CHAPTER

Income Computation and Disclosure Standards

WHAT YOU SHOULD KNOW:

- ICDS I: Accounting Policies
- ICDS II: Valuation of Inventories
- ICDS III: Construction Contracts
- ICDS IV: Revenue Recognition
- ICDS V: Tangible Fixed Assets
- ICDS VI: The Effects of changes in foreign exchange rates
- ICDS VII: Government Grants
- ICDS VIII: Securities
- ICDS IX: Borrowing Costs
- ICDS X: Provisions, Contingent Liabilities and Contingent Assets

Introduction to Income Computation and Disclosure Standards

How many ICDS: Ten (10)

Issued by: The Central Government, in exercise of the powers conferred under section 145(2) vide Notification No. 87/2016, dated 29-09-2016

To be followed by: All assessees (other than individual / HUF who is not required to get his accounts of the PY audited u/s 44AB), following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under PGBP or Income from other sources

Applicability of ICDS: A.Y. 2017-18 and subsequent assessment years

Scope: Applicable for computation of income, not for maintenance of books of accounts

Conflict with Act: In case of conflict between provisions of the Income Tax Act, 1961 and ICDS, the provisions of the Act shall prevail.

ICDS I: Accounting Policies (Related Accounting Standards: AS 1 & AS 5)

Salient Features: *(Points in italics represent that there is no such similar point in AS)*

- This ICDS deals with significant accounting policies.
- It recognizes the fundamental accounting assumptions of **going concern, consistency and accrual**. If any of these is not followed, the fact should be disclosed.
- Accounting policies adopted by a person shall be such so as to represent **a true and fair view** of the state of affairs and income of the business, profession or vocation.
- Considerations in the Selection and Change of Accounting Policies
  - The treatment and presentation of transactions and events shall be governed by their **substance and not merely by the legal form.**
  - ***Marked to market loss or an expected loss is not to be recognized*** *unless recognition of such loss is in accordance with the provisions of any other ICDS.*
  - An accounting policy shall not be changed without ***reasonable cause***.
- Any **change** in an accounting policy which has a material effect shall be **disclosed**, along with the amount.

Comparison with Accounting Standard:

Particulars	ICDS I: Accounting Policies	Accounting Standard
Considerations in the selection of accounting policies	(a) Substance over Form (b) Non-recognition of Marked to market loss or expected loss unless in accordance with any other ICDS	**As per AS 1:** (a) Prudence **(Refer Note 1)** (b) Substance over Form (c) Materiality
Changes in Accounting Policies	An accounting policy shall not be changed without ***reasonable cause***. Note: This term has not been defined and would involve exercise of judgment by management and tax authorities.	**As per AS 5:** Change is allowed if adoption of different accounting policies is required by - (a) statute; or (b) for the purpose of compliance with an accounting standard; or (c) if such change results in a more appropriate presentation of financial statements.

Note 1: Non-consideration of the concepts of Prudence:

The concept of prudence requires that provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

Non-consideration of prudence in selection and application of accounting policies may have the impact of earlier recognition of income and gains or later recognition of expenses or losses for tax computation.

ICDS	**Examples of non-consideration of prudence in the ICDSs**:
III	Non-recognition of expected losses on construction contracts and contract costs, recovery of which is not probable, as an expense immediately.
IV	Absence of requirement of "reasonable certainty of ultimate collection" for recognition of revenue from service transactions and use of resources by others yielding interest, royalties and dividends.
VII	Recognition of a Government grant shall not be postponed beyond the date of actual receipt, even if conditions attached to the grant are not fulfilled.
X	Non-recognition of provision for loss on onerous contracts.

