

INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

The Finance Ministry had notified ten Income Computation and Disclosure Standards (ICDS) from assessment year (AY) 2017-18 [financial year (FY) 2016-17].

The introduction of ICDS will help to bring increased consistency in computation and reporting of taxable income, reduce litigation and minimize the alternatives provided by the existing Accounting Standards issued by the Institute of Chartered Accountants of India.

Given that this is the first year of applicability, there could be transitional concerns on income computation, as well as disclosure under the ICDS vis-à-vis current established practices. Differences in the two practices could have significant cash and tax impact (including risk of a Best Judgement assessment in case of non-compliance). It is critical to understand the applicability of new tax standards and its various practical application issues.

Applicability of ICDS:

- ICDS are applicable for all Assessee following Mercantile system of accounting for computing the “Income from Business & Profession” and “Income from Other Sources” except those individual and HUF, who are not liable for audit u/s 44AB.
- ICDS will not be applicable for computing the Minimum Alternate Tax liability.
- ICDS would not have any impact on the financial statements of the Assessee.
- ICDS will not apply in case of presumptive taxation.

ICDS –I ACCOUNTING POLICIES

1. All income and expenditure is required to be recorded on **accrual basis** and There should be no deviation from Accrual system.
2. If any **prior period expenses** have been debited during the year, then it is to be shown separately in Computation of Income.
3. Small and immaterial capital items like calculator, etc is to be specifically charged off to Profit and Loss Account.

4. Substance over Form will prevail for treatment and presentation of transactions and events.
5. If any **mark to market loss on derivatives or expected losses** of contract have been recognized during the year as per principle of Prudence, then the same will be treated separately in Computation of Income and will not be allowable and it will be disallowed in Return of Income.

ICDS – II VALUATION OF INVENTORIES

1. The inventory is to be **valued at lower of Cost or Net Realisable Value**
2. Cost of inventory is to be valued only by FIFO or Weighted method of valuation of stock

ICDS – III CONSTRUCTION CONTRACTS

(Applicable on determination of income for a construction contract of a contractor)

1. **Only one method i.e. Percentage of Completion method (POCM) is allowed** under ICDS. Therefore, if Project completion method is used then the impact of deviation will be considered as income. i.e. If Project completion method followed then make adjustment as per POCM to income)
2. If the life of service or contract is up to 90 days the same can be recognized using Project completion method.
3. Now Retention money has been recognized as income based on actual receipt and not on accrual basis. Also running/progress bills will have to be accounted for and offered to income.
4. Where any expected losses in the project have been claimed in the year under consideration based on prudence then the same is required to be specified by way of Notes to accounts.

ICDS – IV REVENUE RECOGNITION

1. Sale of Goods – Revenue to be recorded after transfer of significant risks and rewards and when there is reasonable certainty of its ultimate collection.

2. Sale of Services – Revenue to be recorded by Percentage of Completion method.
3. Reasonable certainty of ultimate collection is not a condition precedent for recognition of revenue in case of sale of services.
4. Interest - Interest shall accrue on the time basis and no condition of reasonable certainty of ultimate collection therefore as per ICDS, Interest has to be recorded on Bad and doubtful loans on one hand and the same have to written off as bad debts on other hand.
5. If any refund has been assessed, recognize interest on refund only on actual receipt and not on time basis.
6. All incidental income is required to be offered as income from other sources and not to be reduced from project cost or cost of asset.

ICDS – V TANGIBLE FIXED ASSETS

At the outset, the provisions of Act with regard to Actual cost shall continue to be governed by Section 43(1) and explanations thereto. ICDS is not applicable on transfer of fixed assets being dealt under capital gains and depreciation shall be allowed as per Section 32 of the Act therefore the **standard may not have any impact on income. Therefore, the ICDS may be purely academic.**

ICDS – VI EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

1. Exchange difference on conversion of Integral and Non-integral foreign operations should be charged to Profit and Loss account.
2. All the monetary items i.e. Creditors for import, Debtors for export, etc. will have to be marked to market on the date of Balance Sheet. The exchange gain/ loss on monetary items should be recorded as per ICDS.
3. All non-monetary items, the forex gain/loss is required to be calculated based on date of transaction. E. g. Date of transaction and actual settlement of payment is allowable and not difference between date of transaction and Balance Sheet date.

ICDS – VII GOVERNMENT GRANTS

1. All the subsidies received for any purpose is required to be offered for tax as income.
2. All grants received in respect of non-depreciable assets is required to be credited to Profit and Loss Account.

ICDS – VIII SECURITIES

(Applies only to securities held as stock in trade and not as investments)

1. Where Securities are held as stock in trade the same is required to be valued at actual Cost. However, if the Net realizable value of category of securities e.g. Equity shares, is less than actual cost of category of securities then the valuation is required to be done at Net Realisable Value (NRV).
2. If the valuation is done based on lower of cost of NRV of individual script, the same should be recomputed based on category wise total cost and NRV and the difference should be adjusted to income.
3. In respect of **unlisted securities** or listed but not regularly quoted the inventory of **securities should be valued at cost.**

ICDS – IX BORROWING COSTS

1. Acquisition of Foreign Asset - The exchange difference on borrowings made for acquisition of fixed assets from abroad should be capitalized and not be treated as borrowing cost.
2. Acquisition of Indian Asset – Exchange difference on borrowing cost of foreign loan for asset acquired/constructed/produced in India is not required to be capitalized and can be charged to Profit and Loss Account.
3. Asset would be treated as Qualifying asset only if it more than one year in getting ready.
4. No suspension of capitalization of borrowing cost if interruption of active development of asset (AS 16 provides for suspension of borrowing cost in such situation)

5. Income from temporary investments is not to be reduced from borrowing costs eligible for capitalization under ICDS.

ICDS-X PROVISIONS, CONTINGENT LIABILITIES & CONTINGENT ASSETS

1. No provision is required to be made without any proper basis and without reasonable certainty. If it is made, then the same will be qualified as the contingent and disallowed in return and report in TAR Cl.21(g).
2. If any refund or claim has been accepted either under any law, the same should be recognized as income and corresponding contingent asset should be created if there is reasonable certainty of receipt. (Note that no contingent asset is allowed to be recognized as per accounting standard and the recognition shall only be for the purposes of ICDS).
3. Only disclose provisions in this clause and not liabilities, e.g. Telephone Bill, Electricity bill which are recorded as outstanding based on actual bills received subsequently.

The relevant amendment to the format of the Income Tax Return to capture the impact of ICDS was notified earlier. The relevant amendment to the format of the Tax Audit Report has now been prescribed. As per the revised format, the tax auditor is obligated to disclose detail of adjustment due to application of ICDS and disclosures as per ICDS.

I hope reader will find the above article useful in finalizing Tax Audit Report & Income tax Return for AY 2017-18.

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