

# THE CHAMBER OF TAX CONSULTANTS

## ICDS and its impact on Computation of Income for AY 2018-19

Churchgate,  
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Adv. Dharan V. Gandhi

# History

- ✓ Commercial accounting practice was accepted by the Courts. (See Metal Box Company Of India Ltd. vs. Their Workmen - 73 ITR 53(SC))
- ✓ Finance Act 1995 - section 145 amended to give power to the Central Government to notify accounting standards
- ✓ Notification No. SO 69(E) dated 25-1-1996 - Government introduced two accounting standards to be followed by all the assessee's following mercantile system of accounting from AY 1997-98. (now superseded by the ICDS)
- ✓ Two accounting standards notified were:
  - AS I – Disclosure of significant accounting policies
  - AS II – Disclosure of prior period and extraordinary item and changes in accounting policies.
- ✓ In December 2010 –CBDT constituted committee for Tax Accounting Standards

## History (contd.)

- ✓ In August 2012 –Formulation of 14 Tax Accounting Standards
- ✓ In July 2014 – Nomenclature changed from TAS to ICDS
- ✓ In January 2015 –released 12 draft ICDS
- ✓ Notification No. 32/2015 dated 31-3-2015, the Central Government notified 10 ICDS and the ICDS were made applicable w.e.f. AY 2016-17
- ✓ Implementation of ICDS postponed by one year due to practical difficulty – Notification No. 86/2016 dated 29.9.2016
- ✓ Vide Notification No. 87/2016 dated 29.9.2016, new ICDS notified and made applicable w.e.f. AY 2017-18.

## History (contd.)

- ✓ Circular No. 10/2017 dated 23.3.2017 issued giving certain clarifications in respect of ICDS.
- ✓ Hon'ble Delhi High Court in case of Chamber of Tax Consultants vs. UOI (400 ITR 178) vide order dated 8.11.2017, quashed certain ICDS and certain portion of other ICDS and read down the powers of the Government u/s 145(2).
- ✓ Amendments brought out by Finance Act, 2018 w.r.e.f. AY 2017-18 to over rule the judgment of the Hon'ble Delhi High Court.

# Background

## Parent Section - Section 145 (Method of accounting)

145(1) - Income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall, ***subject to the provisions of sub-section (2)***, be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

145(2) – The Central Government may notify in the Official Gazette from time to time ***income computation and disclosure standards*** to be followed by any class of assesseees or in respect of any class of income.

145(3) – if *income has not been computed in accordance with the ICDS* , then the Assessing Officer may make an assessment in the manner provided in section 144 i.e. Best judgment assessment.

# Introduction to ICDS

## Essential features:

- Applicable to all assessees
- Following mercantile system of accounting (Cash system not governed by ICDS)
- except individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB of the said Act (*Only if Tax audit applicable in a previous year, then ICDS applicable*).
- For computing income under the head 'PGBP' and 'IFOS'
- Effective from AY 2017-18
- Not for the purpose of maintenance of books but only for computation of income (*Q. 1 of circular No. 10*)
- In case of conflict between the provisions of Act/ Rules and the ICDS, the ACT/ Rules shall prevail.
- Not applicable for computation of book profit u/s 115JB (*Q. 6 of Circular No. 10*)

## What did the Delhi High Court held?

A. The Court held that the following are **essential legislative functions**:

- changing the basic principles of accounting that have been recognized in the various provisions of the Act for computation of income
- changing the method of accounting for computation of taxable income
- alteration of system of accounting, or according accounting or taxing treatment to a particular transaction
- To make a validation law to override judicial precedents and that too by actually removing the defect pointed out by such precedent

B. The Court further held that:

- After considering Q.2 of Circular 10, it is unmistakable that the ICDS is intended to prevail over judicial precedents which may be to the contrary.
- ICDS notified under Section 145 (2) of the Act has the effect of modifying the basis for computation of taxable income as recognised by the Act and as interpreted by the Court.

## Findings of the Court - On the issue of Delegation of essential legislative function and Excessive Delegation:

- C. After considering the judgment of the SC in case of **Tuticorin Alkali Chemicals and Fertilizers Limited v. Commissioner of Income Tax (1997) 227 ITR 172**, the Court held that AS has hardly any role to play in the principles governing determination of income, which has been well settled by the provisions of the Act as well as by judicial precedents

**The Court, in order to preserve its constitutionality, read down section 145 (2) of the Act as amended to restrict power of the Central Government to notify ICDS that do not seek to override binding judicial proceedings or provisions of the Act.**

**Thus, the Court held that:**

The Central Government by way of a Notification cannot:

