ICDS and Tax Audit

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Form No. 3CD

- In F. No. 3CD, in clause 13, sub clauses (e) and (f) are inserted.
- Sub Clause (e) requires reporting of addition/deduction to net profit under each ICDS
- Sub clause (f) requires disclosures to be made under each ICDS
- For each ICDS, sub Cl. (f) has a limit of 500 characters.
- Where disclosures per ICDS exceed 500 characters, the same can be printed separately on the letterhead of the audit firm.
- This document can be uploaded along with the accounts of the client while uploading the the xml file on the Income-tax web portal.

Contents

General principles

- ICDS are applicable for computation of income chargeable under the head “profits and gains of business or profession” and “income from other sources” and not for maintaining books of accounts.
- ICDS applies to all taxpayers except individual and HUF who are not covered under the tax audit provisions.
- In case of conflict between the provisions of the Act and ICDS, the provisions of the Act shall prevail to that extent.
  - The risk of best judgment assessment u/s 144 if positions adopted as per ICDS which is contrary to rulings.
- ICDS applies only to taxpayers following mercantile system of accounting.

Circular No. 10/2017 dated 23rd March, 2017

❖ Clarifications-

✓ **Interplay between ICDS I and Maintenance of Books of Account**

It is clarified that ICDS are not applicable to maintenance of books of account. The Accounting Policies in ICDS I are applicable for computation of income.

✓ **Inconsistency between judicial precedents and ICDS**

The ICDSs have been notified after examination of judicial views for bringing certainty on issues covered by it. As the CBDT has now provided certainty by notifying ICDS, the provisions of ICDS shall be applicable to the transactional issues dealt therein from AY 2017-18 and onwards.

Circular No. 10/2017 dated 23rd March, 2017

❖ Clarifications-

✓ **Applicability of ICDS in certain cases**

The clarifications have been issued by the CBDT on the applicability of ICDS to persons covered under presumptive taxation scheme, companies following Ind-AS, computation under Minimum Alternate Tax (‘MAT’) and Alternate Minimum Tax (‘AMT’), banks, etc. as under:

Circular No. 10/2017 dated 23rd March, 2017

Persons covered by presumptive scheme of taxation (eg. Sec 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA of the Income-tax Act, 1961).

It has been clarified that ICDS is applicable to persons having income chargeable under the head ‘Profits or gains of business or profession’ or ‘Income from other sources’. Therefore the relevant ICDS shall also apply to persons computing income under the relevant presumptive taxation scheme.

Circular No. 10/2017 dated 23rd March, 2017

- Clarifications-

✓ **Applicability to companies which adopted Ind-AS**

- ICDS is applicable for computation of taxable income under the Income-tax Act, 1961 ('Act') irrespective of the accounting standards adopted by the companies i.e., either Accounting standards or IND-AS.

✓ **Whether applicable to computation under MAT and AMT**

- As the provisions of ICDS are applicable for computation of income under the regular provisions of the Act, the provisions of ICDS shall not apply for computation of book profit under section 115JB of the Act. However, as AMT is computed on adjusted total income derived by making specified adjustment to total income computed under regular provisions of the Act, the provisions of ICDS will apply for computation of AMT.

Circular No. 10/2017 dated 23rd March, 2017

- ✓ **Applicability to Banks, Non-banking financial institutions, Insurance companies, Power sector etc.**

- The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. (Example: ICDS VIII contains specific provisions for Banks or certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business). Applicability of ICDS III and IV by real estate developers and Build-

- ✓ Operate-Transfer ('BOT') projects and applicability of ICDS for leases As currently there is no specific ICDS notified for real estate developers, BOT projects and leases, the relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

Circular No. 10/2017 dated 23rd March, 2017

✓ **Applicability of ICDS to income liable to tax on gross basis**

The provisions of ICDS shall also be applicable for computation of income on gross basis (e.g. interest, royalty, fees for technical services under section 115A of the Act) for arriving at the amount chargeable to tax.

✓ **Conflict between the provisions of ICDS and Income Tax Rules, 1962**

As ICDS provides for general principles for computation of income, in case of conflict between the provisions of the Rules and ICDS, the provisions of Rules which deal with specific circumstances, shall prevail (e.g. 9A, 9B etc.).

Accounting Policies

Materiality

- No concept of materiality in ICDS unlike, AS-1.
- No likely significant tax impact
- In the absence of materiality concept, considerable time and cost will be involved making trivial adjustments in net profit as per books of account to arrive at PGBP since authorities may insist on strict application of ICDS even on small value items.

Prudence

- Based upon the concept of ‘prudence’, AS-1 precludes recognition of anticipated profits and requires recognition of expected losses.
- However, ICDS provides that **expected losses or mark to market losses** shall not be recognized unless permitted by any other ICDS to avoid differential treatment for recognition of income and losses.
- Finance Act 2018, introduced new section 40A(13) to provide that MTM loss and expected loss shall be disallowed except specifically permitted by other notified ICDS.

Prudence

- Further, Finance Act 2018, introduced new section 36(1)(xviii) to provide that MTM loss and expected loss shall be allowed as specifically permitted by notified ICDS.
- Further, as per FAQ 8 dated 23rd March, 2017 issued by CBDT, **expected gains or mark to market gains** shall not be recognized unless permitted by any other ICDS.