ICDS II: Valuation of Inventories (Related Accounting Standard: AS 2)

Salient Features:

- Inventories are assets:
  - held for sale in the ordinary course of business; (Finished Goods)
  - in the process of production for such sale; (WIP)
  - in the form of materials / supplies to be consumed in production process or in the rendering of services. (R/M)
- Inventories shall be valued at **cost, or net realisable value**, whichever is lower.
- **Cost of inventories** shall comprise of all costs of purchase, costs of services, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
- *The **costs of services** shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.*
- **Costs of conversion** shall include:
  - Direct Costs
  - Production Overheads – Fixed (to be allocated on the basis of normal production capacity) and Variable (to be allocated on basis of actuals)
- Abnormal costs, storage costs (not related to production), administration overheads (that do not contribute to bringing the inventories to their present condition) and selling costs shall be **excluded** from the cost of inventory.
- The Cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by **specific identification** of their individual costs.
- The cost of inventories, other than those dealt above, shall be assigned by using the **First-in First-out (FIFO)**, or **weighted average** cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.
- Techniques for the measurement of the cost of inventories, such as the **standard cost method** or the **retail method**, may be used for convenience if the results approximate the actual cost.
- **Standard costs** take into account normal levels of consumption of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of the current conditions.
- The **retail method** can be used in the retail trade for measuring inventories of large number of rapidly changing items that have similar margins. The cost of the inventory is determined by reducing from the sales value of the inventory, the appropriate percentage gross margin.
- Inventories shall be written down to net realisable value on an **item-by-item basis**. In some circumstances, however, it may be appropriate to group similar or related items.
- *The value of opening inventory shall be the cost of inventory (in case of commencement of business) or the value of closing inventory of preceding previous year (in any other case).*
- *The method of valuation of inventories once adopted by a person in any previous year shall not be changed without reasonable cause.*
- *In case of dissolution of a partnership firm or association of person or body of individuals, **notwithstanding whether business is discontinued or not**, the inventory on the date of dissolution shall be valued at the net realisable value.*

This requirement in is in deviation from the Supreme Court ruling in *Shakti Trading Co. vs. CIT (2001) 250 ITR 871,* where it was held that if the firm is dissolved due to death of a partner and the surviving partners reconstitute the firm and continue the business as before, the firm is entitled to adopt cost or market price, whichever is lower.

- This ICDS requires **disclosure** of the accounting policies adopted in measuring inventories including the cost formulae used, details of inventories (in case of standard costing) and the total carrying amount of inventories and its classification appropriate to a person.

Comparison with Accounting Standard:

Particulars	ICDS II: Valuation of Inventories	Accounting Standard 2
Treatment of recoverable duties and taxes in cost of purchase	The costs of purchase shall consist of purchase price including duties and taxes, freight inwards and other expenditure directly attributable to the acquisition.	The costs of purchase consist of the purchase price including duties and taxes *(other than those subsequently recoverable by the enterprise from the taxing authorities)*, freight inwards and other expenditure directly attributable to the acquisition.

ICDS III: Construction Contracts (Related Accounting Standard: AS 7)

Salient Features:

- This ICDS should be applied in determination of income for a construction contract of a contractor.
- A construction contract may be negotiated for the construction of a single asset or the construction of a number of closely interrelated or interdependent assets.
- Construction contracts are formulated in a number of ways which, for the purposes of this ICDS, are classified as fixed price contracts and cost plus contracts or even both.

Combining and Segmenting Construction Contracts

- The construction of each asset in a contract covering a number of assets should be treated as a **separate construction contract** when there are separate proposals, separate negotiation and identifiability of the costs and revenues of each asset.
- A group of contracts should be treated as a **single construction contract** when it is negotiated as a single package, the contracts are in effect part of a single project with an overall profit margin and the contracts are performed concurrently or in a continuous sequence.
- The construction of the **additional asset** should be treated as a separate construction contract when the asset differs significantly or the price of the asset is negotiated independently.

Contract Revenue

- *Contract revenue shall be recognised when there is* ***reasonable certainty*** *of its ultimate collection.*
- Contract Revenue shall comprise of the initial amount of revenue agreed in the contract, ***including retentions***. Retentions are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified.

