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**WIRC Seminar on
Income Computation and
Disclosure Standards**

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THIS SESSION

- ❑ Origin of ICDS
- ❑ Key Highlights of ICDS
- ❑ List of Notified ICDS
- ❑ ICDS VIII – Securities
- ❑ ICDS X – Provisions, Contingent Liabilities & Contingent Assets

ORIGIN/ BACKGROUND OF ICDS

- Accounting Standards
- Tax Accounting Standards



KEY HIGHLIGHTS OF ICDS

□ Applicability of ICDS:

- All taxpayers
- Taxpayers adopting mercantile method
- Income chargeable as
 - Profit and Gains of Business or Profession
 - Income From Other Sources
- Effective April 1, 2015 i.e FY 2015-16 (i.e. AY 2016-17)
- ICDS only for computing taxable income and not for maintenance of books
- In case of conflict, the Act shall prevail over ICDS

KEY HIGHLIGHTS OF ICDS (Con't...)

- ICDS not applicable for computation of Minimum Alternate Tax (MAT)
- No threshold exemption for applicability
- No concept of prudence or materiality
- ICDS have been broadly framed in line with ICAI AS but substantially modified based on recommendations of the committee
- Non-compliance to ICDS can lead to “Best Judgment Assessment” under section 144 coupled with potential penalty implications. [Section 145(3) of the Act]

KEY HIGHLIGHTS OF ICDS (Con't...)

- ❑ Disclosure requirements - how and where ?
 - ICDS is silent as to how and where disclosures should be made whether Return Of Income (ROI) or Tax Audit report (TAR)
 - It is expected that ROI forms and/ or TAR forms may be modified in due course of time to report the compliance with ICDS
- ❑ Terms not defined in ICDS to derive meaning from the Act
- ❑ Transitional provisions - except ICDS VIII securities

LIST OF NOTIFIED ICDS

ICDS #	Income Computation and Disclosure Standards	Equivalent AS #	Equivalent IND AS #
ICDS I	Accounting Policies	AS-1	IND AS-1 and 8
ICDS II	Valuation of Inventories	AS-2	IND AS-2
ICDS III	Construction Contracts	AS-7	IND AS-11
ICDS IV	Revenue Recognition	AS-9	IND AS-18
ICDS V	Tangible Fixed Assets	AS-10	IND AS-16
ICDS VI	The effects of changes in foreign exchange rates	AS-11	IND AS-21
ICDS VII	Government Grants	AS-12	IND AS-20
ICDS VIII	Securities	AS-13	IND AS-1
ICDS IX	Borrowing Costs	AS-16	IND AS-1
ICDS X	Provisions, Contingent liabilities and Contingent assets	AS-29	IND AS-1

ICDS VIII

Securities



ICDS VIII – SECURITIES

□ Scope

- Securities held as stock-in-trade
- AS 13 deals with accounting for current and long term investments other than shares, debentures or other securities held as stock-in-trade.

□ Exclusions:

- Interest and dividend on securities dealt by ICDS IV – Revenue Recognition
- Securities held by person engaged in the business of Insurance
- Securities held by Mutual Funds, VCF, Bank and Public Financial Institutions

□ Impact/ Significant issues:

- This ICDS is discriminatory as it does not apply to banks, MFs, VCFs, etc
- Whether derivatives are covered?
- Does it exclude NBFCs, FIIIs?

ICDS VIII – SECURITIES (Con't...)

□ Recognition and Initial Measurement

- Acquisition – Actual cost (Purchase price + Brokerage + Fees + Tax + Duty + Cess)
- STT to be included in actual cost – section 40(a)(ib) omitted w.e.f. 1.4.2005
- Acquisition of securities in exchange for:

Sr. No.	Category	ICDS - VIII	AS -13
1.	Securities	Fair Value of securities acquired	Fair Value of securities issued
2.	Assets	Fair Value of securities acquired	Fair Value of securities issued or asset given up, whichever is clearly evident

ICDS VIII – SECURITIES (Con't...)