Prudence

- In the absence of prudence as a fundamental assumption, there could be several situations which could result in earlier recognition of income or gains or later recognition of expenses as compared to that under AS. E.g. provision for warranty expenses on sales made.
- An ambiguity would arise on deductibility of losses which are not covered in any specific ICDS. E.g. Currently no specific proposed ICDS dealing with MTM loss on derivatives. Refer Tech. Guide of ICAI.

Accounting Policy

- Accounting policy shall not be changed without "reasonable cause". The term "reasonable cause" is not defined in the Act.
- The CBDT has clarified in FAQ no 8 that under the Act, "reasonable cause" is an existing concept and has evolved well over a period of time conferring desired flexibility to the tax payer in deserving cases.

Example:

Year	Loss	Anticipated Income	Computation		Remarks
			Income Tax	Books of Account	
1	Expected loss = (5000)	Actual Income = 1,000	1,000	(4,000)	Foreseeable loss is not allowed as deduction in Year 1 as per ICDS but actual profit is taxed and thus tax is required to be paid as per Normal Provisions on 1,000.
2	Actual loss = (5,000)	Actual Income = 1,000	(4,000)	1,000	As per ICDS, the actual loss will now be allowed in year 2 and actual gain will be regarded as income in accounts. However, MAT will apply and tax is required to be paid as per the provisions of MAT.

Deferred Tax Asset (DTA) / Deferred Tax Liability (DTL) as the case may be as per AS 22 would arise.

Disclosures

- Significant accounting policies including any change in it which has material effect in current and likely to have effect in future years.
- The amount by which an item is affected by change shall also be disclosed.
- Disclosure or change in policy cannot remedy wrong or inappropriate item of income.
- If fundamental accounting assumptions of going concern, consistency and accrual are not followed the fact needs to be disclosed else not.

Valuation of Inventories

ICDS II – Service contracts

AS- 2	ICDS
• AS-2 does not include work in progress (WIP) arising in the ordinary course of business ***of service providers.***	• Specifies that it does not apply to WIP which is dealt with by other ICDS.

- Definition of inventory – does not include services ?
- As per section 145A(i) introduced in Finance act 2018, valuation of service inventory to be the lower of **cost or NRV.**
- The costs of services in the case of a service provider shall consist of labour and other costs of personnel directly engaged in providing the service including supervisory personnel and attributable overheads.

ICDS II – Service contracts

As per section 145A(ii) introduced in Finance act 2018, the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation

Valuation of Inventories in case of Firm/AOP/BOI Dissolution

- According to ICDS, 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 realizable value***.
- This is unfair particularly as there is no specific provision for allowing such NRV as the cost to the successor of the business.
- Also this is contrary to law settled by Apex court in the case of ***Sakthi Trading Co. v. CIT***

Case laws discussed

- ***<u>A.L.A. Firm v. CIT [1991] 55 Taxman 497 (SC) / 189 ITR 285</u>***

In cases of dissolution of firm, the stock-in-trade will have to be valued at the prevailing market price while preparing the accounts if the business of the firm is discontinued.

- ***<u>Sakthi Trading Co. v. CIT [2001] 118 Taxman 301 (SC) / 250 ITR 871</u>***

If on dissolution of the firm the business is not discontinued, then, the ordinary principle of commercial accounting permitting valuation of stock-in-trade at Cost or Net Realizable value whichever is lower will apply.

Derivatives held as stock in trade

- ICDS VIII deals with the securities held as stock-in-trade and the term ‘securities’. However, ICDS VIII specifically excludes the derivatives held as stock-in-trade from the meaning of securities.
- ICDS VI provides guidance on derivative contracts such as forward contract and other similar contracts. As per FAQ No 10 in the circular no 10/2017 issued by the CBDT, for derivative contract not falling within the scope of ICDS VI, the provision of ICDS I would apply to such other derivative contract.
- However, the view given by the CBDT is not in accordance with the provisions of ICDS as ICDS II provides the mechanism to value items held as stock-in-trade. Therefore, where F&O instruments are held as stock-in-trade, the provisions of ICDS II would apply and not ICDS I. The same view is also taken in the technical guide issued by ICAI.

Disclosures

- The Accounting Policies adopted in measuring inventories including the cost formulae used. Where Standard Costing has been used as a measurement of cost, details of such inventories and a confirmation of the fact that standard cost approximates the actual cost and
- The total carrying amount of inventories and its classification appropriate to a person.

Construction Contract

Construction Contract

AS-7	ICDS III
❖ **Retention Money**	
Contract revenue shall comprise: The initial amount of revenue agreed in the contract	Contract revenue shall comprise: The initial amount of revenue agreed in the contract, ***including retentions.***
Impact Analysis: There are various judicial precedents like **Angelique International Ltd. vs Department of Income Tax [ITA No.4085/DEL/2011]** which does not recognize retention money as income for tax purpose if there is no enforceable debt. ICDS leads to deviation from the settled judicial position.	

- The CBDT clarified that Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition contained in Para 9 of ICDS –III on Construction Contracts.