- 1. Override any judicial precedents (High Court and Supreme Court)**
- 2. Cannot amend or alter any basic principles of computation of income.**



## Findings of the Court - On the issue of overruling judgments:

The Court has specifically dealt with cases where the judgments are getting overruled and to that extent held the provisions of ICDS to be not valid. However, where the Court has not dealt with any particular judgments which are side tracked by the ICDS, the Court has given a very relevant finding in para 102(ii) **“The ICDS is not meant to overrule the provisions of the Act, the Rules thereunder and the judicial precedents applicable thereto as they stand.”**

**Accordingly, Q. 2 of the Circular is rendered invalid.**

*Q.2.: Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS? The ICDS have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements were pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017-18 and subsequent assessment years*

# Amendments brought in Finance Act, 2018

Explanatory Memorandum to Finance Bill 2018:

- In order to bring **certainty in the wake of recent judicial pronouncements** on the issue of applicability of ICDS,
- Recent judicial pronouncements have raised doubts on the legitimacy of the notified ICDS. However, a large number of taxpayers have already complied with the provisions of ICDS for computing income for assessment year 2017-18. In order to **regularise the compliance with the notified ICDS by a large number taxpayers** so as to **prevent any further inconvenience to them**, it is proposed to bring the amendments retrospectively with effect from 1st April, 2017 i.e the date on which the ICDS was made effective and will, accordingly, apply in relation to assessment year 2017-18 and subsequent assessment years

# ICDS 1 - Accounting Policies

## Finding of High Court on ICDS 1

- ❑ ICDS 1 does away with the concept of 'prudence' which is present in erstwhile AS1 notified u/s 145 (2) of the Act. A negative provision has in fact been made in the ICDS by stating that prudence is not to be followed unless it is specified.
- ❑ Courts have recognised the concept of 'prudence'
- ❑ Infact, concept of prudence is embedded in Section 37 (1) of the Act which allows deduction in respect of expenses "laid out" or "expended" for the purpose of business. The concept of prudence is inherent in this. (ICAI has also taken this view)

**Held: ICDS I which does away with the concept of 'prudence' is contrary to the Act and binding judicial precedents and is therefore, unsustainable in law.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

## Amendment brought in by Finance Act 2018

**S.36(1)** The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—

(xviii) marked to market loss or other expected loss as **computed** in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145

**40A(13)** No deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss, except as allowable under clause (xviii) of sub-section (1) of section 36.

# Issues in ICDS 1

- ✓ Prudence done away with – one cannot claim deduction of expected loss or marked to market loss except provided by ICDS.
- ✓ Only for computation part one has to refer to ICDS. Can the ICDS prescribe which expected loss or marked to market loss can be allowed ?
- ✓ Marked-to-market gains ? See Q. 8 of Circular No. 10 of 2017
- ✓ Materiality – living or dead?–(present in erstwhile Standard 1 and in AS 1 issued by ICAI)
  - ✓ only “significant accounting policies” view whether still remains?

## Issues in ICDS 1

- ✓ Change in accounting policy – only for a reasonable cause – debatable! (See Q 9 of the Circular No. 10)

Possible causes - change in law/ change due to AS/ better disclosure

- To show true and correct picture- ***CIT vs. Pandavapura Sahakara Sakkare Karkhane Ltd. - 201 ITR 56(Kar)***
- Change in method due to change in AS - ***CIT vs. George Oakes Ltd. - 303 ITR 357(Mad)***
- Changed method scientific and a recognised method. - ***CIT vs. Modi Rubber Ltd.- 230 ITR 820 (Del)***

- ✓ Hastily drafted - since if not required for preparation of financial statement, then what is the need?

### Issues in Circular 10:

- ✓ Q. 10 -**Which ICDS would govern derivative instruments?** For derivatives, not within the scope of ICDS-VI, provisions of ICDS-I would apply. – **Since not allowed under ICDS as per the Circular, therefore, not allowable while computing income.**

# ICDS 2 – Valuation of Inventories



## Finding of High Court on ICDS 2

- ❑ ICDS II pertaining to valuation of inventories, eliminates the distinction between a continuing partnership business after dissolution from one which is discontinued upon dissolution is contrary to the decision of the Supreme Court in Shakti Trading Co. 250 ITR 871 (SC)
- ❑ Section 145A will in any case prevail over ICDS and one can value goods in accordance with the method of accounting regularly employed by the Assessee.

**Held: ICDS II is held to be ultra vires the Act and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

# Amendment brought in by Finance Act 2018

## **Method of accounting in certain cases.**

**145A.** For the purpose of determining the income chargeable under the head "Profits and gains of business or profession",—

(i) the valuation of **inventory** shall be made at lower of actual cost or net realisable value **computed** in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145;

(ii) 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 (by whatever name called) 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;

Explanation 1.—For the purposes of this section, any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment.