The requirement in ICDS III to recognize retention money on percentage of completion method marks a significant deviation from the decisions pronounced by the Courts: In *CIT v. Associated Cables (P) Ltd. (2006) 286 ITR 596 (Bom.)* and *CIT v. Ignifluid Boilers (I) Ltd. (2006) 283 ITR 295 (Mad)*, it was held that the payment of retention money in the case of contract is dependent on satisfactory completion of contract work. The right to receive the retention money accrues only after the obligations under the contract are fulfilled and, therefore, it would not amount to income of the assessee in the year in which the amount is retained.

- Contract Revenue shall also comprise of variations in contract work, claims and incentive payments:
  (i) to the extent that it is probable that they will result in revenue; and
  (ii) they are capable of being reliably measured.
- Where revenue recognised as income is subsequently written off in the books as uncollectible, the same shall be recognised as an expense and not as an adjustment of the revenue.

Contract Costs

- Contract costs shall comprise of (a) directly related costs (b) general cost which can be allocated to the contract (c) other specifically chargeable costs to customer (d) allocated borrowing costs
- These costs shall be reduced by any incidental income (other than interest / dividend / capital gains) that is not included in contract revenue.
- Contract costs exclude costs that cannot be attributed to contract activity or cannot be allocated to a contract.
- Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion. They also include the cost of securing contract (provided they were not recognized as expense earlier) if they can be separately identified and it is probable that the contract shall be obtained.
- Costs related to future activity represent an amount due from the customer and are recognised as an asset.

Recognition of Contract Revenue and Expenses

- The percentage of completion method (POCM) is applicable for recognizing contract revenue and contract costs associated with a construction contract.
- Contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed.
- The stage of completion of a contract shall be determined with reference to:
  (a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; (exclude costs related to future activity or advances paid to subcontractors) or
  (b) surveys of work performed; or
  (c) completion of a physical proportion of the contract work.
- Progress payments and advances received from customers are not determinative of the stage of completion.
- During the early stages (not beyond 25% of stage of completion) of a contract, where the outcome of the contract cannot be estimated reliably contract revenue is recognised only to the extent of costs incurred.
- The percentage of completion method is applied on a cumulative basis in each previous year to the current estimates of contract revenue and contract costs.

Disclosure

- This ICDS also contains certain disclosure requirements, like the amount of contract revenue recognized as revenue in the period, the methods used to determine the stage of completion of contracts in progress, amount of costs, profits, advances and retentions.

Comparison with Accounting Standard:

Particulars	ICDS III: Construction Contracts	Accounting Standard 7
Point in time of recognition of expected loss on construction contracts	There is no specific requirement in ICDS III to recognize such expected losses on construction contracts immediately as expense. By implication, such losses are also to be recognized on Percentage of Completion Method as per ICDS III. Consequently, recognition of losses for tax purposes is postponed.	AS 7 permits recognition of expected loss on construction contract as well as contract costs, recovery of which is not probable, as an expense immediately. It also permits recognition of expected loss immediately as an expense, when it is probable that total contract costs will exceed total contract revenue.
Treatment of penalties arising from delays caused by the contractor in completion of the contract	ICDS III does not permit such reduction in contract revenue. Non-recognition of decrease in contract revenue as a result of such penalties would have the effect of inflating the taxable income and consequent tax liability.	AS 7 permits decrease in contract revenue as a result of penalties arising from delays caused by the contractor in the completion of the contract.
Point in time of recognition of retention money	ICDS III requires retention money to be treated as part of contract revenue and recognized on percentage of completion method. Contract Revenue shall comprise of the initial amount of revenue agreed in the contract, including retentions.	As per AS 7, contract revenue should comprise the initial amount of revenue agreed in the contract. There is no specific requirement to include retentions.

ICDS IV: Revenue recognition (Related Accounting Standard: AS 9)

Salient Features:

- This ICDS deals with the bases for recognition of revenue arising in the course of the ordinary activities of a person from –
  - o the sale of goods;
  - o the rendering of services;
  - o the use by others of the person's resources yielding interest, royalties or dividends.
- It does not, however, deal with the aspects of revenue recognition which are dealt with by other ICDSs.
- **Revenue** is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of a person from the sale of goods, from the rendering of services, or from the use by others of the person's resources yielding interest, royalties or dividends.
- In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.

