ICDS-IX Borrowing Costs

ICDS-X Provisions, Contingent Liabilities & Assets

ICDS

Income Computation and Disclosure Standards

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Background

List of notified ICDS (applicable from AY 2017-18)

Sr. No.	ICDS	AS	Ind AS
1	Accounting Policies	AS 1	Ind AS 8
2	Valuation of Inventories	AS 2	Ind AS 2
3	Construction Contracts	AS 7	Ind AS 115
4	Revenue Recognition	AS 9	Ind AS 115
5	Tangible fixed assets	AS 10	Ind AS 16
6	Changes in Foreign Exchange Rates	AS 11	Ind AS 21
7	Government Grants	AS 12	Ind As 20
8	Securities	AS 13 / AS 30	Ind AS 109
9	**Borrowing Costs**	**AS 16**	**Ind AS 23**
10	**Provisions, Contingent Liabilities and Contingent Assets**	**AS 29**	**Ind AS 37**

Background
Key Principles

Impact on the Act?

- Preamble – in case of conflict, Act prevails

Is ICDS mandatory?

- If not followed – income can be recomputed u/s 145(3)

Prospective or retrospective?

- Prospective

ICDS are for maintenance of books of account

- No

Certain ICDS provisions are inconsistent with judicial precedents

- ICDS will prevail

If conflict between ICDS and rules

- Rules will prevail

Whether ICDS will apply to MAT / AMT

- Will not be applicable for MAT but will be relevant for AMT

ICDS IX – Borrowing Costs

ICDS IX: Borrowing Costs
Scope

- Treatment of borrowing costs

- Does not deal with the actual or imputed cost of owners’ equity and preference share capital

ICDS IX: Borrowing Costs
Definitions

- Borrowing costs are interest and other costs incurred by a person in connection with the borrowing of funds and include:
  - commitment charges;
  - amortised amount of premium or discounts relating to borrowing;
  - Amortised amount of ancillary costs incurred in connection with the arrangement of borrowings;
  - finance charges in respect of assets acquired under finance leases or under other similar arrangement

- "Qualifying asset" means
  - land, building, machinery, plant or furniture, being tangible assets
  - know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets
  - Inventories that require a period of twelve months or more to bring them to a saleable condition

ICDS IX: Borrowing Costs

Capitalisation of Borrowing Costs

Particulars	Specific borrowing	General borrowing
Amount to be capitalized	Actual	To be computed as per the formula specified (the qualifying asset shall be such asset that necessarily requires a period of 12 months or more for its acquisition, construction or production)
Commencement of capitalization	From the date on which **<u>funds are borrowed</u>**	From the date on which funds were **<u>utilized</u>**
Cessation of capitalisations	• When the asset is first put to use • In case of inventory–when substantially all the activities necessary to prepare it for its intended sale are complete	

ICDS IX: Borrowing Costs

General Borrowings

Pro rata borrowing costs allocation based on formula A*B/C

(A) = borrowing costs incurred during the previous year except on specific borrowing	
(B) = Cost of qualifying assets	
Appearing on first and last day	Average cost of qualifying asset as on first and last day
Not appearing in the Balance sheet on the first day	Half of cost of qualifying asset
Not appearing on last day	Average cost of qualifying asset as on first day and on the date of put to use or completion, as the case may be.
Excludes extent to which qualifying asset are directly funded out of specific borrowings	
(C) =Average of total assets on the first and last day of the year (other than those directly funded)	

QA shall be such asset that necessarily require a period of twelve months or more for its acquisition, construction or production

