



# Voices on Reporting - ICDS implementation issues

7 June 2018

—

[KPMG.com/in](http://KPMG.com/in)



# Welcome



01

Series of knowledge sharing calls



02

Covering current and emerging reporting issues



03

Scheduled towards the end of each month



04

Look out for our Accounting and Auditing Update, IFRS Notes and First Notes publications



# Speakers for the call



## Madhu Sudan Kankani

Partner

Accounting Advisory Services  
KPMG in India



## Rahul Chowdhary

Director

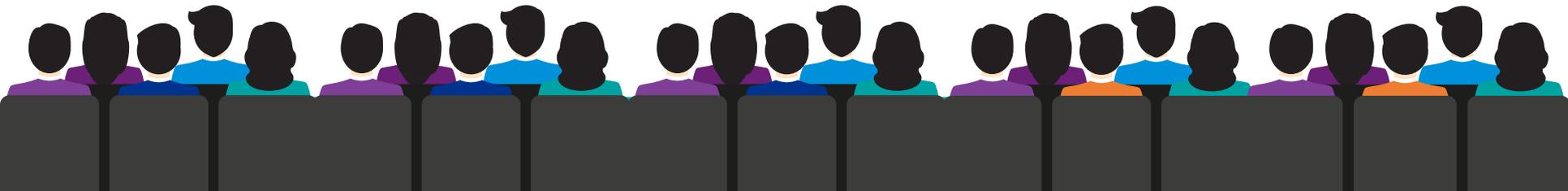
Accounting Advisory Services  
KPMG in India

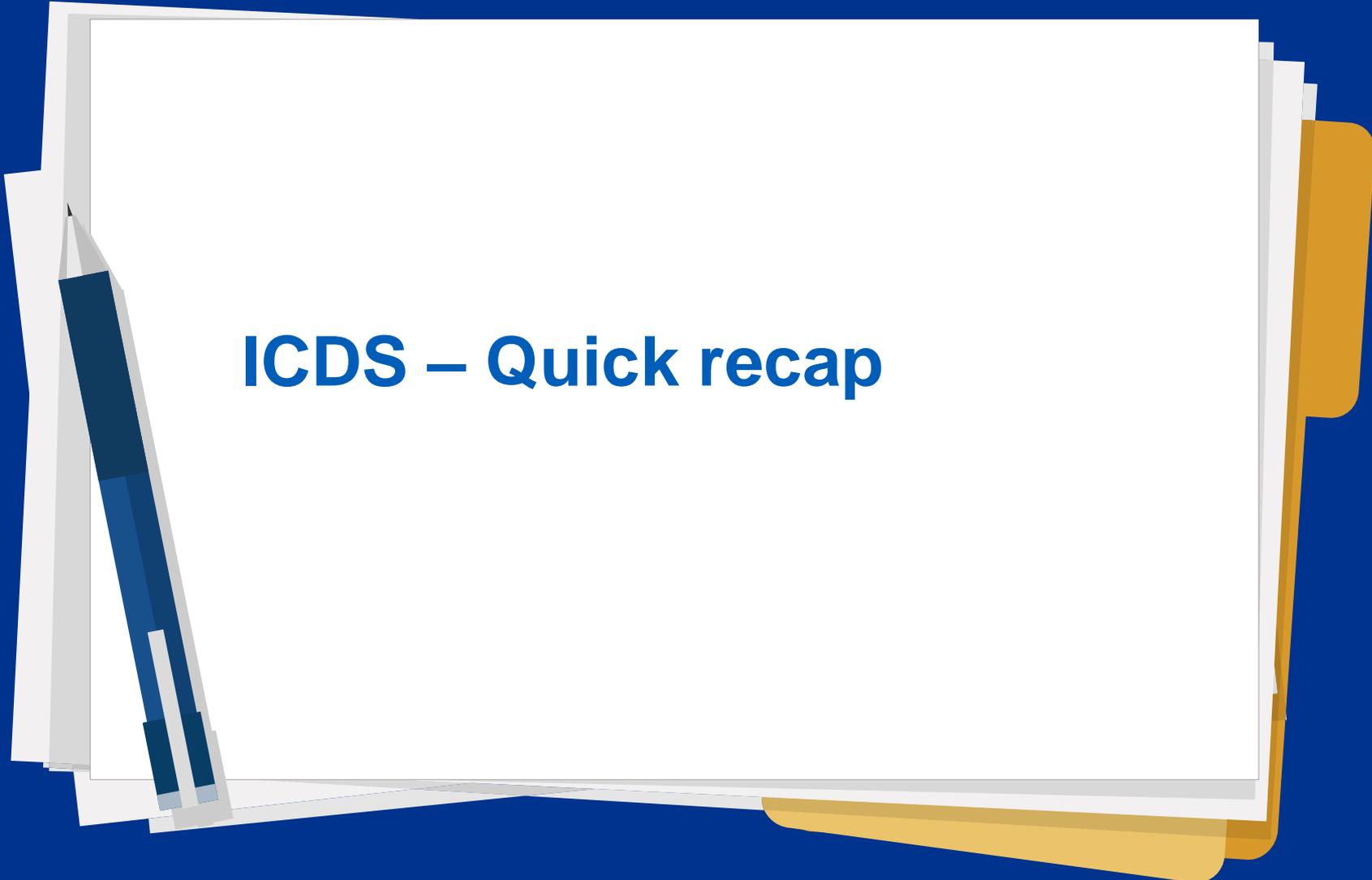


## Ruchi Rastogi

Partner

Assurance  
KPMG in India



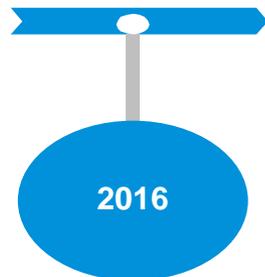
A graphic illustration of a stack of papers. The top paper is white and features the text 'ICDS – Quick recap'. To the left of the papers is a blue pencil with a white eraser. To the right is a yellow folder tab. The entire graphic is set against a dark blue background.