## Issues in ICDS 2

- ✓ What do you mean by inventories? There is no definition under the Act, though defined under ICDS?
- ✓ How to value inventories? As per section 145A – cost or market value whichever is lower without any exception.
- ✓ Only for computation of cost of market value one has to refer to ICDS? Therefore, can the ICDS say that in particular scenario, inventory to be valued at NRV?
- ✓ Para 24 - Valuation of stock on dissolution of the firm – Shakti trading judgment in fact upheld and ALA Firm overruled by the amendment
- ✓ In case of services also one has to add the taxes to the value of inventory or sale etc.? See **CIT vs. Knight Frank (India) P. Ltd. (ITA No. 247 of 2014 and 225 of 2014)(Bom HC)**
- ✓ In case of change of method of accounting whether, the opening inventory is also to be changed ? See para 22 of the ICDS. Also see **Melmould Corporation vs. CIT - (1993) 202 ITR 0789 (Bom)**
- ✓ Para 22 - Cost of inventory on the day of commencement of business – in case of conversion of capital asset into stock in trade, such stock should be valued at FMV as on the date of conversion. See **46 ITR 86(SC) CIT vs. Bai Shirinbai K. Kooka and 116 ITR 125(SC) CIT vs. Groz-beckert Saboo Ltd.**

# ICDS 3 – Construction Contracts

## Finding of High Court on ICDS 3

- ❑ The treatment to retention money under Paragraph 10 (a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income. By deploying ICDS-III in a manner that seeks to bring to tax the retention money the receipt of which is uncertain/ conditional, at the earliest possible stage, the Government would be acting contrary to the settled position in law.
- ❑ Para 12 of ICDS III read with para 5 of ICDS IX, dealing with borrowing costs, which makes it clear that no incidental income can be reduced from borrowing cost is contrary to the decision of the Supreme Court in CIT v. Bokaro Steel Limited (1999) 236 ITR 315.
- ❑ para 6 of ICDS-IV permits only one of the methods, i.e., proportionate completion method for recognising revenue from service contracts and is contrary to the CIT v. Bilhari Investment Pvt. Ltd. (2008) 299 ITR 1 (SC), CIT v. Manish Buildwell Pvt. Ltd. (2011) 245 CTR 397 (Del) and Paras Buildtech India Pvt. Ltd. V. CIT (2016) 382 ITR 630 (Del). – Should apply equally to ICDS III

**Held: ICDS III is held to be ultra vires to the extent as stated above and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

# Amendment brought in by Finance Act 2018

## **Computation of income from construction and service contracts.**

**43CB.** (1) *The profits and gains arising from a **construction contract or a contract for providing services** shall be determined on the basis of percentage of completion method **in accordance with** the income computation and disclosure standards notified under sub-section (2) of section 145<sup>38a</sup>:*

**Provided** that profits and gains arising from a contract for providing services,—

- (i) *with duration of not more than ninety days shall be determined on the basis of project completion method;*
- (ii) *involving indeterminate number of acts over a specific period of time shall be determined on the basis of straight line method.*

(2) *For the purposes of percentage of completion method, project completion method or straight line method referred to in sub-section (1)—*

- (i) *the **contract revenue shall include retention money;***
- (ii) *the **contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.***

## Issues in ICDS 3

- ✓ What do you mean by construction contract u/s 43CB? Will it include real estate construction?
  - ✓ See definition of construction contract under para 2(1)(a) of the ICDS III
  
- ✓ Project completion method vs. Percentage Completion method?
  
- ✓ How to tax retention money?
  - ✓ As per the Court decision
  - ✓ Amendment in section 43CB(2)(i). Also see Q.11 of Circular 10/2017
  - ✓ Also see para 9 of the ICDS III. (reasonable certainty)
  
- ✓ Expected losses are to be taken as allowed?
  - ✓ As per the Court decision - Prudence accepted (See CIT v Triveni Engineering & Industries Ltd (49 DTR 253) (Del) CIT v Advance Construction Co. (P) Ltd (275 ITR 30) (Guj)
  - ✓ No specific amendment in 43CB. However, the income has to be computed in accordance with ICDS III.
  
- ✓ Incidental income can be reduced from contract cost? But not in the nature of interest, dividend or capital gains.

