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CBDT releases draft of Income Computation and Disclosure Standards

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Background

- The Finance Act, 1995 empowered the Central Government to notify Accounting Standards for any class of assessees or class of income vide Section 145(2) of the Income-tax Act, 1961 (‘Act’).
- The CBDT constituted an Accounting Standards Committee (‘Committee’) in December 2010 to suggest on the standards for the purpose of notification under section 145(2) of the Act.
- The Committee submitted its final report alongwith the Draft of Standards [referred to as Tax Accounting Standards (‘TAS’)] in August 2012 which was released for public comments. The Committee had proposed 14 TAS out of 31 Accounting Standards (‘AS’) issued by The Institute of Chartered Accountants of India (‘ICAI’).
- Based on suggestion of the Committee, Section 145(2) of the Act was amended by the Finance (No. 2) Act, 2014 to permit issuance of “income computation and disclosure standards” (‘ICDS’). The said amendment is effective from 1 April 2015.
- Based on the suggestions received from the stakeholders and examination of the same by the CBDT, the draft standards submitted by the Committee have been revised.
- The new draft of 12 ICDS has now been issued by CBDT **seeking comments from stakeholders and general public**
- The TAS has been renamed as ICDS in the new draft in line with the amendment made to Section 145(2) by the Finance (No. 2) Act, 2014.
- The salient features of the draft ICDS are:
  - A transitional provision on the applicability of ICDS with effect from 1 April 2015 has been provided.
  - The changes proposed in ICDS as compared to TAS is to further align the income computation standard with the provisions of the respective AS notified by ICAI
- The draft of 12 ICDS reiterates that the ICDS 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. It further reiterates that in case of conflict between the provisions of the Act and ICDS, the provisions of the Act shall prevail to that extent.

Income Computation and Disclosure Standards

- The changes suggested in the draft ICDS vis-à-vis earlier TAS are briefly summarised hereunder:

ICDS for Accounting Policies

- The transitional provision provides that all contract or transaction existing on 1 April 2015 or entered into on or after 1 April 2015 shall be dealt with in accordance with the provisions of ICDS after taking into account the income, expenses or loss, if any recognised in respect of the said contract or transaction for the previous year ending on or before 31 March 2015.

ICDS for Valuation of Inventories

- The requirement of valuing the inventory of services at cost in case of service provider has been done away with. In case of service provider as well, the inventory of services shall be valued at cost or net realizable value, whichever is lower.
- Where the business has commenced during the previous year, the value of opening inventory shall be the cost of inventory available, if any, on the day of commencement of the business.
- The TAS provided that in case of dissolution of a partnership firm; the inventory on the date of dissolution shall be valued at the net realizable value. The ICDS proposes to extend the said requirement to dissolution of Association of Person (AOP) or Body of Individuals (BOI).
- The transitional provision provides that interest and other borrowing costs which do not meet the criteria for recognition of interest as a component of the cost as specified in the ICDS on borrowing cost, but included in the cost of opening stock as on 1 April 2015 shall be taken into account for determining cost of such inventory for valuation as on close of the previous year beginning on or after 1 April 2015, if such inventory continue to remain part of the inventory as on the close of the previous year beginning on or after 1 April 2015.

ICDS for Construction Contracts

- The contract revenue shall be recognized when there is reasonable certainty of ultimate collection.
- The transitional provision provides that the contract revenue and contract cost

associated with the construction contract which commenced on or before 31 March 2015 but not completed by 31 March 2015 shall be recognized as revenue and cost in accordance with the provisions of the ICDS. The amount of contract revenue, contract costs or expected loss, if any, recognised for the said contract for any previous year commencing on or before 1 April 2014 shall be taken into account for recognizing revenue and costs of the said contract for the previous year commencing on 1 April 2015 and subsequent previous years.

ICDS for Revenue Recognition

- Revenue shall be recognized only when there is reasonable certainty of its ultimate collection. This has been provided to bring it in line with the AS-9 issued by the ICAI.
- The transitional provisions provide that:
  - The transitional provisions of ICDS on construction contracts shall mutatis mutandis apply to recognition of revenue and the associated costs for a service transaction undertaken on or before 31 March 2015 but not completed by 31 March 2015.
  - Revenue for a transaction undertaken on or before the 31 March 2015 but not completed by 31 March 2015 shall be recognised in accordance with the provisions of the ICDS for the previous year commencing on the 1 April 2015 and subsequent previous year. The amount of revenue, if any, recognised for the said transaction for any previous year commencing on or before the 1 April, 2014 shall be taken into account for recognizing revenue for the said transaction for the previous year commencing on the 1 April 2015 and subsequent previous years.

ICDS for Tangible Fixed Assets

- An expenditure that increases the future benefits from the existing asset beyond its pre-assessed standards of performance is to be added to the actual cost of the tangible fixed asset. The earlier TAS provided that expenditure incurred for the purpose of preserving or maintaining an already existing asset and which does not bring new asset into existence or does not result into a new or different advantage that increases the future benefits from existing asset shall be charged to revenue else they would be required to be capitalized.
- Machinery spares shall be charged to the revenue as and when consumed whereas the TAS provided that the machinery spares shall be chargeable to revenue if the criteria prescribed (refer above) are fulfilled.
- When a tangible fixed asset is acquired in exchange for another asset / shares or other securities, the value of the tangible fixed asset so acquired shall be its actual cost. The

TAS provided that the actual cost of assets acquired to be recorded at lower of fair market value of the asset acquired or the fair value of the asset given up/ securities issued.