ICDS IX: Borrowing Costs

Disclosures & Transition Provisions

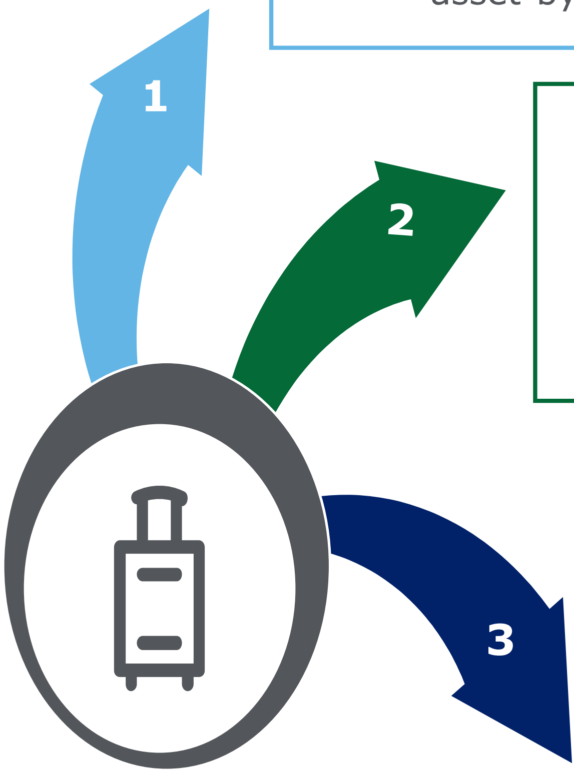
Disclosures

- The accounting policy adopted for borrowing costs;
- The amount of borrowing costs capitalised during the previous year.

Transition 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.

ICDS IX: Borrowing Costs
Clarification issued by CBDT FAQs



How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided to different qualifying assets?

The capitalization of general borrowing cots under ICDS shall be done on asset-by-asset basis.

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

- The definition of the borrowing costs is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing costs

There are specific provisions in the Act read with Rules under which a portion of borrowing costs may get disallowed. Whether borrowing costs to be capitalized under ICDS to extent it being disallowed?

Since specific provisions of the Act overrides provisions of ICDS – said costs will be excluded for purpose of capitalization under the ICDS.

ICDS IX: Borrowing Costs

Borrowing Costs – Points for discussion

- Borrowing costs as per ICDS

  “Borrowings costs” are interest and other costs incurred by a person in connection with the borrowing of funds and include:

  (i) Commitment charges on borrowings;
  (ii) Amortized amount of discounts or premiums relating to the borrowings;
  (iii) Amortized amount of ancillary costs incurred in connection with the arrangement of borrowings;
  (iv) Finance charges in respect of assets acquired under finance leases or under other similar arrangements"

- Interest as per S 2(28A) of the Income-tax Act, 1961 (‘the Act’):

  “Interest means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.”

ICDS IX: Borrowing Costs

Borrowing Costs – Points for discussions

ICDS

- Interest
- Commitment charges
- Amortised cost of disc & premiums
- Amortisation of Ancillary Cost
- Finance charges – Finance lease or similar arrangements

Act

- Interest
- Service fee or other charge
- Credit facility not being utilised

Sec. 2(28A)

ICDS IX: Borrowing Costs
Borrowing Costs – Points for discussions

- Interest as per section 36(1)(iii) of the Act:

  "(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in Section 28

  (iii) The amount of the interest paid in respect of capital borrowed for the purposes of the business or profession."

- Provisions of section 36(1)(iii) of the Act – Core Health Care Ltd [2008] 298 ITR 194 (SC) – No distinction between borrowings for capital or revenue

- Amendment to section 36(1)(iii) of the Act vide Finance Act 2015 w.e.f. 1 April 2016:

  - Words " for extension of existing business or profession" in the first proviso deleted

  - Proviso to section 36(1)(iii) reads as under :

    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.

Whether proviso to Sec 36(1)(iii) applicable to stock-in-trade also?

ICDS IX: Borrowing Costs

Borrowing Costs – Points for discussions

Discount / upfront interest paid on debentures

- Madras Industrial Investment Corporation Ltd [1997] 225 ITR 802 (SC)
- Taparia Tools Limited [2015] 372 ITR 605 (SC)

Ancillary Borrowing costs

- Stamp duty, registration fees, legal fees, etc.?

Arranger's fees / brokerage for loans

- Idea celluar Ltd v ADIT (ITA No. 1619/Mum/2011)
- CBDT Letter : No.F.164/18/77-IT(A-I), dated 13 July, 1978

ICDS IX: Borrowing Costs

Borrowing Costs – Points for discussions

Bill discounting/ Debtor factoring

- Whether discount charges on bills discounted for specific debtors – to be included for purpose of borrowing costs? – ABC International Inc USA, In re [2011] 199 Taxman 211 (AAR New Delhi)

Forex gain / loss

- Whether forex gain / loss arising in respect to the borrowings (say foreign loans for acquiring indigenous assets, etc.) to be considered as part of borrowing costs?