# ICDS – Quick recap

# ICDS implementation in India - story so far



- 10 ICDS notified effective from 1 April 2015.
- Press release in November 2015 - CBDT requested for comments on the issues/challenges for proper implementation of ICDS.



- ICDS deferred - applicable from 1 April 2016.
- The CBDT notified 10 revised ICDS to be applicable w.e.f. AY2017-18. Also amended Form 3CD.



- The CBDT issued FAQs on ICDS.



- On 8 November 2017, the Delhi High Court (HC):
  - Questioned the constitutional validity of ICDS, and
  - Quashed certain provisions of ICDS, and upheld the judicial precedents.



- In March 2018, the Finance Act, 2018, legitimised various provisions of ICDS that were earlier overruled by the Delhi HC judgement.



**ICDS is applicable for AY 2017-18 (i.e. PY 2016 -17)**

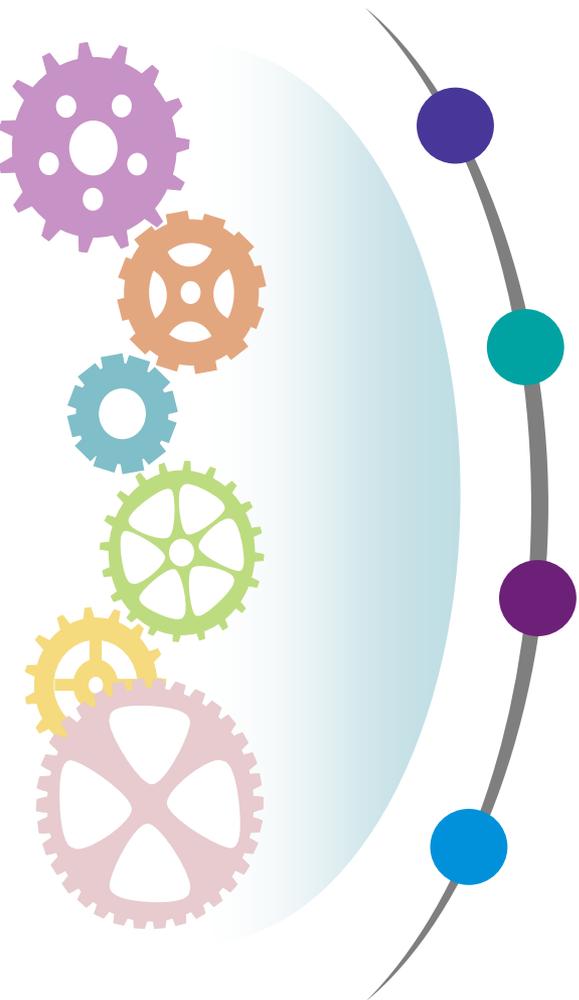
# Notified ICDS



No.	ICDS	Equivalent AS	Equivalent Ind AS
ICDS I	Accounting Policies	AS 1	Ind AS 1 and Ind AS 8
ICDS II	Valuation of Inventories	AS 2	Ind AS 2
ICDS III	Construction Contracts	AS 7	Ind AS 11*
ICDS IV	Revenue Recognition	AS 9	Ind AS 18*
ICDS V	Tangible Fixed Assets	AS 10	Ind AS 16
ICDS VI	Effects of Changes in Foreign Exchange Rates	AS 11	Ind AS 21
ICDS VII	Government Grants	AS 12	Ind AS 20
ICDS VIII	Securities	AS 13	Ind AS 32
ICDS IX	Borrowing Costs	AS 16	Ind AS 23
ICDS X	Provisions, Contingent Liabilities and Contingent Assets	AS 29	Ind AS 37

A draft ICDS on Real Estate was issued by CBDT on 11 May 2017, and is based on Guidance Note on Real Estate Transactions issued in 2012 by ICAI. Recently, the Ind AS version of the guidance note has been withdrawn by ICAI.

\*Ind AS 115, *Revenue from Contracts with Customers*, applicable from accounting year beginning 1 April 2018.



- The revised ICDS were notified in September 2016.
- Later in November 2017, the Delhi HC quashed certain provisions of ICDS.
- The Finance Act, 2018 brought certain amendments in the Income-tax Act, 1961 (IT Act) to validate ICDS.

- Revised return needs to be filed by assesseees who had not considered ICDS adjustments for filing return of income
- Corresponding deferred tax adjustments need to be considered

The ICAI has started the process of updating the erstwhile Indian GAAP i.e. AS. While ICDS are still based on previous versions of ASs.

- The Finance Act, 2017 amended Section 115JB of the IT Act so as to provide the framework for computation of Minimum Alternate Tax (MAT) for Ind AS compliant companies in the year of adoption and thereafter.
- While, MAT guidance on certain equity type transactions still not notified.

# Delhi High Court ruling of November 2017



## Key findings of the Delhi HC

Power to enact law vests with the Parliament and not the Central Government and such enactment can be made by an amendment to the statute.

ICDS has the effect of modifying the basis of computation of income and it cannot overrule the provisions of the IT Act, Rules and judicial precedents.

Section 145(2) should be read down to the extent it is *ultra vires* the IT Act.

