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India | Tax & Regulatory | 7 April 2015

Global Business Tax Alert
Sharp Insights

Income computation & disclosure standards - notified

Issue no: GBTA/8/2015

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Background

The Central Board of Direct Taxes (CBDT) issued a notification on 31st March 2015 stating that the Income Computation and Disclosure Standards (ICDS) will come into effect from 1 April 2015 and shall accordingly apply for assessment year 2016-17 onwards. ICDS have been notified by the Government as per powers granted under section 145(2) of the Income-tax Act, 1961 (Act). ICDS apply to **all** taxpayers following accrual system of accounting for the purpose of computation of income under the heads of ‘Profits and gains of business / profession’ and ‘Income from other sources’.

A draft of 14 Tax Accounting Standards were first issued in August 2012. However, these were revised further and 12 draft ICDS were issued in January 2015 for public comments. By way of above notification, 10 ICDS were finalized – excluding the standards on ‘Leases’ and ‘Intangible Assets’

Summary

- As part of Preamble to the all the ICDS, it has been stated that ICDS are only for income computation and not for maintenance of books of account.
- The Preamble also mentions that in case of conflict between the provisions of the Act and ICDS, the Act shall prevail.
- We have summarized some key highlights of each ICDS below.

ICDS I: Accounting policies:

- ICDS recognizes three accounting concepts – going concern, consistency and accrual.
- Accounting policies must be chosen to represent true and fair view of state of affairs and income. The treatment of transactions will be governed by their substance and not legal form.
- Accounting policy can be changed if there is reasonable cause to do so.
- Mark-to-market or expected loss shall not be recognized unless provided by other ICDS – for example, ICDS II provides for valuation of inventories at cost or net realizable value, whichever is lower

ICDS II: Valuation of inventories

- Inventories shall be valued at cost or net realizable value, whichever is lower.
- Three valuation methods have been identified – First-in First-out, weighted average cost formula and retail method.
- Specific identification of cost is required for goods that are not interchangeable.
- Recording of inventory is now required for service providers.

ICDS III: Construction contracts

- Revenue (including retentions) and costs (i.e. direct cost, allocated cost, borrowing cost as per specific ICDS and other cost specifically chargeable to customer) from construction contracts shall be recognized by reference to the stage of completion of the contract.
- During the early stages of a contract, where the outcome of the contract cannot be estimated reliably, contract revenue must be recognised only to the extent of costs incurred. The early stage of a contract shall not extend beyond 25% of the stage of completion.

ICDS IV: Revenue recognition

- Sale of goods shall be recognised when all significant risks and rewards of ownership are transferred. Claims for escalation of price and export incentives can be postponed to the extent of uncertainty involved.
- Revenue from service transactions will be recognised as per proportionate completion method and ICDS on 'Construction contracts' will apply. 'Completed service contract method', permissible under AS-9 (current Indian accounting standard followed for maintaining books of accounts), is not available to a taxpayer.
- Interest will be recognised on time basis, dividend as per provisions of the Act and royalty as per terms of the relevant agreement.
- Discount or premium on debt securities held should be accrued over the period to maturity

ICDS V: Tangible fixed assets

- Tangible fixed asset shall be recorded at actual cost including purchase price, taxes (excluding those that are recoverable) and other expenditure for bringing the asset to workable condition.
- Administration and general overheads shall be excluded from actual cost if not relating to specific asset. Expenditure on start-up and commissioning of a project shall be capitalized

while expenditure post commencement of commercial production shall be expensed.

- Tangible asset shall be recorded at its fair value if acquired for non-monetary consideration. Consolidated price for acquiring group of assets shall be apportioned on fair basis.
- Depreciation and income on transfer of asset will be as per the Act.