□ AS 13 v. ICDS VIII

	Accounting Standard 13	ICDS VIII
1	Covers long-term, current investments but excludes securities held as stock-in-trade	Deals only with securities held as stock-in-trade
2	Individual security approach for year end valuation	Portfolio approach for year end valuation
3	Weighted Average Method to be used to determine the cost where specific identification not possible	FIFO Method to be used to determine the cost where specific identification not possible

ICDS VIII – SECURITIES (Con't...)

- ❑ Pre-acquisition interest/ Broken period interest:
 - ICDS requires interest to be bifurcated into pre and post acquisition. Pre-acquisition income to be reduced from actual cost.
 - Impact/ Significant issues:
 - Vijaya Bank v. Addl CIT 187 ITR 601- SC held that pre-acquisition interest to be part of acquisition cost of inventory.
 - American Express International Banking Corporation v. CIT 258 ITR 601-Bombay HC held that above SC ruling does not apply to business head of income.
 - Above controversy is also applicable to securities held as stock-in-trade.
- ❑ Can similar practice be followed at the time of sale of securities? – Revenue recognition?

ICDS VIII – SECURITIES (Con't...)

- ❑ Subsequent measurement - **Bucket Approach valuation**
 - Valuation at lower of cost or Net Realizable Value (NRV)
 - Comparison on category wise basis and not individual basis
 - Securities to be classified as follows for comparison purpose:
 - a) Shares b) Debt securities c) Convertible securities
 - d) Any other securities
 - Impact/ Significant issues:
 - Notional profit would be indirectly recognised and brought to tax by this approach since appreciation in the value of certain securities will be set off against diminution in the value of other securities.
 - MTM/ expected losses allowed for loss on valuation of securities

ICDS VIII – SECURITIES (Con't...)

❑ Illustration – Bucket Approach

Individual Security	Cost	NRV	Lower of cost or NRV
Company A	100	25	25
Company B	100	35	35
Company C	100	20	20
Company D	100	500	100
Total	400	580	180
Valuation (AS-13) – lower of 400 or 180			180
Valuation (ICDS) – lower of 400 or 580			400

- ❑ Bucket approach results in accelerated taxation of appreciation
- ❑ Appreciation in value of Company D is brought to tax to the extent of depreciation in value of other securities

ICDS VIII – SECURITIES (Con't...)

- ❑ Valuation of securities which are listed but not quoted with regularity from time to time – Actual cost
- ❑ Allocation of cost – Specific Identification else FIFO:
 - This contemplates a situation where securities are held in Demat form and section 45(2A) read with circular no. 768 dated 24 June 1998 indicates that the transfer therefrom, would be considered to be on FIFO basis.
- ❑ Opening value of securities held as stock in trade:
 - Commencement of business – Cost of securities available
 - Closing value of the Immediately preceding previous year
- ❑ No transitional and disclosure provisions

ICDS VIII - SIGNIFICANT ISSUES

- ❑ Basis of computing NRV
- ❑ Conversion vs Exchange – Purchase cost / fair value
- ❑ ICDS VIII does not specify when securities can be considered as stock-in-trade. Litigation around the same continues and one still have to rely on judgements and CBDT circular no. 4/2007 dated 15 June 2007 read with Instruction no. 1827 dated 31 August 1989.
- ❑ Relevance of “Real income theory” ? (i.e. Bucket Approach)
- ❑ Supreme Court in **United Commercial Bank v. CIT 240 ITR 355** on anticipated profit

ICDS X

Provisions, Contingent liabilities and Contingent assets



ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

□ Scope and Exclusions:

All provisions, contingent liabilities and contingent assets other than arising from :

- Financial instruments
- Executory contracts
- Insurance business from contracts with policyholders
- Covered by other ICDS
- Revenue recognition
- Provision in relation to depreciation, impairment of assets and doubtful assets adjusted to the carrying amount of the assets

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Condt...)

□ Provisions:

- Cumulative conditions for recognition of provision:
 - Present obligation as a result of a past event
 - **Reasonable certainty** of an outflow of resources
 - Reliable estimate of obligation
- Impact/ Significant issues:
 - Deviation from AS 29 – provision to be made as per yardstick of ‘probability’
 - ‘reasonably certain’ vs. ‘probable’
 - ICDS does not define the term “Reasonably certain”
 - Would provision made on the test of ‘probable’ entail disallowance?
 - Obligation under proposed law on enactment

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Con't...)