# ICDS 4 – Revenue Recognition



## Finding of High Court on ICDS 4

- ❑ Taxation of export incentive on making of claim subject to reasonable certainty of ultimate collection (para 5) is against the judgment of the Supreme Court in CIT v. Excel Industries Limited (2015) 358 ITR 295 (SC), wherein it has been held that it is only in the year in which the claim is accepted by the Government that a right to receive the payment accrues in favour of the Assessee and the corresponding obligation to pay arises in the hands of the Government and revenue can be recognised.
- ❑ para 6 of ICDS-IV permits only one of the methods, i.e., proportionate completion method for recognising revenue from service contracts and is contrary to the CIT v. Bilhari Investment Pvt. Ltd. (2008) 299 ITR 1 (SC), CIT v. Manish Buildwell Pvt. Ltd. (2011) 245 CTR 397 (Del) and Paras Buildtech India Pvt. Ltd. V. CIT (2016) 382 ITR 630 (Del).
- ❑ However, para 8 which requires interest to be taxed even in absence of reasonable certainty is constitutionally valid as it has not been demonstrated that para 8 (1) of ICDS IV is contrary to any judgment of the Supreme Court, or any other Court and also there is no challenge to the amendment in section 36(1)(vii).

**Held: para 5, para 6 of ICDS IV is held to be ultra vires the Act and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

# Amendment brought in by Finance Act 2018

## **Computation of income from construction and service contracts.**

**43CB.** (1) *The profits and gains arising from a **construction contract or a contract for providing services** shall be determined on the basis of percentage of completion method **in accordance with** the income computation and disclosure standards notified under sub-section (2) of section 145<sup>38a</sup>:*

**Provided** that profits and gains arising from a contract for providing services,—

- (i) *with duration of **not more than ninety days** shall be determined on the basis of **project completion method**;*
- (ii) *involving **indeterminate number of acts** over a specific period of time shall be determined on the basis of **straight line method**.*

(2) *For the purposes of percentage of completion method, project completion method or straight line method referred to in sub-section (1)—*

- (i) *the **contract revenue shall include retention money**;*
- (ii) *the **contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains**.*

**145B(2):** Any claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

## Issues in ICDS 4

- ✓ Uncertainty in ultimate collection – revenue recognition to be postponed ? See Q.13 of the Circular 10/2017
  - ✓ CIT vs. Excel Industries Ltd - 358 ITR 295(SC) – **Except in case of interest income**
  - ✓ In respect of interest income - to avoid paying taxes on the same, the assessee would have to book the interest income in their books of account and then correspondingly claim deduction u/s 36(1)(vii) read with the second proviso
  
- ✓ Which method to be followed for service contracts?
  - ✓ Duration not more than 90 days – project completion method
  - ✓ Contracts involving indeterminate number of acts over a specific period of time - basis of straight line method.
  - ✓ Other cases – percentage completion method
  
- ✓ Whether loss from service contract not attributable to the stage of completion be recognised as soon as detected? **As per the method of accounting employed.**
  
- ✓ Percentage completion method – practical difficulty?
  
- ✓ Due to Percentage completion method – MAT will become applicable. See CIT vs. Nagarjuna Fertilizers & Chemicals Ltd.( 373 ITR 252 – AP)

## Issues in ICDS 4

- ✓ Ability to measure the revenue accurately – not a criteria (See AS 9)
  
- ✓ Interest accrued but not due?
  - E.D. Sasson & Co. Ltd. & Ors. vs. CIT - 26 ITR 27(SC)
  - DIT vs. Credit Suisse First Boston (Cyprus) Ltd. - 351 ITR 323(Bom)
  - CIT vs. Karnataka Bank Ltd. - 226 Taxman 187(Kar)
  
- ✓ Broken period interest - Sale of securities before the due date then tax treatment of consideration received?
  - **Q. 18 - Broken period interest - Sale of securities before the due date then tax treatment of consideration received?** interest already offered to tax based on accrual system, shall be allowed as deduction while computing capital gains –**Whether valid as per the Act? Can this Circular override the Act? goes against the judgment of various Courts therefore, shall not have any impact.**
  
- ✓ Taxation of export incentive
  - ✓ Decision of the Court
  - ✓ Amendment in section 145B(2)
  - ✓ What if one follows cash system of accounting?

## Issues in ICDS 4

### ✓ Finance Lease – taxability?

- Ownership not transferred but significant risk and reward transferred – therefore sale
- If substance over form is seen then the transaction amounts to financial assistance
- See Q. 12 of the Circular no. 10 – no separate ICDS for leases, but the existing provisions of the act shall apply.