Some of the provisions of ICDS struck down as they are considered unsustainable in the law.

Timing of the Delhi HC ruling coincided with filing deadlines of IT Return/Form 3CD or Form 3CEB



# Snapshot of Amendments by the Finance Act, 2018



## Section 36(1)(xviii)

Deduction for MTM\* loss or other expected loss to be in accordance with ICDS.



## Section 40A(13)

No deduction or allowance in respect of MTM loss or other expected loss.



## Section 43AA

Any foreign exchange gain or loss relating to specified foreign currency transactions would be treated as an income or a loss, if computed according to ICDS.



## Section 43CB

Income from a construction as well as service contracts on the basis of percentage of completion method.



## Section 145A

- Inventory to be valued at the lower of cost or NRV\*\*.
- Inventory in nature of securities is to be valued in line with ICDS.

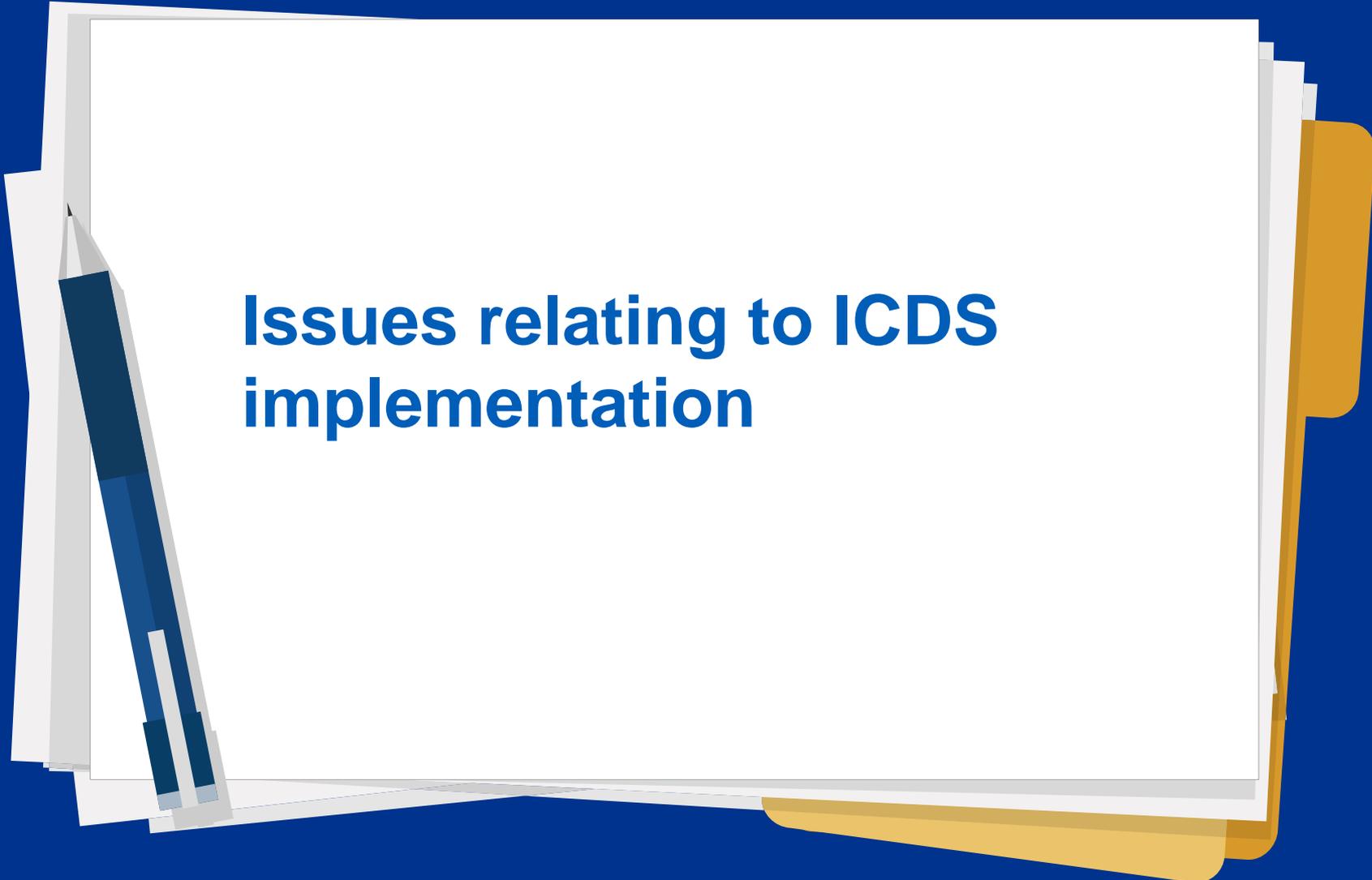


## Section 145B

Provides for taxability of interest received on enhanced compensation, claim for escalation in price or export incentives, subsidy, grants, etc.

\*MTM – Marked to Market

\*\*NRV – Net Realisable Value



# Issues relating to ICDS implementation

# Concept of prudence



## ICDS I: Accounting Policies



ICDS I did not include the concept of prudence which was present in the erstwhile AS 1 relating to disclosure of accounting policies issued under Section 145(2) of the IT Act.

## Held by Delhi HC



Quashed ICDS I as it was considered contrary to the IT Act and binding judicial precedents.



## The Finance Act, 2018 introduced two amendments:

### Section 36(1)(xviii) of the IT Act

MTM loss and other expected loss, computed in accordance with notified ICDS are allowed as deduction.

