Note on Income Computation and Disclosure Standards (ICDS)

INCOME COMPUTATION AND DISCLOSURE STANDARDS

CBDT vide its Notification No: 32/2015 dated 31-03-2015 notified 10 Income Computation and Disclosure Standards (ICDS); which are to be followed at the time of computation of income chargeable to income tax under the head “Profit and gains of business or profession” or “Income from other sources”. The effective dates of these ICDSs are 01st April, 2015 and shall accordingly apply to the Assessment Year 2016-17 and subsequent assessment years.
The taxable income now might be visibly delinked from the accounting income as both will be computed under different set of standards. The areas of significant difference between the existing Accounting Standards (AS) and the corresponding tax positions would be the key areas that need to be considered while implementing ICDS.

**Key Features of ICDS:**

1. Effective Date of ICDS is 01st April, 2015 i.e. FY 2015-16 (AY 2016-17)

2. ICDS are applicable to all Assesses i.e. Corporate & Non Corporate Assesses following mercantile system of accounting.

3. No Net Worth or Turnover or any other criteria prescribed for applicability.

4. Entity need not to maintain separate Books of accounts for ICDS. But the difference between the accounting standards and ICDS may give rise to additional computations and reconciliations which in essence could result in the need for maintaining additional set of records.

5. ICDS are only for computation of income under the head “Profit and gains of business or profession” or “Income from other sources”.

6. ICDS are meant for normal computation of income only. These will not be applicable for Minimum Alternate Tax (MAT) Calculation.

8. It is expected that the income tax return forms and tax audit forms may be modified in due course to report compliance with ICDS.

9. It is to be noted that non-compliance of ICDS gives power to the Tax Authority to assess income on “best judgment” basis. It may have potential penalty implications too.

10. ICDS has been drafted keeping the existing AS as a base. There are significant difference between the Ind-AS and existing AS. Considering the phased adoption of Ind-AS from 01.04.2015 onwards, there would be additional adjustment required to be made.

List of the ICDS Notified with their accounting comparable:

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**AS**: Accounting Standards issued by ICAI.

**Ind AS**: As notified by Ministry of corporate affairs vide Notification dated 16.02.2015

**Applicability of ICDS:-**

These standards are applicable for computation of income chargeable under the head of “Profit and Gains from Business and Profession” or “income from Other Sources” to all assessees following mercantile method of accounting. As already stated, these standards are applicable for AY 2016-17 (Previous Year 2015-16) i.e. applicable immediately with effect from 01.04.2015.

Taxable profits would now be determined after making appropriate adjustments to the financial statements (whether prepared under Ind-AS or existing AS) to bring them in conformity with ICDS. Considering that these standards are already effective, it could have an immediate impact on large companies as they need to take these into account while paying the advance tax as well as accounting of tax expense in the upcoming quarterly results.

**Key Impact Area:-**

As companies are preparing our books of accounts in conformity with the applicable Accounting Standards (AS), the impact will be for those areas where the provisions as per ICDS deviate from the AS. Summary of Significant
Deviations of ICDS from Accounting Standards issued by ICAI (AS) are as follows:-

1. ICDS - I relating to Accounting Policies (Corresponding to AS-1):

   a. ICDS recognizes three accounting concepts – going concern, consistency and accrual. But ICDS does not recognize the concept of prudence.

   b. Expected losses or mark-to-market losses shall not be recognized unless permitted by any other ICDS.

   c. Accounting policies shall not be changed without a reasonable cause. Whereas AS permits change if it is required by statute or for compliance of AS or if the change would result in a more appropriate presentation.

2. ICDS - II relating to valuation of inventories (corresponding to AS-2):

   a. Use of standard cost method, as a technique for measurement of cost, is not permitted.

   b. Method of valuation of inventory once adopted by a taxpayer in any tax year shall not be changed without a reasonable cause.

   c. Recording of inventory is now required for service providers.

3. ICDS – III relating to Construction Contracts (corresponding to AS-7):

   a. Retention money shall be recognized for computing revenue based on percentage of completion method.

   b. Pre-construction income in the nature of interest, dividend and capital gains shall not be reduced from the cost of construction. As per Committee, they
shall be taxed as income in accordance with the applicable provisions of the ITL.

c. ICAI AS requires that contract costs relating to future activity shall be recognized as an asset when it is probable that such costs are recoverable. ICDS provides for recognizing such costs as an asset. As per Committee, if such costs are not realizable then the same may be allowed under the provisions of ITL.

d. Condition of non-recognition of contract revenues, if it is not possible to reliably measure the outcome of a contract, is not incorporated in ICDS based on Committee's recommendation that it is subjective in nature and has resulted in litigation and postponement of tax liability.

e. Losses incurred on a contract shall be allowed only in proportion to the stage of completion. As per Committee, future or anticipated losses shall not be allowed, unless such losses are actually incurred.

f. Once a contract crosses 25% of the completion stage, the revenue in respect of such contract shall be required to be recognized.