### ✓ Disclosure requirement – As such no major difference

## Issues in ICDS 4

### Issues in Circular 10:

- ✓ Q.3 - ICDS apply to non-corporate taxpayers who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc. of the Act? Shall apply – **it shall apply to compute the turnover though as per ICAI it should not apply. (however, one may also contend that the circulars are not binding)**
- ✓ Q.14 – ICDS applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents under section 115A of the Act? Yes – **shall continue though one may choose to not follow the Circular**

# ICDS 5 – Tangible fixed assets

## ICDS 5 – Tangible Fixed assets

**No finding by the Court. Therefore, no amendment.**

### Issues:

- ✓ Commencement of business vs. Set up of business? Depreciation and other expenses allowable?  
Business set up – held expenses and depreciation allowable – no need for commencement
  - ***CIT vs. Shri Rama Multi Tech Ltd. – 393 ITR 371(SC)***
  - ***Western India Vegetable Products Ltd. vs CIT – 26 ITR 151(Bom)***
  - ***CIT vs. ESPN Software - 301 ITR 368(Del)***
  
- ✓ Ready to use or put to use? (See Q 15)
  - ✓ **NATIONAL THERMAL POWER CORPN LTD. vs. CIT - 357 ITR 253(Del)**
  - ✓ **CAPITAL BUS SERVICE (P) LTD vs. CIT - 123 ITR 0404 (Del)**
  
- ✓ Expenditure (other than interest) on start- up or commissioning of the project/ on trial run and experimental production– treatment? Capital or revenue?
  - ***CIT Vs. Dhampur Sugar Mills Ltd. - 360 ITR 82(All) (Favourable)***
  - ***CIT Vs. Saurashtra Cement & Chemical Industries Ltd. - 127 ITR 47(Guj) (Against)***
  - ***CIT vs. G.T. Industries - 203 ITR 538(Bom) (Against)***



# ICDS 5 – Tangible Fixed assets

## Impact:

- ✓ Trial run conducted – depreciation allowable?
  - ✓ ***ACIT vs. Ashima Syntex Ltd. 251 ITR 103 (Guj)***
  - ✓ ***CIT vs. Vindhyachal Distilleries (P) Ltd. - 272 ITR 0583 (MP)***
  
- ✓ Trial run income to be reduced?
  - ✓ ***CIT vs. Bokaro Steel Ltd – 236 ITR 315(SC) – favourable***
  - ✓ ***CIT vs. KARNAL CO-OPERATIVE SUGAR MILLS LTD.- 243 ITR 2(SC) - favourable***
  - ✓ ***247 ITR 268(SC) CIT vs. KARNATAKA POWER CORPORATION – 247 ITR 268(SC) - favourable***
  
- ✓ Changes subsequent to acquisition or construction?
  - ✓ ***Banco Products (India ) Ltd. vs. DCIT – 379 ITR 1(Guj)***
  - ✓ ***341 ITR 467(Del) CIT vs. OSWAL AGRO MILLS LTD***
  - ✓ ***187 TM 111(Del) BHARAT ALUMINIUM CO. LTD. vs. CIT***
  
- ✓ Test of enduring benefits done away with?
  - ✓ ***Empire Jute Co. Ltd. Vs. CIT -124 ITR 1(SC) - still alive***

## ICDS 5 – Tangible Fixed assets

### Impact – Issues in Circular 10:

- ✓ Q.15 - What shall be the treatment of expense incurred after the conduct of test runs and experimental production but before commencement of commercial production? As clarified in Para 8 of ICDS-V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure. – **goes against the judgment of various Courts therefore, shall not have any impact.**

# ICDS 6 – Effects Of Changes In Foreign Exchange Rates

## Finding of High Court on ICDS 6

- ❑ Exchange gain/loss in relation to a loan utilized for acquiring a capital item would be capital in nature as per *Sutlej Cotton Mills Limited v. CIT (1979) 116 ITR 1 (SC)*. ICDS VI is contrary to the said judgment
- ❑ ICDS-VI states that marked to market loss/gain in case of foreign currency derivatives held for trading or speculation purposes are not to be allowed. This is not in consonance with the ratio laid down by the Supreme Court in *Sutlej Cotton Mills Limited*.
- ❑ In reply to Q No. 16, CBDT has clarified that Foreign Currency Translation Reserve Account balance as on 1st April 2016 has to be recognized as income/loss of the previous year relevant to the AY 2017-18. It is held that such losses/gains arising by valuation of monetary assets and liabilities of the foreign operations as at the end of the year cannot be treated as real income. It is only in the nature of notional or hypothetical income which cannot be even otherwise subject to tax.
- ❑ **Held: ICDS VI is held to be ultra vires the Act and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

# Amendment brought in by Finance Act 2018

## **Taxation of foreign exchange fluctuation.**

**43AA.** (1) Subject to the provisions of section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss **shall be computed** in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145.