### Section 40A(13) of the IT Act

Deduction or allowance in respect of MTM loss or other expected loss would not be allowed, except when allowable under newly inserted Section 36(1)(xviii).



## Impacts

- Application of prudence for these expenses might not be allowed.
- MTM loss or expected loss would not be allowed unless actually realised.
- Foreign exchange loss would continue to be allowed under ICDS VI.

# Foreign exchange fluctuation



## ICDS VI: *The Effects of Changes in Foreign Exchange Rates*



- Foreign exchange fluctuation on foreign currency loan for capital purposes would be treated as an income or an expense,
- MTM gain/loss on foreign currency derivatives held for trading/speculative purpose was not allowed as a deduction, and

## Held by Delhi HC



Struck down ICDS VI on the following grounds:

- Treatment of foreign exchange fluctuation on capital purpose loan as an income or an expense, and disallowance of MTM gain/loss on foreign currency derivatives were against the judicial pronouncements.



## The Finance Act, 2018 inserted Section 43AA to the IT Act

Section 43AA, subject to the provisions of Section 43A, provides that any gain or loss arising on account of fluctuation in foreign exchange rates in respect of the specified foreign currency transactions would be treated as income or loss if it is computed in accordance with notified ICDS.

# Foreign exchange fluctuation (cont.)



## Impact of amendment

- Gains/losses arising on any monetary or non-monetary item would be recognised as an income or loss (including gains/losses on foreign exchange loans taken for acquiring domestic assets).
- MTM loss/gain on foreign currency derivatives would be recognised as an income/expense.
- To evaluate treatment of complex instruments like cross-currency interest swap, whether these would be covered under ICDS I or ICDS VI.
- If foreign exchange loss for previous years has not been claimed in return of income, then evaluate whether the same can be claimed as part of the transitional provisions in the return of income for financial year 2016-17.



# Valuation of inventories and securities



## ICDS II: *Valuation of inventories*



Inventory stocks to be valued:

- In accordance with specified provisions mentioned in ICDS, and
- At NRV in case of dissolution of partnership notwithstanding whether business is discontinued or not

## Held by Delhi HC



Struck down ICDS II in its entirety since:

- The IT Act permitted assessee to follow method of accounting regularly employed for inventories (whether or not that was prescribed in ICDS), and
- Requirement to value inventory at NRV on dissolution was not in line with judicial pronouncements.

## ICDS VIII: *Valuation of Securities*



ICDS VIII (Part A) required entities other than scheduled banks and public financial institutions to value securities held as stock in trade on a bucket system basis.

## Held by Delhi HC



The Delhi HC considered the provision *ultra vires* the IT Act, and hence, quashed Part A of ICDS.

# Valuation of inventories and securities (cont.)



## The Finance Act, 2018 amended Section 145A to the IT Act

Section 145A deals with valuation of inventories and securities for determining the income chargeable under the head 'Profits and gains of business or profession' and provides that

- Valuation of inventory at lower of cost or NRV, including any tax, duty, cess or fee actually paid or incurred
- Unlisted/unquoted securities to be valued at actual cost determined as per notified ICDS
- Other securities to be valued at lower of cost/NRV (for this purpose the comparison to be made category-wise).

## Impacts



- The IT Act prescribes that valuation of inventory at cost or NRV, whichever is lower, irrespective of the method of accounting followed by the assessee. Therefore, IT Act provides validity to ICDS II.
- In case of dissolution of business, inventory would be computed at cost or NRV, whichever is lower.
- Since Section 145A is also applicable to service contracts, GST on rendering of services would be added to purchase cost and sales price of the services.
- Valuation of securities would be as per bucket system.

# Revenue recognition for construction and service contracts



## ICDS IV: Revenue Recognition



Percentage of completion method to be adopted for revenue recognition on service contracts.

## Held by Delhi HC



Prescription of only one method for revenue recognition was *ultra vires* the IT Act - Percentage of completion method and contract completion method have been recognised as valid method of accounting.

## ICDS III: Construction Contracts



- Retention money would be accrued and taxed as per the percentage of completion method
- Incremental cost such as interest, dividend and capital gains would not be reduced from contract cost.

## Held by Delhi HC



On the basis of judicial pronouncements, Delhi HC stated that:

- Retention money would be taxed on a case-to-case basis
- All incidental income would be permitted to be reduced from contract cost.

# Revenue recognition for construction and service contracts (cont.)



## The Finance Act, 2018 inserted Section 43CB to the IT Act

Section 43CB(1) provides that the profits arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method computed in accordance with notified ICDS. Additionally it provides:

- Revenue from service contracts with duration of not more than 90 days should be determined on the project completion basis
- When services are provided by an indeterminate number of acts over a specific period of time, revenue may be recognised on a straight line basis.

Section 43CB(2) provides that the retention money would be part of contract revenue. Further, incidental income being interest, dividend and capital gains would not be reduced from contract costs.

## Impacts

- For rendering of services, entities are required to follow percentage of completion method for computing taxable income (other than contract for duration of 90 days).
- Timing of recognition of revenue under Hybrid Annuity model/Build Operate Transfer Annuity model (in public private partnership) projects requires clarification.
- MAT implications in case of different method for maintaining books of accounts and for computing taxable income.
- As per certain judicial precedents retention money is not taxed unless and until the defect liability period is over and the engineer-in-charge certifies that the taxpayer does not have any liability. Under ICDS, reasonable certainty of ultimate collection has to be evaluated.
- Non-reduction of incidental income in the nature of interest, dividends and capital gains from contract cost needs to be evaluated in terms of existing judicial pronouncement.
- Allowability of expected loss in case of old contracts under ICDS I or ICDS IV needs to be evaluated.