4. ICDS - IV relating to revenue recognition (corresponding to AS-9):

a. Revenue from service transactions shall be recognized by following “percentage completion method alone. AS permits adoption of either 'completed service contract method' or 'percentage completion method'. Relevant for shipping division majorly.

b. Sale of goods shall be recognised when all significant risks and rewards of ownership are transferred. Claims for escalation of price and export incentives can be postponed to the extent of uncertainty involved.
c. Interest will be recognised on time basis, dividend as per provisions of the Act and royalty as per terms of the relevant agreement.

5. ICDS - V relating to tangible fixed assets (corresponding to AS-10):-

a. In case of acquisition of an asset in exchange for another asset, shares or other securities, fair value of tangible fixed asset acquired shall be recorded as actual cost of the asset. AS provides that where fixed asset is acquired in exchange for another asset, shares or other securities issued, cost of asset acquired should be recorded either at fair market value of asset given up/shares or securities issued or fair market value of asset acquired, whichever is more clearly evident.

b. Income arising on transfer of a tangible fixed asset and depreciation shall be computed in accordance with the provisions of the Income Tax Laws.

c. Existing AS permits capitalization of foreign exchange difference along with the underlying asset under certain circumstances. ICDS reiterates the fact that capitalization of exchange difference relating to fixed asset shall be in accordance with the Section 43A and other provisions of the Income Tax Act.

6. ICDS-VI relating to the effects of changes in foreign exchange rates (corresponding to AS-11):-

a. ICDS provides that the exchange differences on translation of non-integral foreign operations to be recognized as an income or expense as against accumulation in foreign currency translation reserve in Balance Sheet as prescribed under AS.
b. All gains or losses on forward exchange or similar contracts entered into for trading or speculation contracts shall be recognized only on settlement. This is different from the practice under existing AS of either recognition of gains and losses on mark to market basis or recognition of only losses in line with the principle of prudence.

7. **ICDS - VII** relating to government grants (corresponding to AS-12):

   a. ICDS does not permit the capital approach for recording of government grants. Therefore, Government grants should either be treated as revenue receipt or should be reduced from the cost of fixed assets based on the purpose for which such grant or subsidy is given.

   b. Recognition of Government grants shall not be postponed beyond the date of actual receipt even though all the recognition conditions in accordance with the AS are not met.

8. **ICDS VIII** relating to securities (Broadly corresponding to AS-13):

   a. Since ICDS deals with computation of income under Business or Other Sources heads, ICDS only deals with securities held as stock-in-trade.

   b. Securities should be valued at lower of cost or net realizable value (NRV). Comparison of cost and NRV shall be done category-wise (and not for each individual security), for which securities shall be classified into the following categories: (a.) Shares (b.) Debt securities (c.) Convertible securities (d.) Any other securities not covered above.

   c. Unlisted or thinly traded securities shall be valued at cost.
d. Cost which cannot be ascertained by specific identification shall be determined on the basis of first in-first-out (FIFO) method.

e. In case of acquisition of securities in exchange for issue of shares or other securities, fair value of shares or securities acquired shall be recorded as actual cost of the securities

f. In case of acquisition of securities in exchange for another asset, fair value of securities acquired shall be recorded as actual cost of the securities

9. ICDS IX relating to borrowing costs (corresponding to AS-16):

a. Borrowing cost will not include exchange differences arising from foreign currency borrowings, whereas AS includes such differences to the extent that they are regarded as an adjustment to interest costs.

b. Unlike AS 16, ICDS does not define any minimum period for classification of an asset as a qualifying asset (with the exception of inventories). Borrowing Cost may need to be capitalized even if an asset does not take substantial period of time to construct.

c. ICDS states that in case of specific borrowings capitalization of borrowing cost should commence from the date of borrowing whereas AS requires cumulative fulfillment of three conditions viz. incurrence of capital expenditure, incurrence of borrowing costs and preparatory activities being in progress.

d. In case, asset is not put to use, capitalization under ICDS will be higher than that under AS-16 which stops capitalization when all activities to prepare asset for its use are complete.
e. ICDS has prescribed a new formula for capitalization of borrowing cost on
general borrowings which involves allocating the total general borrowing cost
incurred in the ratio of average cost of qualifying asset on the first day and last
day of the previous year and the average cost of total asset on the first and last
day of the previous year.(except assets funded from specific borrowings).

f. Unlike AS, income on temporary investments of borrowed funds cannot be
reduced from borrowing costs eligible for capitalization in ICDS.

g. Unlike AS, condition of suspension of capitalization during interruption of
active development is removed in ICDS.

10. ICDS - X relating to provisions, contingent liabilities and contingent assets
(corresponding to AS-29) :-

a. A provision can be recognized when it is “reasonably certain” that an outflow
of economic resources will be required to settle an obligation As against
condition of “probable” under AS.

b. A contingent asset can be recognized when the realization of related income
is “reasonably certain: As against condition of “virtual certainty” under AS.

Considering the extent of difference between AS / Ind-AS and ICDS, we would
need to consider the process and system changes that may be warranted to
implement ICDS and maintain records as per these two set of standards.
Considering that the information computed using ICDS would be subject to
audit through the tax audit process, it becomes more important to prepare
and maintain the information in a planned way.
Even after following Accrual based Accounting for all. Can I show Expenses or Income on Cash basis as earlier after introduction of Income Computation and Disclosure Standards PIs reply

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