ICDS IX: Borrowing Costs

General Borrowings – Points for discussion

General Borrowings	Assets
• Borrowing costs to be considered – all general borrowing costs or exclude borrowing for specific purpose? – In case of sec 14A of the Act, specific borrowing is excluded • In case of the general borrowings initially availed for the qualifying asset. However, later the part funding received from the customer by way of interest-free advances at stage of construction itself – To illustrate INR 100 mn loan availed for asset to have gestation period of 3 years. In year 1 itself, INR 60 mn received as interest-free deposit – should borrowings be considered for said asset as only INR 40 mn ?.	• Cost of asset to be as per the books of accounts where the interest capitalization has already happened as per AS-16? • Whether assets to be included to also include P&L (Dr. balance), miscellaneous expenditure to an extent not written-off, etc.? • Whether the assets to be taken at gross values or at net values in case any impairment provision is provided for? • Would deferred tax assets be also included? • Situation in case of first year of adoption of Ind –AS, which values to be adopted? • What happens on destruction of assets (say by fire, natural hazards, etc.) or wirte-off due to being obsolete.

ICDS IX: Borrowing Costs

Qualifying Assets – Points for discussion

Transferable Development Rights

- Will Transferable Development Rights ('TDR') be a Qualifying Asset?

Computation of capital gains

- In case of capitalization of interest to non-depreciable assets, what will be the cost of acquisition for computation of capital gains

Sale of stock-in-trade at WIP stage

- In case, the stock-in-trade (viz. flat under construction, etc.) is sold at WIP stage – should capitalization of the interest cost be stopped at agreement stage / delivery stage / possession stage

ICDS IX: Borrowing Costs

Qualifying Assets – Points for discussion

Borrowings for acquisitions

- Whether borrowings made to fund acquisition – borrowing costs to be capitalized to goodwill as being Intangibles?

ICDS IX: Borrowing Costs

Issues in ICDS – Points for discussion

Subsequent allowance of interest costs

- Whether, the interest disallowed under provisions of Act – section 43B, 40(a)(ia) etc. to be considered or excluded? If excluded then to be included in the year of allowance on compliance of respective section?

Transfer pricing adjustments

- In case of TP disallowance of the interest from associated enterprise – adjustment to the block of asset to be made in year capitalised or year in which litigation is settled?

ICDS IX: Borrowing Costs
AS -16 V. ICDS – Key differences

Treatment for	AS -16	ICDS – IX
Exchange differences arising from foreign currency borrowings to the extent regarded as interest costs	These are regarded as borrowing costs	No clarity
Qualifying assets - Intangibles	Term not defined to cover intangible assets	Includes
Income from temporary investments	Reduced from borrowing cost	Not deducted from borrowing cost but treated as income
Suspension of capitalisation	Suspended during extended periods in which active development is interrupted	No such suspension
Capitalization formula for general borrowings	Based on weighted average rate	Proportionate method

ICDS IX: Borrowing Costs

IndAS vis-à-vis ICDS

Net v/s Gross Interest

IndAS-23

- Income earned from temporary investments of borrowed funds is deducted while capitalizing the borrowing cost (Para 12 of IndAS 23)

ICDS-IX

- Treatment under ICDS?
- Income arising from temporary use of funds shall be charged to income tax under the head Income from Other Sources. The asset value will have to be shown at gross value only. Decision of the **Supreme Court** decision in case of **Tuticorin Alkali Chemicals & Fertilizers Ltd v. CIT (227 ITR 172)**

ICDS IX: Borrowing Costs
IndAS vis-à-vis ICDS

Cessation of capitalization of interest cost

<u>IndAS-23</u>

- No capitalisation of borrowing cost during the extended period in which active development of qualifying asset is suspended (Para 20 of IndAS 23)