# Escalation claims and export incentives



## ICDS IV: Revenue Recognition



- Revenue from export incentives to be recognised in the year in which the claim is raised.
- Interest income would be taxed on time basis.

## Held by Delhi HC



- Provision held *ultra vires* to the IT Act – based on judicial pronouncements reasonable certainty is met in the year claim is accepted by the government.
- Interest accrual as per ICDS IV has not been considered contrary to any judicial precedent or Section 36(1)(vii) of the IT Act. Accordingly, it is held to be valid.



## The Finance Act, 2018 inserted Section 145B to the IT Act

Section 145B provides that:

- Interest received by an assessee on compensation or on enhanced compensation, deemed to be the income of the year in which it is received.
- The claim for escalation of price in a contract or export incentives, deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

## Impacts

- Taxability of interest income on NPAs.
- Taxability of premium on redemption of debt instruments.



# Government grants



## ICDS VII: *Government grants*



Government grants would be recognised as an income not beyond the date of receipt.

## Held by Delhi HC



In many situations government grants could be received in advance i.e. prior to fulfilment of conditions for receipt, then taxation of such grants would be contrary to the accrual system of accounting. Thus, this provision was declared *ultra vires* the IT Act.



## The Finance Act, 2018 introduced Section 145B(3) of the IT Act

Section 145B(3) provides that subsidies and grants should be deemed to be the income of the previous year in which they were received i.e. income has to be recognised on receipt basis which may not have been accrued.



## Impact

- Evaluate a situation when assessee does not fulfil the conditions of the government grant received in advance.

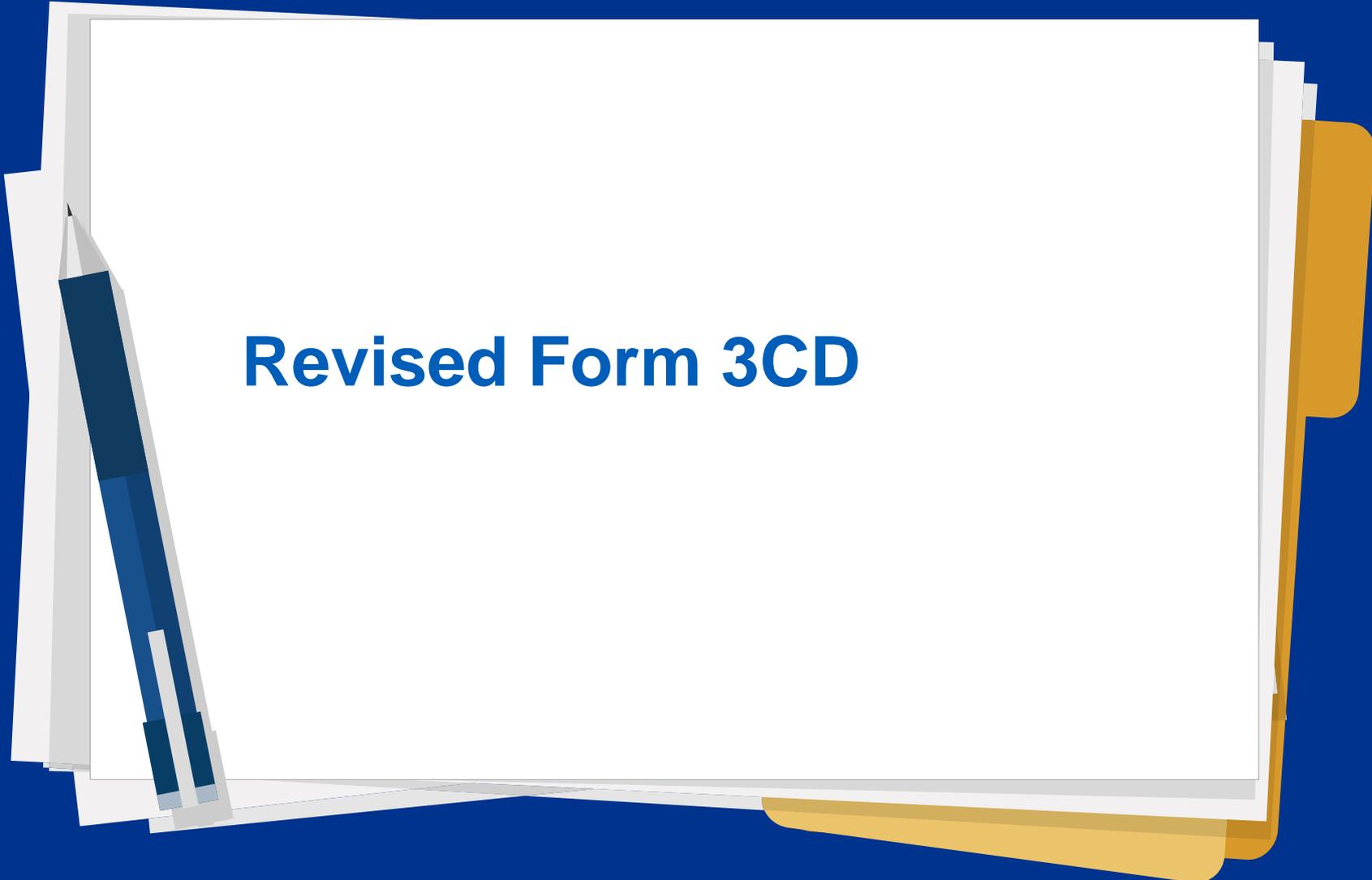
# Implementation issues under ICDS/MAT relating to Ind AS



## Few examples are as following:

- Accounting of shares held as stock in trade are financial instruments and specifically excluded from the scope of Ind AS 2, *Inventories*
- Measurement of compound financial instruments
- Accounting for business combination under common control mergers
- Capitalisation of enabling assets
- Accounting for restoration cost in case of a leasehold land
- Application of revaluation model for land and building
- Accounting treatment of customer loyalty programmes while recognising revenue
- Adjustments of advance payments received for goods or services for the effect of time value of money
- Lease rent with escalation clause
- Security/lease deposit discounting and corresponding impacts
- Capitalisation of dividend distribution tax (as a borrowing cost) paid on a preference share dividend.