<u>Sale of Goods</u>

- The revenue shall be recognised when the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership.
- Revenue shall be recognized when there is reasonable certainty of its ultimate collection.

However, "reasonable certainty for ultimate collection" is not a criterion for recognition of revenue from rendering of services or use by others of person's resources yielding interest, royalties or dividends.
Here, ICDS IV is in deviation with the Supreme Court ruling in *UCO Bank v. CIT (1999) 237 ITR 889*, where it was held that interest on sticky loans would not accrue if the same was not recoverable and the Delhi High Court ruling in *DIT v. Brahmaputra Capital Financial Services Ltd. (2011) 335 ITR 182 (Del.)*, where it was held that interest on non-performing assets which is not received with no possibility of recovery may not be recognized.

- Recognition of any claim for price escalation shall be postponed if there is no reasonable certainty of collection.

<u>Rendering of Services</u>

- Revenue from service transactions shall be recognized by the percentage completion method. (as in ICDS III)
- However, when services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis over the specific period.
- Revenue from service contracts with duration of not more than ninety days may be recognised when the rendering of services under that contract is completed or substantially completed.

<u>Use of Resources by Others Yielding Interest, Royalties or Dividends</u>

- Interest shall accrue on the time basis determined by the amount outstanding and the rate applicable.
- Interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received.
- Royalties shall be recognized in accordance with the terms of the relevant agreement unless some other systematic or rational basis is more appropriate.
- Dividends are recognised in accordance with the provisions of the Act.

Disclosure

- There are certain disclosure requirements, like the amount of revenue from service transactions recognized as revenue during the previous year, the method used to determine the stage of completion of service transactions in progress, information relating to service transactions in progress at the end of the previous year etc.

Comparison with Accounting Standard:

Particulars	ICDS IV: Revenue Recognition	Accounting Standard 9
Criteria of "Reasonable Certainty for ultimate collection"	"Reasonable certainty for ultimate collection" is not a criterion for recognition of revenue from rendering of services or use by others of person's resources yielding interest, royalties or dividends. By implication, revenue recognition cannot be postponed in case of uncertainty regarding collectability of consideration in such cases.	AS 9 requires recognition of revenue only if no significant uncertainty exists regarding the amount of consideration that will be derived from sale of goods, rendering of services or use by others of enterprise resources yielding interest, royalties and dividends.
Recognition of revenue from service transactions – Completed Service Contract Method	Revenue from service contracts with duration of not more than ninety days may be recognised when the rendering of services under that contract is completed or substantially completed. For example, in case of courier services, revenue is recognized only when the goods are delivered at the specified destination.	As per AS 9, Completed service contract method is applicable when performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts.
Interest on refund of any tax, duty or cess	Interest on refund of any tax, duty or cess shall be deemed to be the income of the previous year in which such interest is received.	There is no such provision in AS 9. Hence, as per AS 9, even this interest shall accrue on the time basis.

ICDS V: Tangible Fixed Assets (Related Accounting Standard: AS 10)

Salient Features:

Identification of Tangible Fixed Assets

- **Tangible fixed asset** is an asset
  - o being land, building, machinery, plant or furniture
  - o held with the intention of being used for the purpose of producing or providing goods or services and
  - o is not held for sale in the normal course of business.

  This definition itself contains the criteria for classification of an item as a tangible fixed asset.
- Stand-by equipment and servicing equipment are to be capitalised.
- Machinery spares are of revenue nature except when they can be used only in connection with an item of tangible fixed asset and their use is expected to be regular, in which case they shall be capitalised.