Construction Contract

AS-7	ICDS III
❖ **Incidental Income**	
Any incidental income, not included in the contract revenue, shall be deducted while computing construction cost.	Contract cost shall be reduced by any incidental income, not being in the nature of interest, dividends or capital gains, that is not included in the contract revenue. Therefore, those interest income, dividend income and capital gains shall be taxed as income in accordance with the applicable provisions of the Act.

Section 43CB is introduced in the Finance Act, 2018 to provide that profits arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method except for certain service contracts, and that the contract revenue **shall include retention money**, and contract cost shall not be reduced by incidental interest,
dividend and capital gains

Construction Contract

AS-7	ICDS III
❖ **<u>Recognition of foreseeable losses</u>**	
It permits to recognise immediately the foreseeable losses on a contract regardless of commencement or stage of completion of contract.	ICDS does not permit recognition of the foreseeable/expected losses on a contract. ICDS on accounting policies also does not permit recognition of foreseeable loss.
<u>Impact:</u> ICDS deviates from the present legal settled position in the case of *CIT V/s. Triveni Engineering & Industries Ltd (49 DTR 253) (Del) & CIT v. Advance Construction Co. (P) Ltd (275 ITR 30) (Guj))* in which foreseeable losses on construction contracts were allowed as a deduction for tax purpose.	

Example:

Year	Loss	Unrelated Income	Computation		Remarks
			Income Tax	Books of Accounts	
1	Expected loss = 5,000	4,000	4,000	(1,000)	Foreseeable loss of contract is not allowed as deduction in Year 1 as per ICDS and thus tax is required to be paid as per Normal Provisions.
2	Contract concludes on loss of Rs. 5,000	4,000	(1,000)	4,000	The foreseeable loss is recorded in year 1 as per AS 7 and as per ICDS the same will now be allowed in year 2. However, MAT will apply and tax is required to be paid as per the provisions of MAT.

Disclosures

- 1. The amount of contract revenue recognized as revenue in the period
- 2. the methods used to determine the stage of completion of contracts in progress

For contracts in progress/ service transactions * -

- 1. the amount of costs incurred and recognized profits less recognized losses upto the reporting date
- 2. the amount of advances received
- 3. the amount of retentions

*Disclosure requirement in case of service transactions is under ICDS on revenue recognition.

Revenue Recognition

AS - 9	ICDS
❖ It does not apply to companies engaged in insurance business.	❖ ICDS is silent on same.
❖ Revenue from service transactions are recognised as percentage completion method or by the completed service contract method.	❖ Newly inserted Section 43CB in Finance Act, 2018 provides only for percentage completion method for recognition of service transactions. ❖ Proviso to newly inserted Section 43CB provides that revenue from service contracts with duration of not more than 90 days may be recognized under completed contract method. ❖ Proviso to newly inserted Section 43CB provides that when service is provided by an indeterminate number of acts over a specific period of time, revenue may be recognized on straight line basis over the specific period

Impact: May have minimal impact since service sector largely follows POCM or Cost plus method.

ICDS requires application of ICDS on construction contracts for recognition of revenue on *mutatis mutandis* basis.

- Threshold of 25% stage of completion for recognition of income
- No recognition of the foreseeable losses on a contract. However, AS-7 permits immediate recognition of the foreseeable losses on a contract regardless of commencement or stage of completion of contract.
- Stage of completion can be determined with reference to (a) total estimated costs v/s. cost incurred till balance sheet date; or (b) survey of work performed; or (c) completion of physical proportion of work

