Important Case Laws

Chamber of tax consultants (Del HC)(2017):

Delhi High Court has upheld the constitutional validity of the ICDS. However, it has struck down certain provisions of ICDS which are contrary to the Act/ the settled position of law as laid down by several judicial precedents.
HC held that "The power under Section 145 (2) of the Act cannot permit changing the basic principles of accounting that have been recognized in the various provisions of the Act unless of course corresponding amendments are carried out to the Act itself."

ICDS no.	ICDS provision	Del HC verdict
I	Concept of prudence is not recognised Expected loss and mark to market loss not allowed	1. HC states that ICDS I, which does away with the concept of 'prudence', is contrary to the (IT) Act and binding judicial precedents and is, therefore, unsustainable in law 2. HC states that Section 37 allows deduction of expenses laid out or expended for the purpose of business & therefore, prudence concept is embedded in it.
	Therefore, now prudence concept to be followed & expected loss/mark-to-market loss are to be allowed.	
II	On dissolution of firm, inventory is to be valued at NRV.	HC holds that it is contrary to the SC decision in the case of Sakthi Trading Co. wherein it was held that, on dissolution of firm, where the business of firm is not discontinued and is taken over by other partners, the stock-in-trade of the firm can be valued at cost or market value, whichever is lower.
	Therefore, now on dissolution of firm, where the business of firm is not discontinued and is taken over by other partners, the stock-in-trade of the firm can be valued at cost or market value, whichever is lower.	
III	Retention money is to be treated as part of contract price & to be recognized based on 'proportionate completion method'	HC holds that it is contrary to judicial precedents which held that retention money does not accrue to the assessee unless the defect liability period is over since ICDS III seeks to bring to tax the retention money, the receipt of which is uncertain/conditional, at the earliest possible stage.
	Therefore, HC rules that the treatment to retention money under Paragraph 10 (a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income.	
IV	Income from export incentive to be recognized in the year of making of the claim if there is 'reasonable certainty' of	HC strikes down this as it is contrary to SC ruling

	its ultimate collection.	
	Income to be recognized only on the basis of percentage completion method	HC notes that proportionate completion method & contract completion method both are valid as per mercantile system of accounting as per the SC ruling.
	Therefore, now as per SC ruling income can be recognized on proportionate completion method & contract completion method as it may be applicable.	
VI	Marked to market loss/gain in case of foreign currency derivative held for trading or speculation purposes are not allowed.	HC notes that it is contrary to SC decision, wherein it was held that marked to market loss in case of forward exchange contract held for trading or speculation purposes is allowed.
	Therefore, now marked to market loss in case of forward exchange contract held for trading or speculation purposes is allowed	
VII	Recognition of government grants cannot be postponed beyond the date of actual receipt	HC holds that it is contrary to accrual system of accounting.
VIII	In Part A, for entities not governed by the RBI, prescribes valuation mechanism.	HC held that accounting as per AS to be followed since, such entities will be required to maintain separate records for income tax purposes for every year as the closing value of the securities would be valued separately for income tax purposes and for accounting purposes… This change is therefore not possible to be effectuated without a corresponding amendment to the Act. Therefore, strikes down Part A of ICDS.
IX	ICDS IX on borrowing cost provides that no incidental income is to be reduced from borrowing cost.	HC notes that contrary to SC decision in Bokaro Steel case wherein it was held that if an assessee receives any amount which is inextricably link with process of setting up of machinery, such receipt would reduce the cost of the asset.
	Therefore, now incidental income is to be reduced from borrowing cost.	

HC states that in exercise of its power to issue notifications u/s. 119 of the Act, the CBDT is meant to clarify the law, not change it. However, HC remarks that "Some of the impugned ICDS, to the extent discussed hereinbefore, however do not merely clarify the existing law. Some of them mandate the applicability of accounting principles, contrary to what is recognised by the Act, for the purpose of computation of income."

HC rules that "To the extent the specific ICDS as noted hereinbefore have been struck down as ultra vires the Act, the impugned notification Nos. 87 and 88 dated 29th September 2016 and Circular No. 10 of 2017 issued by the CBDT are also held to be ultra vires the Act and struck down as such."

HC rules that "In order to preserve its constitutionality, Section 145 (2) of the Act as amended is required to and is hereby read down to restrict power of the Central Government to notify ICDS that do not seek to override binding judicial proceedings or provisions of the Act."

Student Note:
Students are advised to solve the questions as per the position under ICDS. However, in the notes they are required to mention the Delhi HC observations, wherever required.