ICDS VI: Effects of changes in foreign exchange rates

- Foreign currency transaction shall be recorded initially at exchange rate as on the date of transaction or at a weekly / monthly average rate (if rates do not fluctuate significantly from actual).
- Exchange difference on monetary items (and not non-monetary items) at each year-end shall be recognised as income / expense.
- All exchange differences relating to integral foreign operations will be done as mentioned above and those relating to non-integral foreign operations will be treated as income / expense.
- The above is made subject to section 43A and rule 115 of the Act.
- Premium / discount on certain forward exchange contracts shall be amortised over life of the contract and exchange differences / differences on renewal or cancellation will be recognised as income / expense.
- ICDS prescribes that premium / discount / 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 should be recognised at the time of settlement.

ICDS VII: Recognition of government grants

- Government grants will be recognised when there is reasonable certainty that related conditions will be complied with and it is reasonably certain that ultimate collection will be made - recognition cannot be postponed beyond the date of actual receipt.
- Grants relating to depreciable asset must be reduced from actual cost or written down value. Grants received for a group of assets will be apportioned.
- Grants for compensation of expense / loss or for giving immediate financial support with no further related costs will be recognised as income in year in which it is receivable.
- Grants relating to non-depreciable assets and other grants will be recognised as income over the period over which related cost is charged to income.

ICDS VIII: Securities

- ICDS deals with securities held as stock-in-trade – shall be carried at actual cost (including purchase price, brokerage, cess, tax, etc.) or net realizable value, whichever is lower at year-end. Securities not listed or not quoted regularly will be recognised at actual cost.
- Securities shall be recorded at their fair value if acquired for non-monetary consideration.
- Pre-acquisition interest shall be reduced from the actual cost.

ICDS IX: Borrowing costs

- Borrowing costs (including interest, commitment charges, premium, etc.) shall be capitalized in case of tangible and intangible assets to the extent provided in the standard. With respect to inventory, they shall be added to cost only if inventory takes twelve months or more for bringing to saleable condition.
- The period of capitalization starts from the date when specific borrowings have been taken and ends on the date when asset is first put to use (in case of inventory, capitalization ends when substantially all the activities necessary to prepare such inventory for its intended sale are complete). In case, asset is not put to use, capitalization under ICDS will be higher than that under AS-16 which stops capitalization when all activities to prepare asset for its use are complete.
- ICDS provides a specific formula for capitalizing borrowing costs relating to general borrowings based on the ratio of qualifying assets to total assets. Also, the capitalization will begin from date of utilization of funds.

ICDS X: Provisions, contingent liabilities and contingent assets

- A provision should be recognized 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.
- However, as per AS-29, provision is recognised when outflow of resources is 'probable' and not when it is 'reasonably certain'.
- 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 recognized in previous year in which the change occurs. However, as per AS-29, contingent asset is recognised when inflow of resources is 'virtually certain' and not when it is 'reasonably certain'.

- Provisions and contingent assets will be reviewed at each year-end and reversed if they do not meet recognition criteria.

Comments

Broadly, ICDS is aligned with the existing provisions of the Act and it acts as a tool for bringing in greater clarity by giving specific instructions for computation of taxable income. However, since the Act prevails over ICDS, the impact of ICDS on existing judicial precedents needs to be evaluated. Also, while ICDS applies prospectively, it is not clear whether ICDS affects existing litigation.

Further, certain accounting treatments which were used as a base for computing taxable treatment cannot be taken for granted and must be re-looked at from ICDS perspective. The accounting scenario in India is also undergoing a sea change. The new Indian Accounting Standards are being made mandatory for certain class of companies with effect from 1 April 2016. Accordingly, differences between ICDS and the current / new accounting standards must be mapped by companies to assess the impact on taxable income including book profits as well as maintenance of relevant documentation.

Source:

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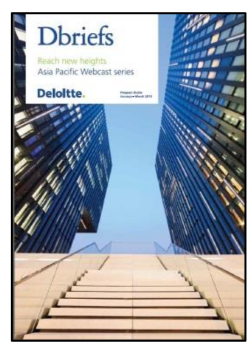

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