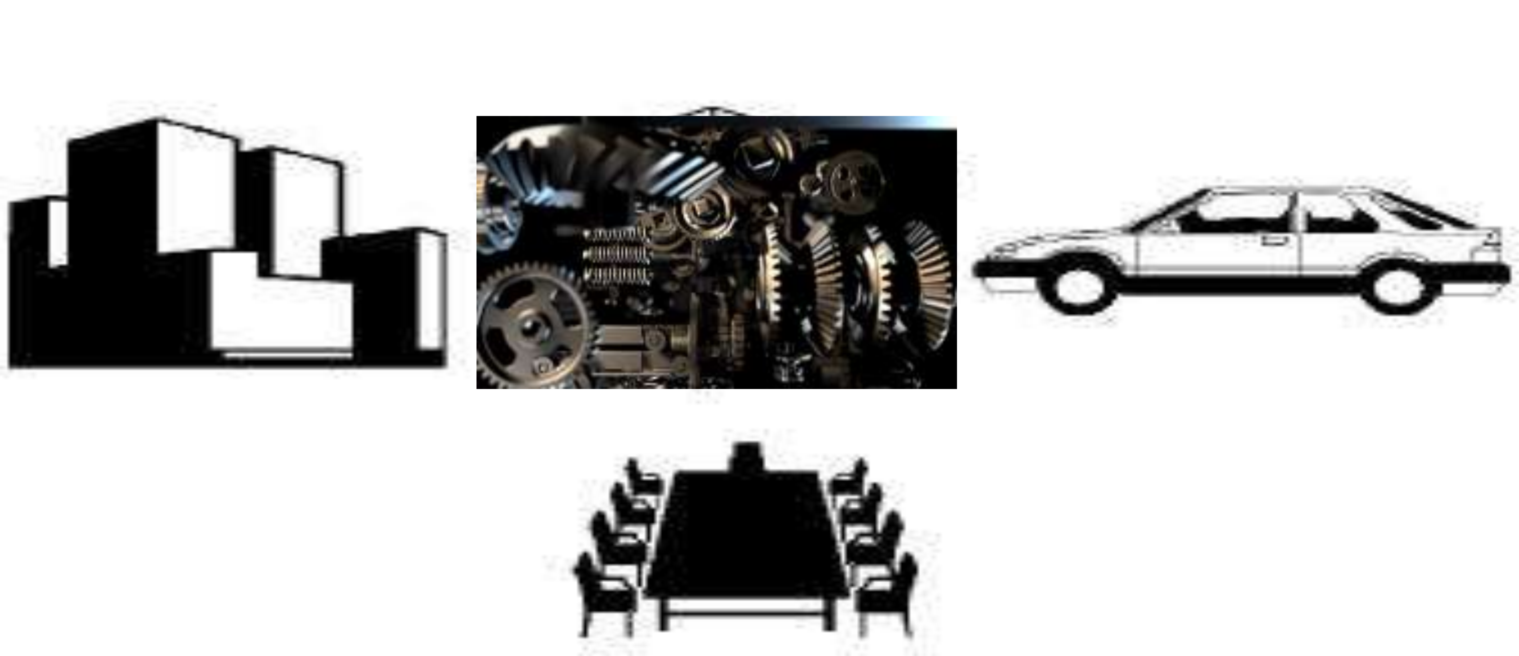
- Interest shall be accrued on time basis determined by the amount outstanding and the rate applicable.
- Newly inserted Section 145B of the Act provides that any compensation or enhanced compensation like Interest on refund of any tax, duty or cess shall be taxable on receipt basis.
- Contract Revenue and Contract Costs associated with the construction contract which commenced on or before 31 March 2016 but not completed by the said date, shall be recognized based on method regularly followed by the person prior to 1 April 2016.
- Revenue for a service transaction undertaken on or before the 31st day of March, 2016 but not completed by the said date shall be recognised in accordance with the provisions of this standard after considering the amount recognized in earlier years.

Disclosures

- Transaction involving sale of goods, amount not recognised as revenue during previous year due to lack of reasonable certainty of its ultimate collection along with the nature of uncertainty.

- The amount of revenue from service transactions recognised as revenue during the previous year.

Tangible Fixed Assets



AS- 10	ICDS
❖ It applies to tangible fixed assets	❖ It applies to only tangible fixed assets.
❖ Cost of fixed asset comprises its purchase price, non refundable taxes and any directly attributable cost of bringing the asset to its working condition for its intended use.	❖ It has similar definition to AS 10 but the words used are actual cost as compared to cost in AS -10.

Impact:

The Act provides for the definition of the term 'actual cost' and it is again repeated in the ICDS but it does not modify the concept of actual cost. However when there is conflict in interpreting the abovementioned term under ICDS and Act, the Act will prevail over ICDS. Such a narrow definition in ICDS might encourage the taxpayer to contend that expenditure on acquisition which is not part of actual cost should be deductible as revenue instead of capitalising.

AS- 10	ICDS
❖ AS 10 read with guidance note on Machinery for Spares provides for charge to P/L, however spares to specific asset should be capitalised and shall form part of that Asset .	❖ It provides that machinery spares which can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, shall be capitalized.

Impact:

ICDS specifies that machinery spares dedicated to a tangible fixed asset should be capitalized, it does not provide any further guidance on subsequent treatment that whether it will form part of the block of the asset. However, in absence of such clarification spares would form part of the block and once the principal asset is put to use, the spares shall qualify for the depreciation at the same rate.

Misc.

1. Assets held for rental- If income from such assets is taxable under PGBP or IOS, ICDS V is applicable.

2. Purchase of insignificant items under AS 10 and IndAS 16 to be expensed, under ICDS V no distinction between significant and non significant items as materiality not relevant.

3. Standby Equipments, Servicing Equipmets, Machinery Spares under As 10, IndAS 16 and ICDS V.

4. Land is a qualifying asset under ICDS on Borrowing Costs- Capitalisation of interest

5. Under AS 10 and IndAS 16, dismantling cost and the cost of removing the item and restoring the site is required to be capitalized at the inception. Adjustment will be required to block of assets and in computation to the net profit as per P/L A/c. These costs will be allowed in the year in which it is actually incurred.

6. IndAS 16/IndAS 23 require deemed interest in case of deferred credit to be reduced from the cost of the asset and debit to P/L A/c

Misc.

7. Para 6 of ICDS V- Cost of tangible fixed asset may undergo changes on account of

a) Price adjustment, changes in duties or similar factors

b) Exchange fluctuation as per ICDS VI

8. Government Grants- IndAS 16 requires credit to P/L A/c, Explanation 10 to S. 43(1) requires reduction from the cost of the asset.

9. Para 7 of ICDS V- Administrative and General Overheads attributable to specified asset to be capitalized. As per AS 10, in case of running business such overheads are debited to P/L A/c.