(2) For the purposes of sub-section (1), gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all 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

## Issues in ICDS 6

- ✓ Wordings of section 43AA is very vague – it says that all types of foreign currency transactions are covered and any gain or loss on account of change in foreign exchange rate to be recognised as income or loss – only for computation one has to go to ICDS 6
- ✓ Whether ICDS 6 can say that exchange difference arising on last day cannot be recognised as income or loss? [see para 5(i), 5(ii), 7, 8]
- ✓ Forex fluctuation if related to capital asset, then whether capital in nature? SC decision in case of Sutlej Cotton Mills Ltd holding the filed for almost 40 years done away with
- ✓ MTM loss in case of foreign currency derivatives held for trading or speculation purposes whether to be allowed?
- ✓ Treatment provided in section 43A and section 43AA are contrary to each other?

## Issues in ICDS 6

### Issues in Circular 10:

- ✓ Q.16 - the taxability of opening balance as on 1st day of April, 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognised as per Accounting Standards (AS) 11? FCTR balance as on 1 April 2016 pertaining to exchange differences on monetary items for non-integral operations, shall be recognised in the previous year relevant for assessment year 2017-18 to the extent not recognised in the income computation in the past– **Held invalid by the Court. Amendment also doesn't cover this.**

# ICDS 7 – Government Grants



## Finding of High Court on ICDS 7

- ❑ ICDS VII requires that amount has to be taxed in the year of receipt. Court held the same to be contrary and in conflict with the accrual system of accounting.

**Held: To the above extent, ICDS VII is held to be ultra vires the Act and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

# Amendment brought in by Finance Act 2018

## **Taxability of certain income.**

**145B(3)** 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.

## Issues in ICDS 7

- ✓ Government grants whether can be taxed on receipt basis? Judgment overruled to this extent.
  
- ✓ MAT implication due to section 145B(2)
  
- ✓ Para 5,7: Government Grants if relating to depreciable fixed assets, then the same should be reduced from the cost or WDV? Is it possible to reduce from WDV?
  - ✓ **Banco Products (India ) Ltd. vs. DCIT – 379 ITR 1(Guj)**
  - ✓ **341 ITR 467(Del) CIT vs. OSWAL AGRO MILLS LTD**
  - ✓ **187 TM 111(Del) BHARAT ALUMINIUM CO. LTD. vs. CIT**
  
- ✓ Inherent inconsistency between para 5, 6 and 9.
  - ✓ Para 5 states that grants in respect of depreciable asset to be reduced from cost.
  - ✓ Para 10 states that Government grants in the form of non-monetary assets, given at a concessional rate, shall be accounted for on the basis of their acquisition cost.
  - ✓ However, para 6, states that grants relating to non-depreciable assets to be taken as income.

## Issues in ICDS 7

- ✓ Para 8: The Government grant that is 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, shall be recognised as income of the period in which it is receivable – Not in sync with section 41(1) – there it is taxable on receipt basis. Act to prevail.
- ✓ Para 10 - The Government grants in the form of non-monetary assets, given at a concessional rate, shall be accounted for on the basis of their acquisition cost – whether the same is in sync with section 2(24)(xviii)?

## Issues in Circular 10:

- ✓ Q.17 - For subsidy received prior to 1st day of April 2016 but not recognised in the books pending satisfaction of related conditions and achieving reasonable certainty of receipt, how shall the same be recognised under ICDS on or after 1st day of April 2016? The grants received prior to 1st day of April, 2016 shall continue to be recognised as per the law prevailing prior to that date – **In line with the HC judgment.**

# ICDS 8 – Securities

## Finding of High Court on ICDS 8

- ❑ ICDS VIII prescribes bucket approach for valuation of securities as at the end of the year. The Court held that such approach is not possible to be effectuated without a corresponding amendment to the Act. Further, the Court held that such entities will be required to maintain separate records for income tax purposes for every year since the closing value of the securities would be valued separately for income tax purposes and for accounting purposes.

**Held: To the above extent, ICDS VIII is held to be ultra vires the Act and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

# Amendment brought in by Finance Act 2018

## **Method of accounting in certain cases.**

**145A.** For the purpose of determining the income chargeable under the head "Profits and gains of business or profession",—

(iii) the inventory being securities not listed on a recognised stock exchange, or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised **in accordance with** the income computation and disclosure standards notified under sub-section (2) of section 145;

(iv) the inventory being securities other than those referred to in clause (iii), shall be valued at lower of actual cost or net realisable value **in accordance with** the income computation and disclosure standards notified under sub-section (2) of section 145:

Provided that the inventory being securities held by a scheduled bank or public financial institution shall be valued in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145 after taking into account the extant guidelines issued by the Reserve Bank of India in this regard:

Provided further that the comparison of actual cost and net realisable value of securities shall be made **category-wise**.