Components of Actual Cost

- The actual cost of a tangible fixed asset shall comprise:
  - o its purchase price
  - o import duties and other taxes, excluding those subsequently recoverable
  - o any directly attributable expenditure on making the asset ready for its intended use
  - o expenditure on up and commissioning of the project, including the expenditure incurred on test runs and experimental production
  - o expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance (if the addition / extension has a separate identity, then it shall be treated as a separate asset)
- The actual cost of an acquired tangible fixed asset shall not include:
  - o any trade discounts and rebates (i.e. these are to be deducted to arrive at actual cost)
  - o administration and other general overhead expenses (if not related to a specific tangible fixed asset)
  - o expenditure incurred after the plant has begun commercial production
- The cost may undergo subsequent changes due to price adjustment or exchange fluctuations.
- Any internal profits shall be eliminated in arriving at costs of self-constructed tangible fixed assets.
- The fair value of a tangible fixed asset acquired in exchange for shares or other securities or another asset shall be its actual cost.

Valuation in special cases

- Where a person owns tangible fixed assets jointly with others, the proportion in the actual cost, accumulated depreciation and written down value is grouped together with similar fully owned tangible fixed assets.
- Where several assets are purchased for a consolidated price, the consideration shall be apportioned to the various assets on a fair basis.

- Depreciation on such assets and income arising on transfer of such assets shall be computed in accordance with the provisions of the Income-tax Act, 1961.
- The ICDS also contains disclosure requirements in respect of such assets, like the description of asset or block of assets, rate of depreciation, actual cost or written down value, as the case may be, etc.

ICDS VI: The Effects of Changes in Foreign Exchange Rates (Related Accounting Standard: AS 11)

Salient Features:

- This ICDS deals with treatment of transactions in foreign currencies, translating the financial statements of foreign operations and treatment of foreign currency transactions in the nature of forward exchange contracts.

Foreign Currency Transactions

- A foreign currency transaction shall be recorded, on **initial recognition** in the reporting currency, by applying actual rate of exchange on transaction date or average weekly / monthly rate.

- **Treatment of Monetary and Non-Monetary Items:**

	Monetary Items	**Non-Monetary Item**
Meaning	Money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money.	Assets and liabilities other than monetary items.
Conversion at last day of PY	Apply the closing rate (**If** the closing rate (i) doesn't accurately reflect the amount likely to be realised or disbursed, or (ii) is unrealistic, **then** report the item at the likely amount.)	Use the exchange rate at the date of the transaction (in case of inventory which is carried at net realisable value denominated in a foreign currency, it shall be reported using the exchange rate that existed when such value was determined)
Exchange Differences	To be recognized as income or as expense in that PY.	Not to be recognized as income or as expense in that PY.

- These provisions shall be subject to the provisions of Sec 43A of the Income Tax Act, 1961 and Rule 115 of the Income-tax Rules, 1962.
- The financial statements of a foreign operation shall be translated using the above mentioned principles and procedures as if the transactions of the foreign operation had been those of the person himself.

Forward Exchange Contract:

means an agreement to exchange different currencies at a forward rate, and includes a foreign currency option contract or another financial instrument of a similar nature.

- **a)** For contract that is entered into to establish the amount of the reporting currency required or available at the settlement date of the transaction.

Item	**To be**
Premium or discount arising at the inception	Amortised as expense or income over the life of the contract
Exchange differences on such a contract	Recognised as income or as expense
Profit or loss arising on cancellation or renewal	Recognised as income or as expense

- **b)** For 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:

Premium, discount or exchange difference	To be recognised at the time of settlement.

Comparison with Accounting Standard:

Particulars	ICDS VI: The Effects of Changes in Foreign Exchange Rates	Accounting Standard 11
Classification as integral and non-integral foreign operation	ICDS VI does not classify between integral or non-integral foreign operations. It treats all operations as they would be treated under AS 11 as integral foreign operation.	The AS requires classification of a foreign operation as an **integral foreign operation** (a foreign operation, the activities of which are an integral part of the operation of the person) or a non-integral foreign operation.