# Revised Form 3CD

# Amendment to Form No. 3CD to report ICDS adjustments



The tax audit report in Form 3CD has been amended, to provide for disclosures required by ICDS in clause 13. The extract of new sub-clauses are as under:

## 1) Details of adjustments relating to ICDS

*“(d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)?*

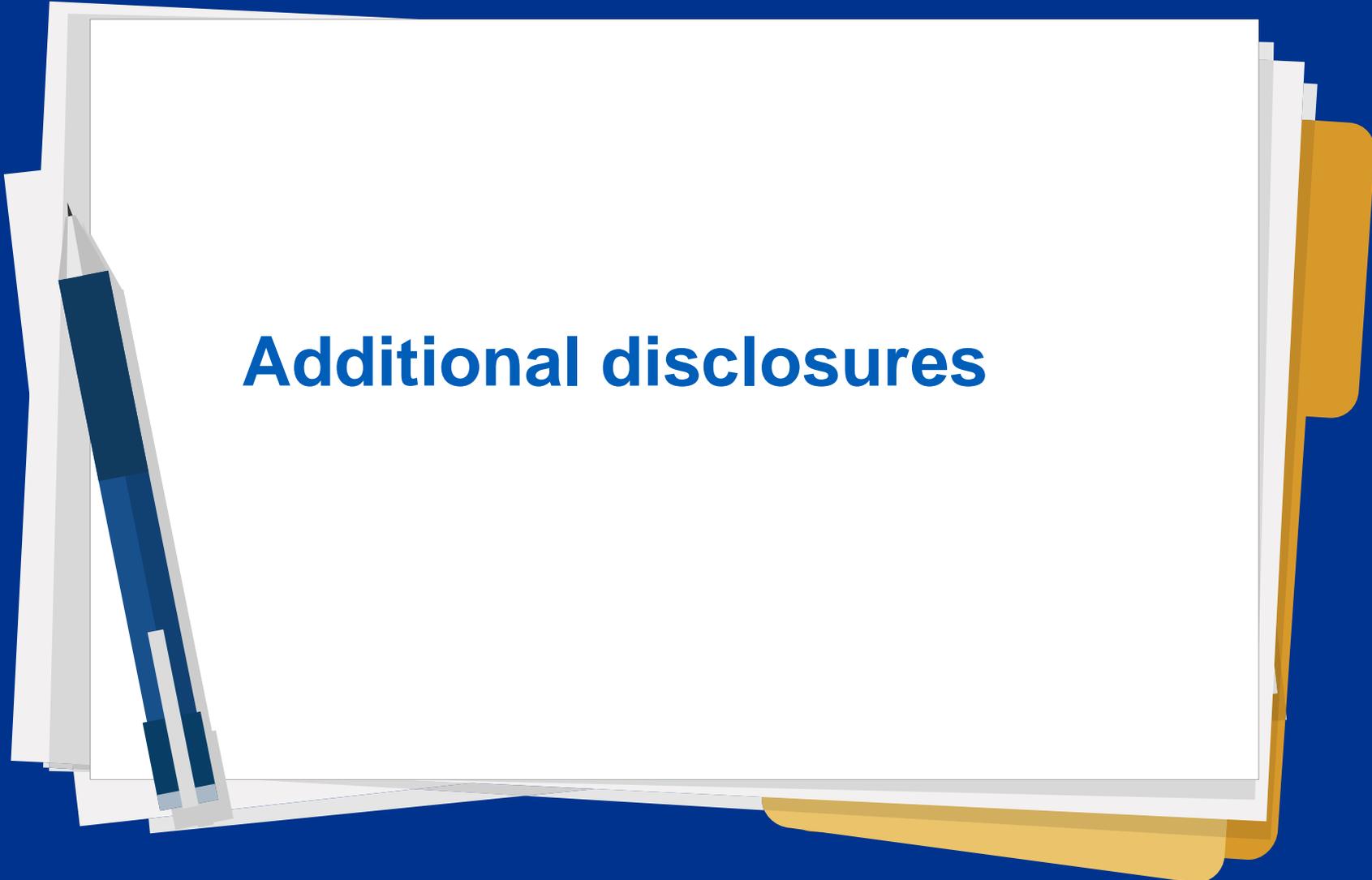
*“(e) If answer to (d) above is in the affirmative, give details of such adjustments:”*

		Increase in Profit (Rs.)	Decrease in Profit (Rs.)	Net Effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
ICDS IV	Revenue Recognition			
ICDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Government Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			
Total				

## 2) Disclosures as per ICDS

*“(f) Disclosure as per ICDS*

(i)	ICDS I – Accounting Policies
(ii)	ICDS II – Inventories
(iii)	ICDS III – Construction Contracts
(iv)	ICDS IV – Revenue Recognition
(v)	ICDS V – Tangible Fixed Assets
(vi)	ICDS VII- Government Grants
(vii)	ICDS IX – Borrowing Costs
(viii)	ICDS X –Provisions, Contingent Liabilities and Contingent Assets”



# Additional disclosures

# Additional disclosures under ICDS



## ICDS II: Valuation of inventories

- 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.