10. Para 8 of ICDS V- Expenditure on start up, commissioning of project and test run expenses to be capitalized as per ICDS. Conflicting judgements. FAQ 15 of Circular No 10 dated 23rd March, 2017.

Disclosures

- Description of assets or block of asset.
- Rate of depreciation
- Additions or deductions during the year with dates in case of any addition of an asset put to use, including adjustment on account of CENVAT,FOREX, subsidy or grant or reimbursement.
- Depreciation allowable.
- WDV at year end.

The Effects of Changes in Foreign Exchange Rates

Capital monetary items – Relating to Imported assets

AS- 11	ICDS
❖ Requires recognition in P&L A/c. ❖ Option of capitalization u/s 211(3C) of companies Act, 1956 as per which (Para 46 & 46A) exchange differences arising in case of long-term foreign currency monetary items shall be either adjusted to capital asset or accumulated in FCMITDA.	❖ Requires recognition in P&L A/c subject to provisions of Section 43A. ❖ No Para 46 & 46A exists.

Impact:

- ❖ Presently, Section 43A permits capitalization on payment basis of exchange differences relating to asset acquired from a country outside India.
- ❖ Hence, there would be no change in the tax position.

Capital monetary items – Not relating to Imported assets

AS- 11	ICDS
❖ Requires recognition in P&L A/c. ❖ Option of capitalization u/s 211(3C) of companies Act, 1956 as per which (Para 46 & 46A) exchange differences arising in case of long-term foreign currency monetary items shall be either adjusted to capital asset or accumulated in FCMITDA.	❖ Requires recognition in P&L A/c subject to provisions of Section 43A. ❖ No Para 46 & 46A exist.

Impact:

❖ Section 43A does not apply since it applies only if it relates to the imported assets.

❖ Presently, such FE differences are not recognized for tax purposes i.e. gain is not taxable, loss is not deductible/ allowable.

Capital monetary items – Not relating to Imported assets

Judicial precedents

- Section 43A of the Act was introduced by the Finance (No. 2) Act, 1967 with effect from 1st April, 1967.

- In the case Tata Iron & Steel [TISCO - (1998) 231 ITR 285 (SC)] for the case relating to AY 1960-61 and AY 1961-62 (When Section 43A was not introduced), Supreme Court had held that cost of an asset and cost of raising money for purchase of asset are two different and independent transactions and events subsequent to acquisition of assets cannot change price paid for it. Therefore, fluctuations in foreign exchange rate while repaying instalments of foreign loan raised to acquire asset cannot alter actual cost of assets for computing depreciation.

Capital monetary items – Not relating to Imported assets

Hence, **given that the provisions of Section 43A requiring foreign exchange gain/loss to be adjusted with the cost of the assets, apply only with respect to imported assets, the case of indigenous assets will continue to be governed by the ratio of the Tata Iron & Steel's decision.**

- ❖ Gains arising on deposits (in foreign currency) are capital receipt as the deposits were in essence loan/capital and not a trading receipt - Shell Company of China Ltd. [22 ITR 1 (CA)]
- ❖ If the foreign currency is held as a capital asset or as fixed capital, profit or loss to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, would be of capital nature. - Sutlej Cotton Mills Ltd., [(1979) 116 ITR 1 (SC)]

Capital monetary items – Not relating to Imported assets

- Conclusion

- Since ICDS requires recognition in P&L A/c subject to provisions of Section 43A and Section 43A applies only if it relates to imported assets, a controversy may arise, whether such exchange fluctuation gain or loss on capital monetary items (not relating to imported assets) would be allowable as an income or expense as per ICDS or not.

- However, Finance Act 2018 inserted new Section 43AA providing that “subject to the provisions of section 43A, any gain or loss arising on account of effects of changes in foreign exchange rates in respect of **specified foreign currency transactions** shall be treated as income or loss”.

Capital monetary items – Not relating to Imported assets

Conclusion

Foreign currency transactions, including those relating to —

(i) monetary items and non-monetary items;
(ii) translation of financial statements of foreign operations;
(iii) forward exchange contracts;
(iv) foreign currency translation reserves.”.

Government Grants

Government Grants

AS- 12	ICDS VII
❖ **<u>Recognition of grant</u>**	
• On reasonable assurance of compliance of attached conditions and reasonable certainty of ultimate collection • Mere receipt is not sufficient	• On reasonable assurance of compliance of attached conditions and reasonable certainty of ultimate collection • Recognition cannot be postponed beyond date of actual receipt
<u>Impact:</u> If the grant is recognized on receipt basis, it would create DTA/DTL and MAT mismatch also. Further, an issue may arise whether grants received in earlier years but not recognized pending fulfillment of conditions will require recognition on receipt basis as per ICDS in year of transition.	
❖ **<u>Grants other than those covered by specific provisions</u>**	
• Revenue grant to be credited as income or reduced from related expense.	• Same as AS-12 but no clarification that it is restricted only to revenue grants.

