CBDT notifies revised Income Computation and Disclosure Standards

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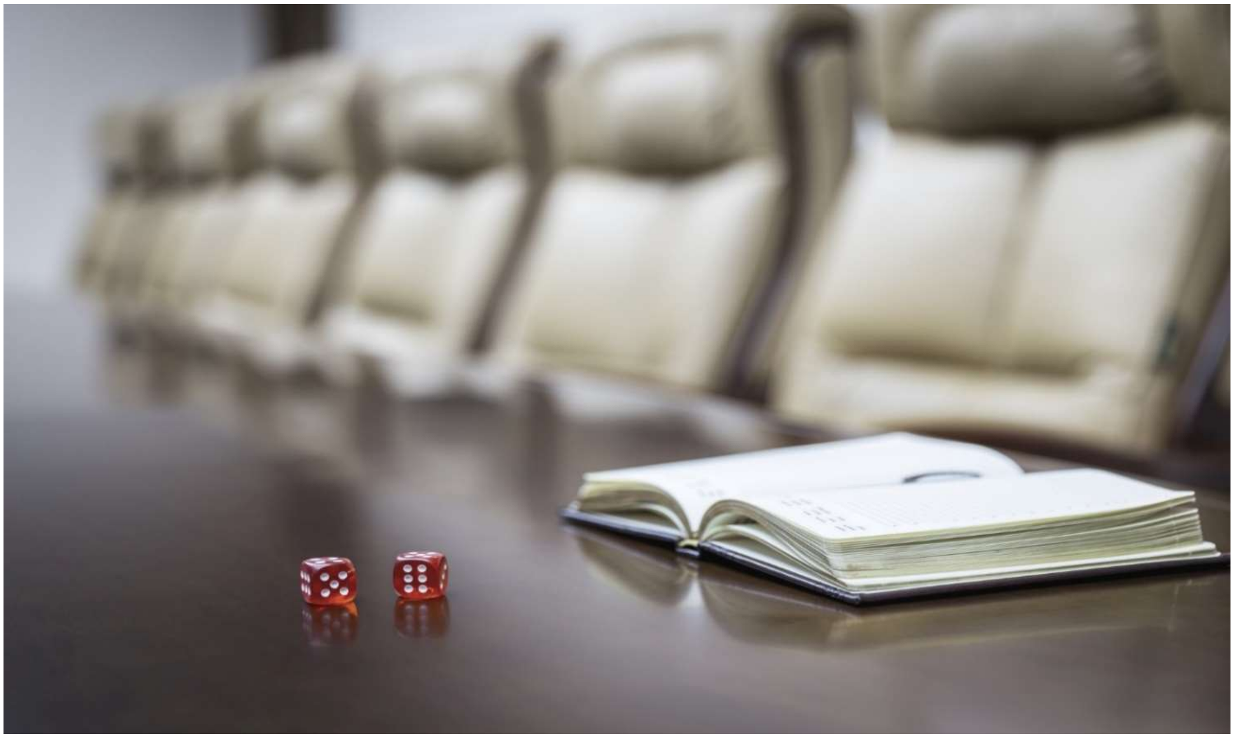

Background:

The Central Board of Direct Taxes (CBDT) had earlier notified 10 Income Computation and Disclosure Standards (ICDS) to be applicable from Financial Year 2015-16 (Assessment Year 2016-17) for all taxpayers following the mercantile system of accounting. A number of concerns were raised by stakeholders and professional bodies seeking clarifications on implementation of the ICDS. Subsequently, the CBDT issued a Press Release and deferred the implementation of ICDS by one year i.e. from Assessment Year 2017-18 onwards.

