenditure** for the acquisition, construction or production of a qualifying asset is being **incurred**;
- ✓ **borrowing costs** are being **incurred**; and
- ✓ **activities** that are necessary to prepare the asset for its intended use or sale are in **progress**.

Further, para 17 of AS-16 says that capitalisation of borrowing costs should be **suspended** during extended periods in which active development is interrupted. (no such provision is there in ICDS)

Simultaneous reading of this entire point suggests that if some borrowing is made for specific asset construction then capitalization of its borrowing costs will commence (under ICDS) immediately irrespective of the fact whether expenditure for the construction of a qualifying asset is being incurred or not as laid down by AS-16.

Suppose, term loan is taken for construction of a factory building and two plant machineries of the company. Date of borrowing is 01/04/2016. Date of first utilization of that term loan is 01/05/2016. Now, if we read simultaneously the proviso to section 36(1)(iii) of Income Tax Act, 1961 and Para 7(b) of ICDS-IX on Borrowing Costs, interest from 01/05/2016 to 31/03/2017 shall be capitalized, but interest (plus initial processing charges) from 01/04/2016 to 30/04/2016 can neither be capitalized as per para 7(b) of this ICDS nor it can be charged to revenue as per proviso to section 36(1)(iii).

- **Cessation of Capitalisation** : AS-16 says that capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete. Para 17 says that an asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

ICDS-IX say to cease capitalization [1] in case of a qualifying asset referred to in item (i) and (ii) of clause (b) of sub-paragraph (1) of paragraph 2 (means other than inventory), when such asset is **first put to use**; [2] in case of inventory referred to in item (iii) of clause (b) of sub-paragraph (1) of paragraph 2 (means inventory), when substantially all the activities necessary to prepare such inventory for its intended sale **are complete**.

Thus, in case of qualifying assets other than inventories, capitalization under ICDS will cease only after it is first put to use and not only because of substantially all the activities are complete or its ready to use.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in

relation to a part shall cease mutatis mutandis in line with preceding paras.

- **Transitional Provisions** : All the borrowing costs incurred on or after 1st day of April, 2016 shall be capitalised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard **after taking into account** the amount of borrowing costs capitalised, if any, for the same borrowing for any previous year ending on or before 31st day of March,2016.
- **Disclosure**: The following disclosure shall be made in respect of borrowing costs, namely:—
 - a) the accounting policy adopted for borrowing costs; and
 - b) the amount of borrowing costs capitalised during the previous year.
- Position under Income Tax Act, 1961 (even before introduction of ICDS)

Proviso to section 36(1)(iii) says that provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

Explanation 8 to Section 43(1) says that for the removal of doubts, it is hereby declared that where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such asset.

Chapter–11: ICDS - X Provisions, Contingent Liabilities and Contingent Assets

- This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:
 - a) resulting from financial instruments;
 - b) resulting from executory contracts; (“Executory contracts” are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent).
 - c) arising in insurance business from contracts with policyholders; and
 - d) covered by another Income Computation and Disclosure Standard.

[In line with AS-29 except a minor diff. regarding onerous contracts]

- Almost all contents of ICDS-X are in line with AS-29. A few relevant differences and other tax effect related points are discussed as under.
- Para 14 of AS-29 says that A provision **should** be recognised when:
 - a) an enterprise has a present obligation as a result of a past event;
 - b) it is **probable (means more likely than not)** that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - c) a **reliable estimate** can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised.

Whereas Para 5 of ICDS-X says that a provision **shall** be recognised when:

- a) a person has a present obligation as a result of a past event;
- b) it is **reasonably certain** that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- c) a **reliable estimate** can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

Further this ICDS says that (1) No provision shall be recognised for costs that need to be incurred to operate in the future. (2) It is only those obligations arising from past events existing independently of a person's future actions, that is the future conduct of its business, that are recognised as provisions (3) Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is enacted.

Thus, certain “provisions” which satisfy the above mentioned conditions of ICDS-X are now allowable under Income Tax Act, even if there is not any specific provision under Income Tax Act to allow them as deduction.

- **Transitional Provisions:** All the provisions or assets and related income shall be recognised for the previous year commencing on or after 1st day of April, 2016 in accordance with the provisions of this standard **after taking into account** the amount recognised, if any, for the same for any previous year ending on or before 31st day of March, 2016.
- **Disclosure:** Following disclosure shall be made in respect of each class of **provision**, namely:-
 - a) a brief description of the nature of the obligation;
 - b) the carrying amount at the beginning and end of the previous year;

- c) additional provisions made during the previous year, including increases to existing provisions;
- d) amounts used, that is incurred and charged against the provision, during the previous year;
- e) unused amounts reversed during the previous year; and
- f) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Following disclosure shall be made in respect of each class of asset and related **income** recognised as provided in para 11, namely:—

- a) a brief description of the nature of the asset and related income;
 - b) the carrying amount of asset at the beginning and end of the previous year;
 - c) additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and
 - d) amount of asset and related income reversed during the previous year.
- Whether provisions for employee benefits such as provident fund, gratuity etc., are excluded from the scope of ICDS-X?
- Answer:** Provisions for employee benefits that are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS-X (CBDT Circular no. 10/2017 dated 23/03/2017).

Important Links

1. CBDT Notification No. 87/2016 dated 29/09/2016 [ICDS]
<http://www.incometaxindia.gov.in/communications/notification/notification872016.pdf>
2. CBDT Circular No. 10/2017 dated 23/03/2017 [Clarifications on ICDS]
http://www.incometaxindia.gov.in/communications/circular/circular10_2017.pdf
3. Accounting Standards
http://www.icaai.org/post.html?post_id=8660
4. Accounting Standard Interpretations
http://www.icaai.org/post.html?post_id=10972
5. Income Tax Act, 1961
<http://www.incometaxindia.gov.in/pages/acts/income-tax-act.aspx>
6. Income Tax Rules, 1962
<http://www.incometaxindia.gov.in/Pages/rules/income-tax-rules-1962.aspx>
7. Draft ICDS on Real Estate Transactions
<http://www.itatonline.org/info/draft-income-computation-and-disclosure-standard-icds-on-real-estate-transactions/draft-icds-real-estate-transactions-cbd-11052017/>