- ❑ Decisions where provision allowed based on probable condition.
 - Kone Elevator India (P) Ltd. Vs. ACIT [2012] 21 taxmann.com 81 (Madras High Court)
 - FL Smidth Minerals (P) Ltd. Vs. DCIT [2013] 36 taxmann.com 72 (Madras High Court)
 - Himalaya Machinery (P) Ltd Vs. DCIT [2011] 16 taxmann.com 60 (Gujarat High Court)
 - Rotork Controls India (P) Ltd Vs.CIT [2009] 180 taxman 422 (Supreme Court)

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Condt...)

- ❑ Contingent assets to be recognised if inflow of economic benefit is ‘reasonably certain’
 - Deviation from AS 29 which prescribes ‘virtual certainty’

- ❑ Impact/ Significant issues:
 - ICDS does not define the term “reasonably certain”.
 - Increase in litigation.....

- ❑ Amendment to Finance Bill 2015 to “align Act with ICDS”
 - Second proviso to s. 36(1)(vii) inserted to provide for deduction of bad debts, in regard to income recognised as per ICDS without recording in books of account, in the year in which such debt ‘becomes irrecoverable’ – deemed to be written off in accounts

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Con't...)

- ❑ Contingent liabilities should not be recognized.
- ❑ **Contingent liability vs liability /obligation:**
 - No specific guidance for meaning of “obligation”
 - As per AS-29, obligations may be legally enforceable and may arise from normal business practice, custom and a desire to maintain good business relations.
 - Impact/ Significant issues:
 - Can provisions made on account of obligations be disallowed ?
- ❑ **Transitional provisions :**
 - Recognition of assets and related income as on 1st April 2015
 - Illustration – A claim accepted by the High Court in FY 2014-15. Appeal is preferred to the Supreme Court. Should the claim be recognized as receivable on the basis of reasonable certainty? Impact of ICDS on revenue recognition ?
 - Does it conflict with the concept of ‘accrual’ ?

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Con't...)

- ❑ **Onerous & executory contracts and Restructuring provisions:**
 - ICDS does not apply to executory contracts
 - It is silent on onerous contract and restructuring provisions
 - AS- 29 mandates recognition of present obligation under onerous contracts
 - Impact/ significant issues:
 - Can deduction for liability under onerous contract be allowed on accrual basis ? Real income theory?
- ❑ **Measurement and review at the end of year:**
 - Recognition of provision at best estimate of the expenditure required to settle the obligation/ value of economic benefit
 - Estimate not to be discounted to its present value
 - Provision to be reviewed at year end

ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Con't...)

❑ ICDS X vs. Ind AS 37

Sr. No.	Item	ICDS X	IND AS 37
1	Discounting the amount of provisions	Prohibits discounting the amount of provisions	Requires discounting the amount of provisions, if effect of the time value of money is material.
2	Additional guidance	-	<p>a) Rights to interest arising from De-commissioning, Restoration and Environmental Rehabilitation Fund.</p> <p>b) Liabilities arising from participating in a specific Market – Waste Electrical and Electronic Equipment</p>

ICDS X - SIGNIFICANT ISSUES

- ❑ Recognizing the expenditure on the basis of prudence by AS 29 v recognition on basis of reasonable certainty – Impact on taxable income and timing of tax outflow.
- ❑ Recognition of a provision as per ICDS could be a two way sword
 - Assessee keen on claiming deduction of expenditure which is reasonably certain though it may not have been debited to P&L.
 - TDS implication on such claim
- ❑ Timing difference on account of increase in gap between book profit and taxable profit resulting in creation of deferred tax asset/ liability.

ICDS X - SIGNIFICANT ISSUES (con't...)

- ❑ In case of conflict between ICDS and Act, Act shall prevail. BUT
 - In case of conflict between ICDS and Supreme/ High Court pronouncements ??
 - Increased litigation on account of uncertainties and conflict - contrary to the stated objective for origin of ICDS.

- ❑ Although, ICDS categorically states that separate books of accounts are not required, it would be almost impossible to adhere to tax computation provisions as per ICDS without maintaining so.

THANK YOU