The CBDT has now notified the revised ICDS vide Notification No 87/ 2016 dated 29 September 2016. The revised ICDS have to be followed by all taxpayers from Assessment Year 2017-18 onwards (other than an individual or a Hindu Undivided Family who is not required to get the accounts audited in accordance with the provisions of Section 44AB of the Income-tax Act, 1961) following the mercantile system of accounting. The amendments provided under the Notification are briefly discussed below:

ICDS	Earlier ICDS	Revised ICDS
I – Accounting Policies	• No change	
II – Valuation of Inventories	• Only First-in First-Out (FIFO)/Weighted Average Cost method was permissible. • Under retail method, cost of inventory was to be determined by reducing from the sales value of the inventory, the appropriate percentage gross margin.	• Recognizes standard cost method for valuation of inventories, if the result approximates the actual cost. Disclosure requirements applicable on adoption of standard cost [Paragraph 18(1) and 26(a)]. • Retail method provides for applying an average percentage gross margin for each retail department [Paragraph 18(2)].
III – Construction Contracts	• No grandfathering provided for ongoing construction contracts.	• Grandfathering provided for contracts commenced before 31 March 2016 but not completed by the said date. • Recognition of contract revenue and costs as per method regularly followed prior to 31 March 2016 [Para 22(2)].
IV – Revenue Recognition	• Revenue for services to be recognized as per Percentage of Completion Method (POCM) only. • All interest income (including interest on tax refund, duty, cess) to be recognized on accrual basis.	• In line with Accounting Standard-9 issued by Institute of Chartered Accountants of India (ICAI), revised ICDS permits revenue recognition on a Straight Line basis over a specific period of time where services are provided by an indeterminate number of acts over such period [Paragraph 6]. • Revenue from service contracts with duration less than 90 days can be recognized when rendering of services under contract is completed or substantially completed [Paragraph 7]. • Interest on refund of any tax, duty or cess has to be recognized on receipt basis [Paragraph 8(2)].

ICDS	Earlier ICDS	Revised ICDS
V – Tangible Fixed Assets	• Joint ownership of fixed assets to be indicated separately in the tangible fixed assets register.	• This requirement has been done away with [Paragraph 14].
VI – Effects of changes in foreign exchange rates	• Foreign operations to be classified into integral and non-integral foreign operations. Differential treatment was mandated for translating the financial statements of integral and non-integral foreign operations. • All non-monetary items including inventory to be reported at the exchange rate as on the date of the transaction.	• No classification required for foreign operations and accordingly, single treatment has to be followed for translating the financial statements of a foreign enterprise. • The non-monetary items (being inventory carried at net realizable value) are required to be reported at the exchange rate that existed when such value was determined [Paragraph 4(d)].
VII- Government Grants	• No change	
VIII – Securities	• Securities have been assigned the meaning as per Section 2(h) of Securities Contract Regulation Act, 1956, other than derivatives referred to sub-clause (1a) of that clause. • Value of securities to be determined on FIFO basis only.	• Securities to include shares of a company in which public are not substantially interested [Paragraph 3(1)(b)]. • Value of securities can also be determined as per Weighted Average Cost formula [Paragraph 13]. • New Chapter – Part B introduced to provide for valuation of securities held by a Scheduled bank, public financial institutions, etc.
IX – Borrowing Costs	• For general borrowings, the amount of borrowing costs to be capitalized was computed in accordance with a	• Borrowing costs to be capitalized as per the same formula. However, for such purpose, qualifying asset has been defined to include asset which

ICDS	Earlier ICDS	Revised ICDS
	prescribed formula. However, no time limit was prescribed for the qualifying assets.	necessarily requires a period of 12 months or more for its acquisition, construction or production. • It has been clarified that borrowing costs eligible for capitalization for both specific and general borrowings are subject to cessation of capitalization specified in Paragraph 8.
X – Provisions, Contingent Liabilities & Contingent Assets	• No changes	

Our Comments

The amendments incorporated under the revised ICDS such as recognition of standard cost method for inventory valuation, grandfathering of on-going construction contracts and elimination of separate treatments for integral and non-integral foreign operations is a welcome step which seems to have addressed the concerns raised earlier.

However, in the current form also, there exists ambiguities in many areas such as new concepts like 'reasonable cause' or 'reasonable certainty' have been left undefined, non-recognition of mark-to-market losses on hedge contracts, category-wise valuation of securities, etc. which may lead to litigation. There may also be a need to ensure that revised ICDS are in line with the Indian Accounting Standards (Ind AS) which have been made mandatory for certain class of companies beginning from 1 April 2016.

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