## ICDS IV: Revenue recognition

- Revenue from service transactions during the previous year
- Method used to determine the stage of completion of service transactions in progress
- For service transactions in progress at the end of the previous year:
  - Costs incurred and profits recognised (net of losses),
  - Advances received, and
  - Retentions.



# Additional disclosures under ICDS



## ICDS V: Tangible fixed assets

- Description of asset or block of assets along with actual cost or WDV
- Rate of depreciation
- Additions during the previous year (giving details of adjustments made for CENVAT credit, exchange rate and subsidies received), and date of put to use
- Deductions during the year and
- Written down value at the end of year.

*Note: As per para 14 of ICDS V, details of jointly owned tangible fixed assets (if there are any) shall be indicated separately in the tangible fixed assets register.*

## ICDS VII: Government grants

- Nature and extent of government grant recognised as:
  - Income during previous year
  - Deduction from actual cost of asset/from WDV of block of assets.
- Nature and extent of government grants not recognised, and reasons for non-recognition as:
  - Income during previous year
  - Deduction from actual cost of asset/from WDV of block of assets.



# Additional disclosures under ICDS

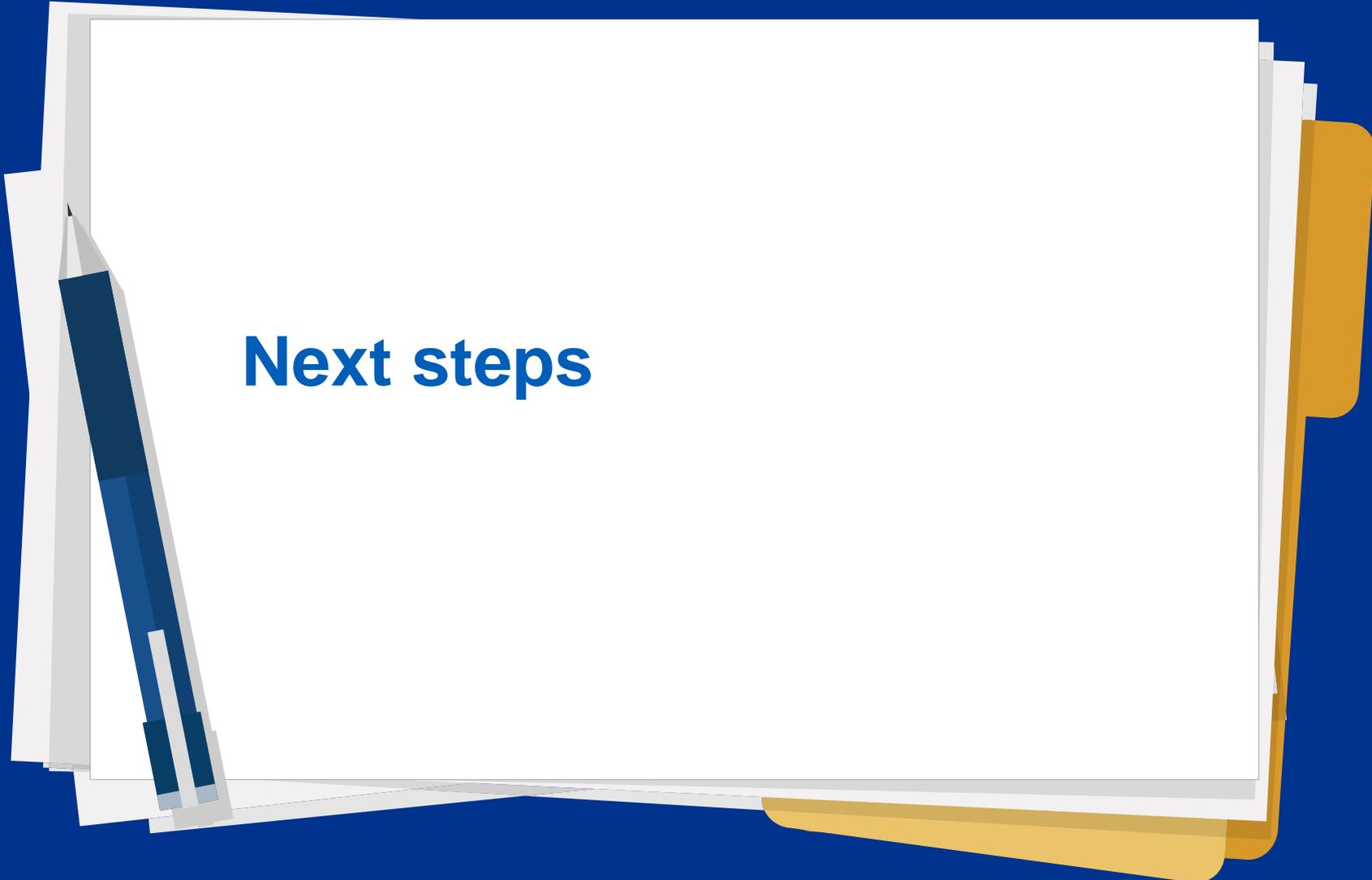


## ICDS X – Provisions, Contingent Assets and Contingent Liabilities

For each class of contingent asset and related income recognised:

- Brief description of the nature of the asset and related income
- The carrying amount of asset at the beginning and end of the previous year
- Additional amount of asset and related income recognised during the year, including increases to assets and related income already recognised, and
- Amount of asset and related income reversed during the previous year.