ICDS VII: Government Grants (Related Accounting Standard: AS 12)

Salient Features:

- Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks etc. This ICDS does not deal with Government assistance other than in the form of Government grants and Government participation in the ownership of the enterprise.
- It requires recognition of Government Grants when
  (i) there is a reasonable assurance that the person shall comply with the conditions attached to them and
  (ii) the grants shall be received.
- *Recognition of Government grant shall not be postponed beyond the date of actual receipt.*
- **Treatment of Government Grants:**

<table>
<tr><th>If the grant</th><th>Then</th><th>Treatment of Refund</th></tr>
<tr><td>Relates to depreciable fixed assets</td><td>To be reduced from actual cost / WDV</td><td>Increase the actual cost / WDV</td></tr>
<tr><td>Not directly relatable to the asset acquired</td><td>A pro-rata reduction of the amount of grant should be made in the same proportion as such asset bears to all assets with reference to which the Government grant is so received.</td><td>-</td></tr>
<tr><td>Relates to non-depreciable fixed assets</td><td>To be recognized as income over the same period over which the cost of meeting such obligations is charged to income</td><td rowspan="3">Amount refundable to be first applied against any unamortised deferred credit remaining.
If amount exceeds the deferred credit, the amount shall be charged to P&L Account.</td></tr>
<tr><td>Receivable as compensation for expenses or losses incurred in a previous financial year or for the purpose of giving immediate financial support to the person with no further related costs</td><td>To be recognized as income of the period in which it is receivable</td></tr>
<tr><td>All other Government Grants</td><td>To be recognized as income over the periods necessary to match them with the related costs which they are intended to compensate.</td></tr>
</table>

- Disclosure requirements: Nature and extent of Government grants recognized during the PY as income, nature and extent of Government grants not recognized during the PY as income and reasons thereof etc.

Comparison with Accounting Standard:

Particulars	ICDS VII: Government Grants	Accounting Standard 12
Initial Recognition of Government Grants	Initial recognition of government grants cannot be postponed beyond the date of actual receipt even in a case where all the recognition conditions in accordance with AS 12 are not met.	Grants should not be recognised until there is a reasonable assurance that the enterprise will comply with the conditions attached to them and the grants will be received.
Grants of capital nature and in the nature of promoter's contribution	ICDS VII does not contain specific requirement to capitalize govt. grants in the nature of promoter's contribution. Except in case of government grant relating to a depreciable fixed asset, which has to be reduced from written down value or actual cost, all other grants have to be recognized as upfront income or as income over the periods necessary to match them with the related costs which they are intended to compensate.	AS 12 permits govt. grants in the nature of promoters' contribution, i.e., grants given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for eg., central investment subsidy scheme) to be treated as capital reserve which can neither be distributed as dividend nor considered as deferred income.

Amendment in the Income Tax Act, 1961 to keep in line with the requirement in ICDS VII:

Position Before amendment: As per the Act and settled judicial pronouncements -

- If the government grant is of revenue nature, it would be taxable. And if it is of capital nature it would not be taxable.
- The object for which the subsidy/ assistance is given which determines the nature of the incentive subsidy.
- If the object of the subsidy scheme was to enable the assessee to run the business more profitably, then, the receipt was on revenue account. Hence taxable.
- On the other hand, if the object of the assistance under the subsidy scheme was to enable the assessee to set up a new unit or to expand an existing unit, then, the receipt of the subsidy was on capital account. Hence not taxable. For example:

(a) Grants given with a view to develop backward area or to enable industries to trade over financial crisis or to generate employment in a State.

(b) Subsidy received by the assessee from the Government of West Bengal under the scheme of industrial promotion for expansion of its capacities, modernization and improving its marketing capabilities.

(c) Incentive received under the scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken for setting up/expansion of a sugar factory. *[CIT v Ponni Sugar Mills (2008) 306 ITR 392]*

Need for amendment in the Act: The requirement in ICDS VII to treat Government Grants as upfront or deferred income marks a significant deviation from the settled judicial precedents.