Government Grants

AS- 12	ICDS VII
❖ **<u>Relatable to depreciable fixed assets</u>**	
• Requires reduction from the cost of fixed asset or recognition as deferred revenue by systematic credit to P&L A/c.	• Consistent with Explanation 10 to Section 43(1), requires reduction from the cost of fixed asset.
❖ **<u>Relatable to non depreciable fixed assets</u>**	
• To be credited as capital reserve, if no conditions attached to the grant. • To be credited to P&L A/c over period of incurring cost of meeting conditions of grant.	To be treated as income – • on an upfront basis, if there are no conditions attached to grant. • over period over which cost of meeting conditions is incurred.

Government Grants

AS- 12	ICDS VII
❖ **<u>Grant in the nature of promoter's contribution</u>**	
• To be credited to capital reserve and to be treated as shareholders funds.	• No such clarity for grants in the nature of promoter's contribution. Therefore, by implication, requires recognition as income.
❖ **<u>Compensation for expenses / loss incurred or for giving immediate financial support</u>**	
• To be recognised in P&L A/c in the year in which it is receivable	• Same as AS-12
❖ **<u>Disclosure requirement</u>**	
• No disclosure of unrecognized grants	• Disclosure of unrecognized grants

Government Grants

- Based on the purpose and object for which the subsidy has been given, various judgments have been pronounced.
- ICDS does not seek to recognize the need for assessing characterization of subsidy into a revenue or a capital grant on the basis of motive test.
- To the extent ICDS requires recognition of any subsidy as income (for example, subsidy of a capital nature relatable to non depreciable fixed asset) will have conflict with the Act.
- To circumvent the same, the definition of 'Income' under Section 2(24) has been amended by inserting a new sub-clause (xviii) to provide that assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement by the CG or a SG or any authority or body or agency in cash or kind to the assesse [other than one considered under Explanation10 to Section 43(1)] shall be the income of an assessee. Subsidy which is reduced from the actual cost of the asset as per Explanation 10 to Section 43(1) shall not be taxable as revenue receipt.

Disclosures

- The said amendment is in line with the ICDS. Further, newly inserted section 145B provides that The income referred to in sub-clause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income-tax in any earlier previous year.
- Nature and extent of government grants recognised during the previous year by way of deduction from actual cost as well as income.
- Nature and extent of government grants not recognised during the previous year by way of deduction from actual cost as well as income and reasons thereof

Securities


Securities
Investment
Woori
Financial
industry
billion
approximately
Nonghyup
likely
trillion
won
capital
package
securities
firms
companies
year
equity
business
Company
Tong
deal
well
sector
due
Holding
Yang
Group
stock
new
years
contract
get
giant

Securities

AS- 13	ICDS VIII
❖ **<u>Applicability</u>**	
This Standard deals with accounting for investments in the financial statements of enterprises. **<u>Assets held as stock-in-trade are not 'investments'*</u>**	This ICDS deals with securities held as **<u>stock-in-trade.</u>** "Securities" shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and **shall include share of a company in which public are not substantially interested but shall not include derivatives referred to in sub-clause (ia) of that clause (h).**
*However, as per AS 13, the manner in which they are accounted for and disclosed in the financial statements is quite similar to that applicable in respect of current investments. Accordingly, the provision of AS 13 in respect of current investments are applicable to securities held as stock-in-trade.	

Securities

- A sub-chapter - Part B included to deal with securities held by a scheduled bank or public financial institutions formed under a Central or a State Act or so declared under the Companies Act, 1956 (1 of 1956) or the Companies Act, 2013 (18 of 2013)
- Securities shall be classified, recognised and measured in accordance with the existing 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.

Securities

AS- 13	ICDS VIII
❖ **<u>Carrying amount</u>**	
Current investments are valued at lower of cost and fair value.	Securities held as Stock-in-trade shall be valued at actual cost or NRV, whichever is lower. (where the actual cost cannot be ascertained by reference to specific identification, the cost shall be determined on the basis of FIFO or weighted average formula.)
Individual Scrip wise Valuation	Category wise Valuation is provided in second Proviso to Section 145A. Classification into four categories namely, (a) shares; (b) debt securities; (c) convertible securities; and (d) any other securities not covered above. **<u>Valuation of unlisted/ thinly traded securities at cost</u>** - At the end of any previous year, securities not listed on a recognized stock exchange; or listed but not quoted on a recognized stock exchange with regularity from time to time, **<u>shall be valued at actual cost</u>** initially recognized.

Securities

Certain specific issues for consideration

- The cost of a security shall comprise of it purchase price and include acquisition charges such as brokerage, fees, tax duty or cess. Hence it will include STT also
- As per section 36(1)(xv) of the Income Tax Act, such STT ought not to be added to cost, otherwise this would amount to double deduction.
- Section 145A(iii) states that securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity shall be valued at cost regardless of NRV.

Securities

Certain general issues for consideration

- The cost of bonus shares is taken at NIL for capital gains purpose. However for a trader, the cost of bonus shares is computed on averaging principle in terms of SC rulings in case of Dalmia investment (52 ITR 567).. However ICDS does not provide any specific treatment for Bonus shares.
- Part B of this ICDS deals with securities held by specific entities, namely scheduled banks or public financial institutions formed under central or state act or so declared under Companies Act 1956 or Companies Act 2013.
- Part A deals with securities held as stock in trade. Part B is silent on the same, income from securities held by bank as well as financial institution as investment will be computed under the head capital gains and will not be dealt by this ICDS, hence part B would not apply to securities held as investments but only to stock in trade.