- The transitional provision provides that the actual cost of tangible fixed assets, acquisition or construction of which commenced on or before 31 March 2015 but not completed by 31 March 2015 shall be recognised in accordance with the provisions of ICDS. The amount of actual cost, if any, recognized for the said assets for any previous year commencing on or before 1 April 2014 shall be taken into account for recognizing the actual cost of the said assets for any previous year commencing on 1 April 2015 and subsequent years.

ICDS for The effects of changes in foreign exchange rates

- In relation to initial recognition of a foreign currency transaction, the ICDS permits use of an average rate for a week or a month that approximates the actual rate at the date of the transaction, for all the transaction in each foreign currency occurring during that period.
- In relation to conversion at last day of previous year, if the closing rate does not reflect with reasonable accuracy, the amount in reporting currency that is likely to be realized from or required to disburse, a foreign currency monetary item owing to restriction on remittances or the closing rate being unrealistic and it is not possible to effect an exchange of currencies at that rate, then the relevant monetary item shall be reported in the reporting currency at the amount which is likely to be realized from or required to disburse such item at the last date of previous year.
- The transition provision provides as under:
  - All foreign currency transactions undertaken on or after 1 April 2015 shall be recognised in accordance with the provisions of the ICDS.
  - Exchange differences arising in respect of monetary items or non-monetary items, on the settlement thereof during the previous year commencing on 1 April 2015 or on conversion thereof at the last day of the previous year commencing on 1 April 2015, shall be recognised in accordance with the provisions of the ICDS after taking into account the amount recognised on the last day of the previous year ending on the 31 March 2015 for an item, if any, which is carried forward from said previous year.
  - The financial statements of foreign operations for the previous year commencing on 1 April 2015 shall be translated using the principles and procedures specified in the ICDS after taking into account the amount recognised on the last day of the

previous year ending on the 31 March 2015 for an item, if any, which is carried forward from said previous year.

  – All forward exchange contracts existing on the 1 April 2015 or entered on or after 1 April 2015 shall be dealt with in accordance with the provisions of the ICDS 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 31 March 2015.

ICDS for Government Grants

- The transitional provision provides that all the Government grants, which meet the prescribed recognition criteria on or after 1 April 2015, shall be recognised for the previous year commencing on or after 1 April 2015 in accordance with the provisions of ICDS after taking into account any amount recognised for any previous year ending on or before 31 March 2015.

ICDS for Securities

- When a security is acquired in exchange for another asset, the value of the security so acquired shall be its actual cost as against the lower of the fair value of asset acquired or the fair value of the asset given up, as was provided in TAS.

ICDS for Borrowing costs

- In relation to funds which are borrowed generally and used for the purpose of acquisition of qualifying asset, the ICDS prescribes a formula for determining the amount of borrowing costs to be capitalized. The TAS also prescribed a formula for the said purpose. The formula prescribed in ICDS however seeks to explicitly cover the following situations:
  – where the qualifying asset does not appear in the balance sheet of a person on the first day of previous year, the half of cost of qualifying asset has to be considered as the numerator in the formula;
  – where the qualifying asset does not appear in the balance sheet of a person on the first and last date of previous year, the half of the cost of the qualifying asset has to be considered as the numerator in the formula;
  – where the qualifying asset does not appear in the balance sheet of a person on the last date of previous year, the average of the cost of qualifying asset as appearing in the balance sheet of a person on the first date of previous year and on the date of completion has to be considered as the numerator in the formula.
- The transitional provision provides that all the borrowing costs incurred on or after 1 April 2015 shall be treated in accordance with the provisions of the ICDS after taking

into account the amount of borrowing costs capitalised, if any, for the same borrowing for any previous year ending on or before 31 March 2015.

ICDS for Leases

- The transitional provision provides that all the lease transactions undertaken on or after 1 April 2015 shall be recognised in accordance with the provisions of ICDS. The lease transactions undertaken on or before 31 March 2015 shall continue to be governed by the provisions of the Act applicable to the previous year ending on or before 31 March 2015.

ICDS for Intangible Assets

- When an intangible fixed asset is acquired in exchange for another asset/ shares or other securities, the value of the intangible asset so acquired shall be its actual cost as against the fair value of the asset given up/ securities issued as was provided in TAS.
- Under TAS it has been provided that the cost of an intangible asset may undergo a change on account of price adjustment, changes in duties or similar factors. In ICDS, this has been extended even for changes on account of exchange fluctuations.
- The transitional provision provides that the identification, recognition and measurement of an intangible asset for previous year commencing on or after the 1 April 2015 shall be made in accordance with the provisions of ICDS after taking into account the amount recognised for the said asset for the previous year ending on or before 31 March 2015

ICDS for Provisions, contingent liabilities and contingent assets

- The transitional provision provides that all the provisions or assets and related income shall be recognised for the previous year commencing on or after 1 April 2015 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 31 March 2015.

Comments

- The CBDT has requested to provide comments and suggestions to the draft ICDS by 8 February 2015. The transitional provisions in the ICDS highlight the earnestness of the CBDT to have the ICDS notified from 1 April 2015.

- Please refer to our earlier alert dated 29 October 2012 which contains salient features of TAS issued in August 2012 and the changes in TAS vis-à-vis corresponding AS issued by the ICAI.

Source: Draft Income Computation and Disclosure Standards issued by CBDT on 9 January 2015

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