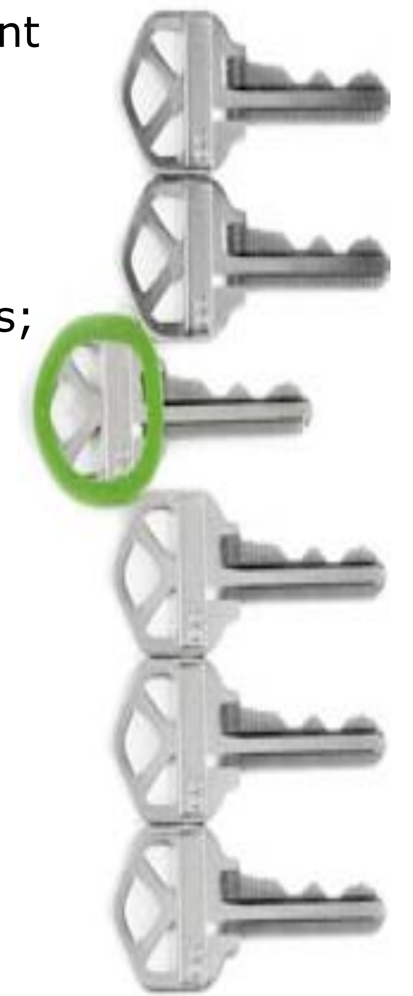
<u>ICDS-IX</u>

- As per proviso to sec 36(1)(iii), amount of interest paid in respect of capital borrowed for acquisition of an asset (whether capitalized or not) from the date of borrowing till the time asset was put to use is not allowed as a deduction.

ICDS X – Provisions, Contingent Liabilities and Contingent Assets

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Scope



- ICDS X deals with provisions, contingent liabilities and contingent assets except those:
  - resulting from financial instruments;
  - resulting from executory contracts;
  - arising in insurance business with contracts with policy holders; and
  - covered by any other ICDS
- ICDS X does not deal with recognition of revenue which is dealt with by ICDS IV on revenue recognition
- The term used in context of items such as depreciation, impairment of assets and doubtful debts are adjustments to carrying amount of assets; these are also not covered by this ICDS

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Definitions

- "Provision" is a liability which can be measured only by using a substantial degree of estimation.
- "Obligating event" is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.
- "Contingent liability" is:

  (i) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person; or

  (ii) a present obligation that arises from past events but is not recognised because:

    (A) it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or

    (B) a reliable estimate of the amount of the obligation cannot be made.

- "Contingent asset" is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person.
- "Present obligation" is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Recognition of provisions

- A provision should be recognised when
  - a person has a ***present obligation*** as a result of a past event;
  - it is '***reasonably certain'*** that an outflow of resources embodying economic benefits will be required to settle the obligation; and
  - a ***reliable estimate*** can be made of the obligation amount
- Provision should not be recognised for costs that need to be incurred to operate in the future
- Provisions are recognised only for those obligations arising from past events that exist independently of the assessee's future actions
- An obligation, for which a person is jointly and severally liable, is a contingent liability to the extent it is expected that the obligation will be settled by other parties

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Measurement of provisions, impact of reimbursement and use of provisions

- **Measurement of provisions**
  - The best estimate of the expenditure required to settle the present obligation at the end of the previous year will be recognised as provision
  - The amount of provision shall not be discounted to its present value
  - Obligation for proposed law arises only when the legislation is actually enacted
- **Impact of reimbursements**
  - Reimbursement shall be recognised when it is ***reasonably certain*** that reimbursement will be received if the person settles the obligation; the amount recognised as reimbursement shall not exceed the amount of provision
  - Where a person is not liable for payment of costs in case the third party fails to pay, no provision shall be made for those costs
- **Use of provisions**
  - A provision shall be used only for expenditures for which the provision was originally recognised

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Contingent liabilities and contingent assets