Example

Shares	Cost	NRV	Valuation as per AS 13	Valuation as per ICDS
			Lower of cost or NRV - Individual scrip wise	Lower of cost or NRV - Category wise
ABC Ltd.	100	40	40	
XYZ Ltd.	200	140	140	
PQR Ltd.	300	150	150	
EFG Ltd.	400	250	250	
LMN Ltd.	100	500	100	
Total	**1100**	**1080**	**680**	**1080**

Impact: Category wise valuation results into accelerated taxation since appreciation in the value of certain securities will be set off against diminution in the value of other securities.

Borrowing Cost

Borrowing Costs

AS - 16	ICDS
• Qualifying Asset is an asset that takes substantial period of time to get ready for its intended use or sale.	• Qualifying Assets mean: o Tangible Assets – land, plant, etc. o Intangible Assets – patents, licenses, etc. o Inventories – that require 12 months or more to bring them to saleable condition.

Impact:

- Specified tangible & intangible assets are qualifying assets regardless of substantial period condition. However, in case of **capitalization of general borrowing cost**, a qualifying asset has been defined to be an asset that requires a period of 12 months or more for its acquisition, construction or production.
- ICDS includes 'land' also in the definition of qualifying assets, unlike AS-16. As per ICDS, the borrowing cost in respect of land shall be capitalized. The depreciation shall not be allowed on the same since the land is a non-depreciable asset. However, the capitalized cost shall form part of the cost of an asset while calculating Income from Capital Gain in respect of that land.

Borrowing Costs

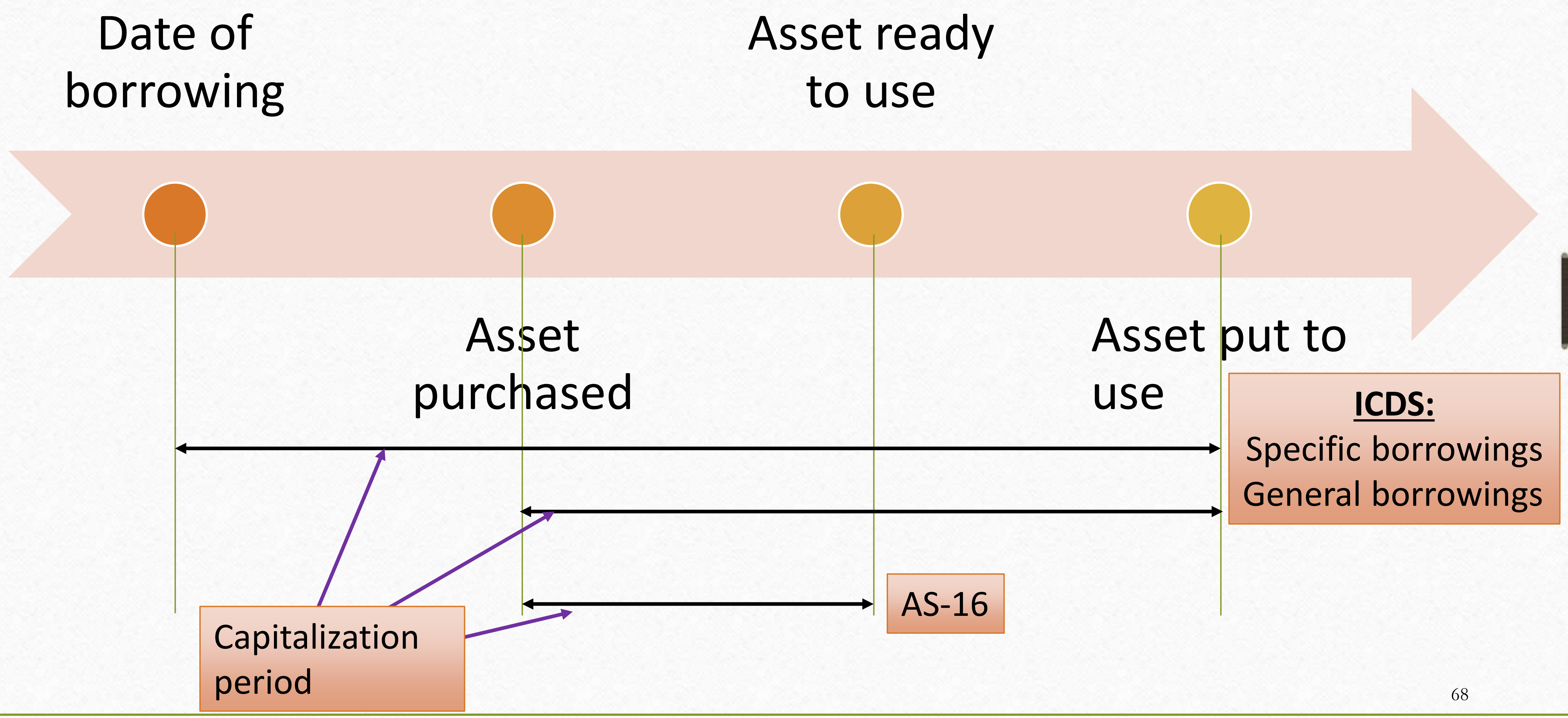
AS - 16	ICDS
• **<u>Commencement of Capitalisation:</u>**	
The date of fulfilment of three conditions viz. incurrence of capex, incurrence of borrowing costs and preparatory activities are in progress.	a) Specific borrowings – Date on which funds were borrowed b) General borrowings – Date on which funds were utilised.
<u>Impact: The capitalisation period starts early under the ICDS as compared to AS-16.</u>	