Explanation 2.—For the purposes of this section,—

(a) "public financial institution" shall have the meaning assigned to it in clause (72) of section 2 of the Companies Act, 2013 (18 of 2013);

(b) "recognised stock exchange" shall have the meaning assigned to it in clause (ii) of Explanation 1 to clause (5) of section 43;

(c) "scheduled bank" shall have the meaning assigned to it in clause (ii) of the Explanation to clause (viia) of sub-section (1) of section 36.

## Issues in ICDS 8

- ✓ Bucket approach quashed by the High Court, brought back by the amendment. See Q.19 – How shall the valuation be computed - Illustration of bucket approach given
- ✓ Derivatives not included ? Treatment of derivatives? Can it be considered as Stock-in trade?
  - ✓ See Edelweiss Capital Ltd. vs. ITO [ITA No. 5324/M/2007]



# ICDS 9 – Borrowing costs

## Finding of High Court on ICDS 9

- para 5 of ICDS IX, dealing with borrowing costs, makes it clear that no incidental income can be reduced from borrowing cost. This is contrary to the decision of the Supreme Court in CIT v. Bokaro Steel Limited (supra) and is therefore struck down.

**Held: To the above extent, ICDS IX is held to be ultra vires the Act and struck down as such.**

**Also, corresponding amendments in Form 3CD and any clarification in the Circular is struck down**

## Issues in ICDS 9

- ✓ No period specified for fixed asset – fixed asset even if requires less than 12 months to get ready for use, then also capitalisation is required.
- ✓ Inventories that require 12 months or more to put them to saleable condition [All inventories including real estate covered] - No such condition in 36(1)(iii)? Conflicting with the Act?
  - ✓ ***Lokhandwala Construction Inds. Ltd. 260 ITR 579 (Bombay HC)***
  - ✓ ***CIT vs. Cellice Developers (P.) Ltd. (231 TM 255)(Cal)***
  - ✓ ***DCIT vs. Core Health Care Ltd - 298 ITR 194(SC)***
- ✓ Borrowed funds temporarily parked in FD's – corresponding interest income – should be taxed as income or should it be deducted from the interest cost? **Incidental income to be reduced. No amendments made in this regards.**

# Issues in ICDS 9

- ✓ Specific borrowings - funds are borrowed specifically for the purposes of acquisition, construction or production of a qualifying asset -
  - ✓ If the purpose for which the funds are borrowed is not acquisition or construction or production of a qualifying asset, however, the funds are specifically used for the said purposes, then whether the said specific funds would fall in specific borrowing criteria?
  - ✓ When funds are borrowed for specified purposes, however, same are not utilised for the same purposes, whether the said funds would fall within the realm of specific borrowing criteria?
  
- ✓ General borrowings – Formula given for computation of interest –
  - ✓ No other formula in case of general borrowings can be used? Compare with S.14A and R. 8D, where only if not satisfied one can travel to Rule 8D.
    - ✓ **GODREJ & BOYCE MFG. CO. LTD. vs. DCIT - 328 ITR 0081 (Bom)**
  
  - ✓ Arguments of own funds valid?
    - ✓ **CIT vs. Reliance Utilities & Power Ltd. - 313 ITR 340(Bom)**
    - ✓ **CIT vs. Gujarat Reclaim & Rubber Products Ltd. (ITA No. 2116 of 2013)(Bom)**
  
  - ✓ General borrowings para applies to all the borrowings other than the specific borrowings. Therefore, even a borrowing which is specifically for a purpose not being the specified purpose and has been utilised for the said purpose, still the interest amount would be liable to the included in the formula given?
  
  - ✓ Practical difficulty for big companies with multiple borrowings and different blocks?

## Issues in ICDS 9

- ✓ Cessation of capitalisation

- ✓ Other assets - Put to use vs. ready to put to use?