- **Contingent liabilities**
  - Contingent liabilities should not be recognised

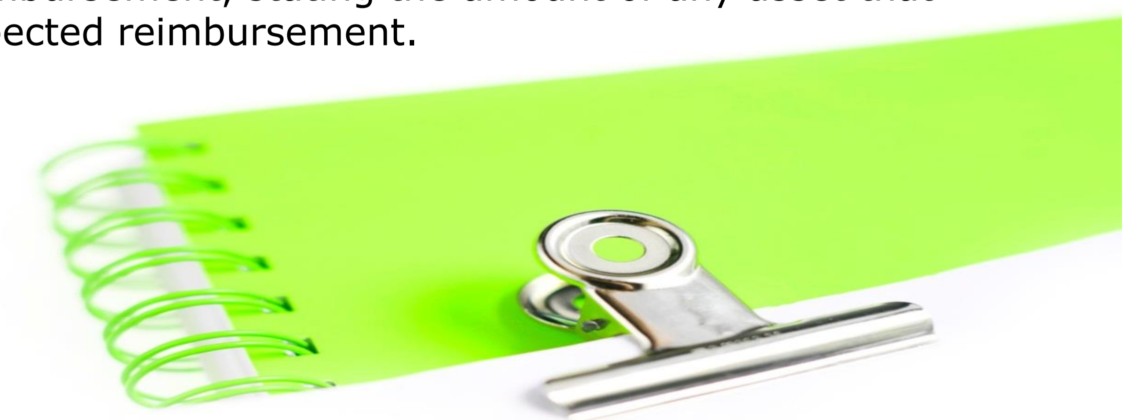
- **Contingent assets**
  - Contingent assets should not be recognised
  - Contingent asset must be assessed continually and if it becomes ‘reasonably certain’ that inflow of economic benefit will arise, the asset and the income are recognised in previous year in which the change occurs.

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Transitional provisions

- All the provisions or assets and related income shall be recognised for FY 2016-17 and future years in accordance with the provisions of this standard after taking into account the amount recognised, if any, for the same for FY 2015-16 and earlier

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Disclosures (1/2)

- Following disclosure shall be made in respect of each class of **provision**, namely:-
  - A brief description of the nature of the obligation;
  - The carrying amount at the beginning and end of the previous year;
  - Additional provisions made during the previous year, including increases to existing provisions;
  - Amounts used, that is incurred and charged against the provision, during the previous year;
  - Unused amounts reversed during the previous year; and
  - The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.



ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Disclosures (2/2)

- Following disclosure shall be made in respect of each class of **contingent asset** and related income recognised, namely:-
  - A brief description of the nature of the asset and related income;
  - the carrying amount of asset at the beginning and end of the previous year;
  - additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised; and
  - amount of asset and related income reversed during the previous year

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Clarification issued by CBDT FAQs

- **Question 23:** What is the impact of Para 20 of ICDS X containing transitional provisions?

  Answer: Para 20 of ICDS X provides that 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 March 2016. The intent of transitional provision is that there is neither 'double taxation' of income due to application of ICDS not there should be escape of any income due to application of ICDS from a particular date. This explained as under:

Provision required as per ICDS on 31st March 2017 for items brought forward from 31st day of March 2016…(A)	INR 3 Crores
Provisions as per ICDS for FY 2016-17..(B)	INR 5 Crores
Total gross provision…(C) = (A) + (B)	INR 8 Crores
Less: Provision already recognised for computation of taxable income in FY 2016-17 or earlier…(D)	INR 2 Crores
Net provisions as per ICDS in FY 2016-17 to be recognised as per transition provision…(E)= (C) – (D)	INR 6 Crores

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Clarification issued by CBDT FAQs

- **Question 24:** Expenditure on most post-retirement benefits like provident fund, gratuity, etc. are covered by specific provisions. There are post-retirement benefits offered by companies like medical benefits. Such benefits are covered by AS – 15 for which no parallel ICDS has been noticed. Whether provision of these liabilities are excluded from scope of ICDS X?

  Answer: It is clarified that provisioning for employee benefit which 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.