Borrowing Costs

AS - 16	ICDS
• **<u>Method of Capitalisation:</u>**	
❖ <u>Specific Borrowings:</u> Actual borrowing costs incurred on the borrowing during the period less any income from temporary investment of those borrowings.	❖ <u>Specific Borrowings:</u> Actual borrowing costs incurred during the period on the funds borrowed.
<u>Impact:</u> AS-16 requires income from temporary deployment of unutilised funds to be reduced from borrowing cost. However, ICDS does not provide for the same. The income from temporary deployment of unutilised funds from specific loans shall be taxable as Income from other sources under the ICDS. SC ruling in Tuticorin Alkali Chemicals (227 ITR 172) requires that interest income earned from temporary deployments of funds has to be offered to tax immediately as IFOS. Hence above deviation has no tax impact.	

Borrowing Costs

AS - 16	ICDS
• **Suspension of Capitalisation:**	
During extended periods in which active development of the asset is interrupted.	No provision regarding suspension of capitalisation of borrowing cost.
Impact: Borrowing cost incurred during the periods in which active development of the asset is interrupted can also be capitalised under the ICDS.	
• **Cessation of Capitalisation:**	
When substantially all activities necessary to prepare the qualifying asset for its intended use or sale are complete.	a) Qualifying Asset – when such asset is first put to use. b) Inventory – when substantially all activities necessary to prepare it for its intended sale are complete.
Impact: Income-tax Act allows capitalisation of the borrowing cost till the asset is put to use (Section 43(1) r.w. Expl. 8). ICDS also allows the capitalisation till the date of put to use. Hence, there is no impact.	


Date of borrowing
Asset ready to use
Asset purchased
Asset put to use
ICDS:
Specific borrowings
General borrowings
AS-16
Capitalization period

Disclosures

- Accounting policy adopted for borrowing cost and
- The amount of borrowing cost capitalised during the previous year.

Provisions, Contingent Liabilities and Contingent Assets

Recognition of provisions

AS - 29	ICDS
❖ Provisions shall be recognised if it is **<u>probable</u>** that outflow of economic resources will be required. ❖ Provision is not discounted to NPV	❖ Provisions shall be recognised if it is **<u>reasonably certain</u>** that outflow of economic resources will be required. ❖ Provision is not discounted to NPV

<u>Impact:</u>

- ❖ The criterion for recognition of provisions on the basis of the test of 'probable' (i.e. more likely than not criterion) replaced with the requirement of 'reasonably certain'.
- ❖ In the absence of definition and scope of 'reasonably certain' criterion, an ambiguity would arise on assessment of 'reasonably certain' criterion.
- ❖ In the Act, there is no specific provision for recognition of provisions. However, provisions are allowed based on accrued liabilities as per ordinary principles of commercial accounting.

Recognition of provisions

<u>Impact:</u>

❖ Provision for Warranty is allowed as an expenditure upholding the test of ‘probable’ warranty obligation in the following judgments.

- Rotork Controls India P. Ltd. (2009) 314 ITR 62 (SC) (extract on next slide)
- Himalaya Machinery (P) Limited v DCIT 334 ITR 64
- CIT vs. Luk India P. Ltd. 52 DTR 117.
- Siemens Public communication Networks Limited v CIT
- CIT v Indian Transformer Limited. 270 ITR 259

Recognition of provisions

***Rotork Controls India (P.) Ltd. v.* CIT [2009] 180 TAXMAN 422 (SC)**

- A provision to qualify for recognition, there must be a present obligation arising from past events, settlement of which is expected to result in an outflow of resources and in respect of which a reliable estimate of amount of obligation is possible.
- If historical trend indicates that in past large number of sophisticated goods were being manufactured and defects existed in some of the items manufactured and sold, then provision made for warranty in respect of army of such sophisticated goods would be entitled to deduction from gross receipts under section 37(1), provided data is systematically maintained by assessee.

Contingent assets & reimbursement claims

AS - 29	ICDS
❖ Contingent assets/ reimbursement claims are recognized if inflow of economic benefits/ reimbursement is "virtually certain".	❖ Contingent assets/ reimbursement claims to be recognized if inflow of economic benefits/ reimbursements is "reasonably certain".

<u>Impact:</u>

- ❖ Revenue authorities may contend that 'reasonably certain' is a lower threshold than 'virtually certain'.
- ❖ It is not made clear whether transitional provision requires recognition of all past accumulated contingent assets in F.Y. 2016-17.

Contingent assets & reimbursement claims

- The CBDT has clarified that provisioning for employee benefits which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS -X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Thank You