- ✓ ***Whittle Anderson Ltd. vs CIT – 79 ITR 613(Bom)***

- ✓ ***NTPC vs. CIT – 357 ITR 253(Del)***

# Issues in ICDS 9

## Issues in Circular 10:

- ✓ Q.20 - There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a)(1), 40(a)(ia), 40A(2)(b), etc of the Act. Whether borrowing costs to be capitalized under ICDS-IX should exclude portion of borrowing costs which gets disallowed under such specific provisions? it is clarified that borrowing costs to be considered for capitalization under ICDS-IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act – **goes against the judgment of various Courts as well as the provision of the Act, therefore, shall not have any impact. (See. (2013) 0358 ITR 0043 (P&H) CIT vs. MARK AUTO INDUSTRIES LTD.)**
- ✓ Q.21 - Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost? The definition of borrowing cost is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing cost. – **As such no impact. However, one can choose not to follow the Circular**
- Q. 22 : How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS-IX to different qualifying assets? The capitalization of general borrowing cost under ICDS-IX shall be done on asset-by-asset basis. – **No impact**

# ICDS 10 – Provisions, Contingent Liabilities and Contingent Assets

# ICDS 10 – Provisions, Contingent Liabilities and Contingent Assets

## No finding by the Court. No amendments proposed

### Issues:

- ✓ Onerous contract (Covered by AS 29) – covered by ICDS or not- recognition of liability?
  - If executory or if non executory?
  
- ✓ Outflow of resources is **probable vs. reasonably certain?**
  - Probable – more likely than not (more than 50% chance)
  - What do you mean by reasonably certain?
  
- ✓ Practical difficulty – subjective
  
- ✓ Warranty
  - Class of obligation taken together rather than a single transaction
  - In ***Rotork Control India (P) Ltd. vs. CIT – [314 ITR 62(SC)]***, the Court has held that provision for warranty claim is allowable as a deduction u/s 37(1) as the enterprise has a present obligation as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of



# ICDS 10 – Provisions, Contingent Liabilities and Contingent Assets

## Issues:

- ✓ Reimbursement by third party - Virtually certain vs. reasonably certain?
  
- ✓ Contingent asset – virtually certain vs. reasonably certain?
  - If it deals with recognition of revenue then ICDS 4 shall apply?
  - Mark-to-market gain? (See Q. 8 of the Circular No. 10)
  
- ✓ Legal claim – outcome is uncertain – contingent asset when to be recognised?
  
- ✓ Apply to existing contracts also – so if provision already booked based on ‘probable outcome’ however no ‘reasonable certainty’ - in respect of continuing contract then have to be reversed?
  - See Q. 23 of the Circular No. 10 giving example.

## Some other important issues

### Issues:

- ✓ Whether the ruling of the Delhi High Court is binding over the assessee and the officers all over India
- ✓ What about the other issues where the ICDS run contrary to the rulings and not dealt with by the Delhi High Court?
- ✓ What if there is a SC or HC judgment subsequent to the notification of the ICDS? Can still the judgments be preferred over the ICDS?

## Some other important issues

### Issues:

- ✓ The Delhi High Court in some cases has struck down the entire ICDS and in some cases, some parts of the ICDS. This striking down was mainly on the ground that judgments were sought to be overruled by an act of executive, which was ultra vires and that only legislature could have overruled the judgments by way of legislation. Further, the corresponding amendments in Form 3CD and the clarifications in the Circular are also struck down. In the amendments, the Legislature has referred to the ICDS notified u/s 145(2) but no new notification has yet been issued. Further, Notification No. 88/2017 dealing with the amendments in Form 3CD also has not been reissued.
- ✓ Can one say that in so far as the status of said notification No. 87 and 88 is concerned, the Delhi High Court ruling would still prevail till the time the same is reversed by the Supreme Court and the Government is supposed to notify new ICDS? Or has the Notification No. 87 or 88/2017 come to life automatically because of the retrospective amendment?
- ✓ If the notifications have come to life then to what extent?
- ✓ What to be done in respects of returns for AY 2017-18?

## Some other important issues

### Issues:

- ✓ The amendments made by the Finance Act, 2018 apply to all assessees. All the amendments invariably refer to the ICDS notified u/s 145(2). ICDS do not apply to individuals/ HUF not required to get the books of account audited. What should such people do?

# Disclosure in ROI for AY 18-19

## ☐ Disclosure

- ✓ Relevant change in ITR –
  - ✓ Part A-OI – Effect on the profit because of deviation as per ICDS
  - ✓ Separate sheet on ICDS – Effect of ICDS on profit (one item for each ICDS)
  - ✓ Such figure would be picked up in computation of Business income. However, no amendment in IFOS schedule.
  
- ✓ Consolidated figure is required
  
- ✓ One should prepare a statement of ICDS disclosure in accordance with the disclosure requirements of each ICDS, which cannot be submitted with the ROI, but should be kept ready or should be made an annexure to the Form 3CD.
  
- ✓ See Q. 25 of the Circular No. 10.

# QUESTIONS, IF ANY?

## THANK YOU

Dharan V. Gandhi,  
(B.Com, CA, LL.B.)  
Advocate, Bombay High Court,  
Email: [adv.dharangandhi@outlook.com](mailto:adv.dharangandhi@outlook.com)  
Tel: +919820068466