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Points for discussion – Variation from the Accounting Standards

Issue	AS – 29	ICDS X
Applicability	Applies for the purpose of preparation of financial statements	Applies for computation of income under the heads 'profits and gains of business or profession' and 'capital gains'
Recognition of provisions	Provision to be recognised when outflow of resources is <u>probable</u>	Provision to be recognised when outflow of resources is <u>reasonably certain</u>
Recognition of contingent assets	When it becomes <u>virtually certain</u> that inflow of economic benefit will arise, asset and related income are recognised in the financial year in which the change occurs	When it becomes <u>reasonably certain</u> that inflow of economic benefit will arise, asset and related income are recognised in the financial year in which the change occurs
Recognition of reimbursement in respect of a provision	When it is <u>virtually certain</u> that reimbursement will be received if the obligation is settled, reimbursement should be recognised	When it is <u>reasonably certain</u> that reimbursement will be received if the obligation is settled, reimbursement should be recognised
Onerous executory contracts	Not excluded from purview of AS 29	Excluded from purview of ICDS X
Restructuring provisions	Contains guidance of provisions for restructuring	No such guidance

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Points for discussion

- Recognition of provision
  - Pre – ICDS – Provisions recognised if it is ***probable*** that outflow of economic resources will be required
  - Post – ICDS – Provisions to be recognised if it is ***reasonably*** certain that outflow of economic resources will be required
- Whether recognition of provisions to be postponed under ICDS?
  - Provision created on a scientific basis would not be a contingent liability and deduction would be admissible u/s 37(1) - SC case of Metal Box Co. of India Ltd. V. Their Workmen
  - For a liability to qualify for recognition there must be not only present obligation arising out of obligating events but also the probability of an outflow of resources to settle that obligation and reliable estimate of the same – SC case of Rotork Controls India (P.) Ltd. [180 TAXMAN 422]
  - If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one - SC case of Bharat Earth Movers [245 ITR 428]

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Provision as per books and ICDS

Year 1 – book profits	
Revenue	250
Less : Provision based on probability	(90)
Net profit	160

Year 2 – book profits	
Revenue	250
Less : Provision based on probability	Nil
Net profit	250

Year 1 – Taxable income (ICDS)	
Revenue	250
Less : Provision based on reasonable certainty	Nil
Net profit	250

Year 2 – Taxable income (ICDS)	
Revenue	250
Less : Cost incurred as per provision	(90)
Net profit	160

The tax liability in second year can fall under the provisions of MAT

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Points for discussion

- In case of trading liabilities where suit filed by customer is disputed, even then the same is to be allowed since it is capable of being estimated with reasonable certainty - Delhi HC case of R C Gupta [298 ITR 161]

- Where it was held that where appeal was pending in SC, the liability remained contingent. This was in the case of additional sugar levy - Delhi HC case of Triveni Engg [320 ITR 430]

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Points for discussion

- ICO is contesting case of price escalation and matter is before HC

Court	Status
Consumer Forum	Lost
Tribunal	Lost
High Court	Won
Supreme Court	Pending

- Situation 1 : Matter is pending before HC
- Situation 2 : Matter won in SC. Court granted 200 days time to consumer to pay
- Situation 3 : Matter won but law changed retrospectively next month in favour of customers. Lawyers has opined that law is unconstitutional

ICDS X: Provisions, Contingent Liabilities and Contingent Assets
Points for discussion

- Recognition of contingent asset
  - Pre – ICDS – Recognition only in case of ***virtual certainty*** regarding inflow of economic benefit
  - Post – ICDS – Recognition even in case of ***reasonable certainty*** regarding inflow of economic benefit
- Whether this would mean early recognition of asset/income?
  - Supreme Court in Excel Industries (38 Taxmann.com 100) has laid down certainty of ultimate collection as important and inevitable principle of recognition of income

ICDS IX: Borrowing Costs

IndAS vis-à-vis ICDS

Parameters of recognition

IndAS-37	**ICDS-X**
• Provision is recognized when the outflow of resource ***is probable*** • Contingent asset is recognized when it becomes ***virtually certain*** (Para 33) • Reimbursement (in respect of provision of expensed) is recognized when it becomes ***virtually certain*** (Para 53)	• Provision is recognised when outflow of resources is ***reasonably certain*** • Contingent asset is recognises when it becomes ***reasonably certain*** • Reimbursement (in respect of provision of expenses) is recognized when it becomes ***reasonably certain***

ICDS IX: Borrowing Costs
IndAS vis-à-vis ICDS

Time value

<u>IndAS-37</u>

- Where the effect of time value of money is material, discounting of provision is allowed (Para 45)

<u>ICDS-X</u>

- Provisions (undiscounted) will be allowed

Questions & Answers

Thank You