A graphic illustration of a stack of papers. The top paper is white and features the text 'Next steps'. To the left of the paper is a blue pencil with a white eraser. To the right is a yellow folder tab. The entire graphic is set against a dark blue background.

## Next steps

# Way forward for taxpayers



Reevaluate position  
taken on the basis of  
Delhi HC judgement



Evaluate the  
possibility of filing a  
revised return



Impact on accounting  
of deferred taxes



Robust reconciliation  
between financial  
books and tax books



Assess impact of ICDS  
on continuous basis





# Q&A



# Sources

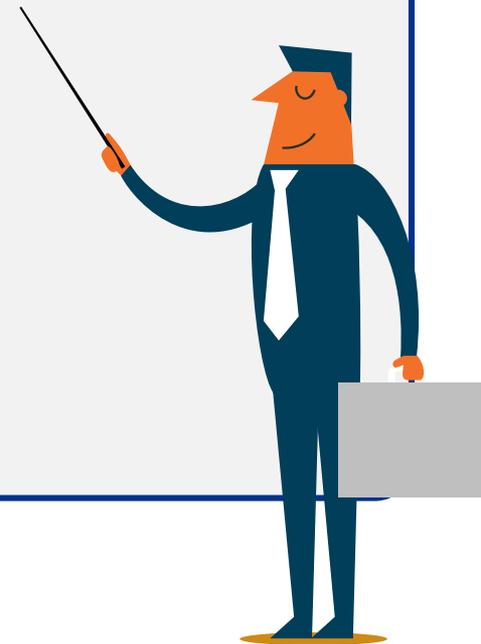


1. The CBDT notification No. 87/2016 dated 29 September 2016.
2. The CBDT notification No. 88/2016 dated 29 September 2016.
3. The Delhi HC judgement dated 8 November 2018 in the case of The Chamber of Tax Consultants & Anr vs Union of India & Ors
4. The Finance Act, 2018.





- ICDS – Income Computation and Disclosure Standards
- MAT – Minimum Alternate Tax
- ICAI – The Institute of Chartered Accountants of India
- CBDT – The Central Board of Direct Taxes
- MTM – Marked to Market
- NRV – Net Realisable Value
- CENVAT – Central Value Added Tax
- WDV – Written Down value



# Links to previous recordings of VOR



Month	Topics	Link
<b>October 2017</b>	<ul style="list-style-type: none"> <li>• Ind AS updates</li> <li>• Updates on the 2013 Act</li> <li>• Updates on SEBI regulations</li> </ul>	Click <a href="#">here</a>
<b>January 2018</b>	<ul style="list-style-type: none"> <li>• Companies (Amendment) Bill, 2017</li> <li>• SEBI Corporate Governance Committee Report</li> <li>• ITFG clarification: Bulletin 12</li> <li>• Delhi HC decision on constitutional validity of ICDS</li> </ul>	Click <a href="#">here</a>
<b>January 2018 (special session)</b>	<ul style="list-style-type: none"> <li>• Ind AS 115, <i>Revenue from Contract with Customers</i></li> </ul>	Click <a href="#">here</a>
<b>March 2018 (special session)</b>	<ul style="list-style-type: none"> <li>• Ind AS 115 - Sector series 1</li> </ul>	Click <a href="#">here</a>
<b>April 2018</b>	<ul style="list-style-type: none"> <li>• Ind AS 115, <i>Revenue from Contracts with Customers</i></li> <li>• New/revised Standards on Auditing (SAs)</li> <li>• SEBI accepts some recommendations of the committee report on corporate governance</li> <li>• Other regulatory updates</li> </ul>	Click <a href="#">here</a>
<b>April 2018 (special session)</b>	<ul style="list-style-type: none"> <li>• Ind AS 115 - Sector series 2</li> </ul>	Click <a href="#">here</a>
<b>May 2018 (special session)</b>	<ul style="list-style-type: none"> <li>• SEBI implements Kotak Committee recommendations</li> </ul>	Click <a href="#">here</a>

For other archives of VOR calls, visit [www.KPMG.com/in](http://www.KPMG.com/in)

# Our Publications

## Accounting and Auditing Update



## First Notes



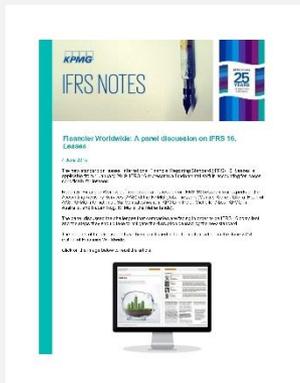
## Coming up next

New issue of:

- Accounting and Auditing Update
- First Notes
- IFRS Notes

Download from [www.kpmg.com/in](http://www.kpmg.com/in)

## IFRS Notes





# Thank you

## **KPMG in India contacts:**

**Madhu Sudan Kankani**  
**Partner**  
Accounting Advisory Services  
E-mail: [mkankani@kpmg.com](mailto:mkankani@kpmg.com)

**Ruchi Rastogi**  
**Partner**  
Assurance  
E-mail: [ruchirastogi@kpmg.com](mailto:ruchirastogi@kpmg.com)

**Rahul Chowdhary**  
**Director**  
Accounting Advisory Services  
[rahulchowdhary@kpmg.com](mailto:rahulchowdhary@kpmg.com)

**Feedback/queries can be sent to: [aaupdate@kpmg.com](mailto:aaupdate@kpmg.com)**



[kpmg.com/socialmedia](https://kpmg.com/socialmedia)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2018 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

This document is for e-communications only.