Amendment: W.e.f. A.Y. 2016-17, the following sub-clause (xviii) has been included in the definition of income u/s 2(24): *"Assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee other than the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to section 43(1)."*

Effect of Amendment:

As specific provision has been inserted to include the government assistance in the definition of income, it will be taxable whether the receipt is of revenue nature or capital nature. The only exception is when the subsidy is reduced from the actual cost or WDV in case of depreciable assets.

ICDS VIII: Securities (Related Accounting Standard: AS 13)

Salient Features:

- This ICDS deals with securities held as stock-in-trade.
- 'Securities' means securities as defined in the Securities Contract Regulation Act, 1956 and shall include shares of a closely held company but shall not include derivatives.
- A security on acquisition shall be recognised at actual cost which shall comprise of its purchase price and include acquisition charges like brokerage, fees, tax, duty or cess.
- The actual cost of a security acquired in exchange for other securities or another asset shall be the fair value of the security so acquired.
- Where unpaid interest has accrued before the acquisition of an interest-bearing security and is included in the price paid for the security, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion of the interest is deducted from the actual cost.
- Subsequently, at the end of any PY, securities held as stock-in-trade have to be valued at actual cost (specific identification or FIFO method or weighted average cost formula) initially recognized or net realizable value at the end of that PY, whichever is lower.
- Such comparison of actual cost initially recognized and net realizable value has to be done category-wise (shares, debt securities, convertible securities, any other) and not for each individual security.

This requirement in the ICDS VIII deviates from the judicial position that anticipated profit should not be taken into consideration for valuation of stock-in-trade. The Supreme Court, in the case of UCO Bank Ltd. v CIT 240 ITR 355, observed that it is not proper to take into account anticipated profit in the shape of appreciated value of closing stock, as no prudent trader would show increased profit before actual realization. This is the theory underlying the valuation of closing stock at the lower of cost or market price. The requirement to compare the actual cost and net realizable value category-wise, in effect, results in recognition of anticipated profits since rise in value of some securities will absorb the decrease in value of the remaining securities in the same category.

- *ICDS VIII requires valuation of the following securities at actual cost initially recognized –*
  (i) Securities not listed on a recognized stock exchange; or
  (ii) Securities listed but not quoted on a recognized stock exchange with regularity from time to time.

This requirement in ICDS VIII to value such securities at cost would also impact computation of taxable income and consequent tax liability.

- *Securities held by a scheduled bank or public financial institutions shall be classified, recognised and measured in accordance with the extant guidelines issued by the Reserve Bank of India in this regard and any claim for deduction in excess of the said guidelines shall not be taken into account.*

ICDS IX: Borrowing Costs (Related Accounting Standard: AS 16)

Salient Features:

- This ICDS deals with the treatment of borrowing costs. It does not deal with the actual or imputed cost of owners' equity and preference share capital.
- It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset. Other borrowing costs have to be recognized in accordance with the provisions of the Act.
- Qualifying asset has been defined to mean –
  - o land, building, machinery, plant or furniture, being tangible assets;
  - o know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets;
  - o inventories that require a period of twelve months or more to bring them to a saleable condition.
- This ICDS requires capitalization of specific borrowing costs and general borrowing costs.
- This ICDS provides the following formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset:

  A x B / C

  where, A = General Borrowing Costs incurred during the PY
  B = Cost of qualifying asset (average) (other than those directly funded out of specific borrowings)
  C = Average of amount of total assets (other than those directly funded out of specific borrowings)
- A qualifying asset shall be such asset that necessarily requires a period of twelve months or more for its acquisition, construction or production.
- Capitalization shall commence:
  - o In case of specific borrowing costs, from the date on which funds were borrowed.
  - o In case of general borrowing costs, from the date on which funds were utilised.
- Capitalization shall cease when the qualifying asset is put to use (in case of fixed asset) or when substantially all the activities necessary to prepare such inventory for its intended sale are complete (in case of inventory).
- It requires disclosure of the accounting policy adopted for borrowing costs and the amount of borrowing costs capitalized during the year.

Comparison with Accounting Standard:

Particulars	ICDS IX: Borrowing Costs	Accounting Standard 16
Minimum period for classification of an asset as a qualifying asset	A qualifying asset shall be such asset that necessarily requires a period of twelve months or more for its acquisition, construction or production.	Qualifying asset has been defined to mean an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. AS 16 clarifies that ordinarily a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case.
Income earned from temporary investment of borrowed funds	ICDS IX does not permit such reduction from borrowing costs. This deviation between AS 16 and ICDS IX would result in increase in taxable income.	AS 16 permits income earned on temporary investment of borrowed funds pending their expenditure on the qualifying asset to be deducted from borrowing costs incurred.
Suspension of capitalization of borrowing costs	ICDS IX does not permit suspension of capitalization of borrowing costs. This deviation between AS 16 and ICDS IX would result in increase in taxable income.	AS 16 permits suspension of capitalization of borrowing costs during extended periods in which active development is interrupted.

ICDS X: Provisions, Contingent Liabilities and Contingent Assets

(Related Accounting Standard: AS 29)

Salient Features:

Provision

- **Provision** is a liability which can be measured only by using a substantial degree of estimation.
- A provision shall be recognised when
  (a) a person has a present obligation as a result of a past event;
  (b) it is reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; and
  (c) a reliable estimate can be made of the amount of the obligation.
- No provision shall be recognised for costs that need to be incurred to operate in the future.
- The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the previous year. The amount of a provision shall not be discounted to its present value.
- Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when it is reasonably certain that reimbursement will be received if the person settles the obligation.
- Provisions shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate.
- A provision shall be used only for expenditures for which the provision was originally recognised.
- Disclosure requirements: Description, carrying amount, additional provisions, amounts used, reversed, expected reimbursement.

Contingent Liability

- **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 non-occurrence 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.
- A person shall not recognise a contingent liability.
- An obligation, for which a person is jointly and severally liable, is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Contingent Asset

- **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.
- A person shall not recognise a contingent asset.
- Contingent assets are to be assessed continually. When it becomes reasonably certain that inflow of economic benefit will arise, the asset and related income have to be recognized in the PY in which the change occurs.
- The amount recognised as asset and related income shall be the best estimate of the value of economic benefit arising at the end of the PY.

- An asset and related income recognised as provided in para 11 shall be reviewed at the end of each previous year and adjusted to reflect the current best estimate.
- Disclosure requirements: description, carrying amount, additions and reversal.

Comparison with Accounting Standard:

<table>
<tr><th>Particulars</th><th>ICDS X: Provisions, Contingent Liabilities and Contingent Assets</th><th>Accounting Standard 29</th></tr>
<tr><td rowspan="2">Condition for recognition of Provision</td><td>ICDS X requires recognition of a provision only when it is “reasonably certain” that an outflow of resources embodying economic benefits will be required to settle the obligation.</td><td>AS 29 requires recognition of a provision when it is “probable” that an outflow of resources embodying economic benefits will be required to settle the obligation.</td></tr>
<tr><td colspan="2">The requirement of “reasonable certainty” in ICDS X to recognize a provision is more stringent as compared to the requirement of “probability” in AS 29. This will have the effect of postponing the recognition of provision for tax purposes and consequently, result in earlier payment of taxes.</td></tr>
<tr><td rowspan="2">Condition for recognition of Contingent Asset</td><td>After continual assessment, recognition of contingent assets and related income is required in ICDS X, if inflow of economic benefits is “reasonably certain”.</td><td>After continual assessment, recognition of contingent assets and related income is required in ICDS X, if inflow of economic benefits is “virtually certain”.</td></tr>
<tr><td colspan="2">The requirement of “reasonable certainty” in ICDS X to recognize a contingent asset and the related income is more stringent as compared to the requirement of “virtual certainty” in AS 29. This deviation between AS 29 and ICDS X would have the effect of advancing recognition of income for tax purposes and consequently, result in earlier payment of taxes.</td></tr>
</table>