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Emerging Trend in Indian Direct Taxation: An Analysis of Income Computation and Disclosure Standards

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ABSTRACT

Income computation and disclosure standard is one of the competent standard which minimizes the divergence between accounting income and tax income. This standard does not require any additional books of accounts to be maintained by the business organizations but only the thing is the manner of computation of income for the purpose levying of tax under the head 'Profit or gains from business or profession' and 'Income from other sources'. The present study is purely based on secondary data and is a descriptive study to analyse the impact of ICDS on business transactions and its implementation challenges in India.

Keywords: *Income Computation and Disclosure Standards (ICDS); Ind-As; Income determination; Business income.*

1.0 Introduction

India is one of the fastest growing economies and is always struggling to globalize its economic system. For this purpose, central government have taken various reforms like Make in India, Skill India, Digital India, Demonetization of high denominated currency notes, introduction of GST, Implementation of Ind-As and the major step towards direct taxation reforms is implementation of ICDS (Income Computation and Disclosure Standards). This ICDS is one of the burning issue in the arena of direct taxation. This standard is applied to determine the Income earned from the 'Profit or gains from business or profession' and 'Income from other sources' heads under Income Tax Act of 1961.

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ICDS will not create the additional burden of preparation and maintenance of separate set of books of accounts for accounting and income tax purposes. It means preparation of books of accounts shall continue to prepare as per prevailing norms, framework and GAAPs. In India books of accounts of all the commercial entities are prepared and maintained as Ind-As in confirmation with Companies Act, 2013 and Companies Rules Act, 2014.

1.1 Need for ICDS

All the business operations are recorded as per the accounting GAAPs, rules, principles and accounting standards and the taxable income is calculated based on the accounting results and the income tax provisions applicable to determine the taxable income. This creates the diversity in both the income calculated as per accounting and income tax rules, so it is necessary to bring uniformity in the results of both accounting and taxation purview. For this purpose, Government of India is developed a separate set of standards to reduce the divergence between accounting and taxable income that is ICDS.

1.2 Nature of ICDS

- Income computation disclosure standards are the standards which gives the framework for determination of taxable income under the income from business or profession and other sources. And it will not impact on computation of minimum alternative tax by the corporate assesses and which will be determined based on the book profit calculated as per the current accounting standards.
- This standard applicable to all group of tax payers whether they are belonging to business communities or non-business communities or whether resident or non-residents who are following mercantile system of accounting.
- This standard is only for computation of taxable income and not for maintaining the books of accounts and if any differences arises between Income Tax Act and ICDS then provisions relating to income tax will apply.
- Except ICDS-8 relating securities, all other ICDSs have transitional provisions to allow to recognize the outstanding contracts and transactions as on 1st April 2015 as per the provisions of ICDS by taken into consideration of expenses, losses, incomes, gains already recognized during the past periods. It means no older rule in this respect will not continue from 31st march 2015.
- If ICDS is not followed, then income tax department is having the sole authority to determine the income based on best judgement assessment and if any deviations

found in determined income then the authority is having the power to levy the penalty as per section 145(3) of the Income tax Act.

- ICDS is totally different from accounting standards and which do not give any descriptions, instances for implementation but it will give the principles to be followed at the time of determining the taxable income.
- There is no threshold limit for the application of ICDSs.
- By applying the principles of ICDSs taxable profit of the business can be determined after making certain adjustments to the financial statements prepared as per Ind-Ass.
- For the revenues or expenses in relation to which there are no ICDS in such a case income should be determines as per the existing accounting standards.
- ICDS is not based on the conservatism principle so therefore it results in earlier recognition of incomes and gains and later recognition of expenses and losses.

1.3 Applicability of ICDSs

ICDSs are applicable for all the assessee from the Assessment Year 2017-18. For ICDSs purpose there is no distinction among the assesses which means it is applicable to all assesses whether they are corporate or non -corporate, resident or non -residents who follows accrual system of accounting and which is not applicable to individual or HUF which need not to be audited their books of accounts under section 44 AB of income tax act of 1961. ICDSs is compulsory for all the assesses whether they are following accounting standards are not. If the assesses paying tax based on presumption rather than actual basis, then they are not liable for getting audited their accounts and they are out of the purview of ICDSs.

1.4 Development of ICDSs

For the purpose of development of separate set of accounting standards for income tax purpose a separate committee was set up by the central government that is popularly known as TAS committee (Tax Accounting Standard Committee) and which gave the recommendation on implementation of ICDS which are given below.

1.5 TAS committee recommendations

The TAS committee recommended to implementing the following tax accounting standards in the name of 'Income Computation And Disclosure Standards' shown in Table 1.

Table 1: List of Income Computation and Disclosure Standards and Corresponding Accounting Standards

ICDS No.	ICDS Particulars	Accounting standards matching to ICDS
1.	Accounting policies	AS-1. Disclosure of accounting policy
2.	Valuation of inventories	AS-2. Valuation of inventories
3.	Construction contracts	AS-7. Construction contracts
4.	Revenue recognition	AS-9. Revenue Recognition
5.	Tangible fixed assets	AS-10. Property, Plant and Equipment
6.	The effect of changes in foreign exchange rates	AS-11. The effects of changes in foreign exchange contracts
7.	Government grants	AS-12. Accounting for government grants
8.	Securities	AS-13 Accounting for investments
9.	Barrowing cost	AS-16 Barrowing costs
10.	Provisions for contingent assets and liabilities	AS-29 Provisions for contingent liabilities and contingent assets.

Source: Author compiled

2.0 Review of Literature

Nishanth et al. (2015). have analysed the Indian taxation structure and found that there is a huge dependency on indirect taxation than direct taxation by the government and indirect tax is the major source of revenue to the government than the direct taxation. Chawla et al. (2013) conducted a study to examine the satisfaction and awareness level of the tax payers toward e-filing of income tax returns. 300 filled questionnaires from respondents (162 males and 138 females) were used to analyse the results by using mean score for ranking by using a Likert scale of 5, ANOVA and chi-square test through SPSS was also used.

Kumar et al. (2014) discussed about the benefits of electronic filing of tax to the authorities, policy makers, present and prospective tax payers, e-filing intermediaries, financial software engineers and academicians. The paper focused on the benefits derived by the different sections of the society due to e-filing of income tax returns. Saravanan and MuthuLakshmi (2017) conducted the study to analyse the planning of individual income tax and examine the tax saving instruments. They found that the majorly adopted tax saving instrument is Provident Fund, Life Insurance policy.

Kaiser Family Foundation (2003) concluded that the people gave much more importance to the expenditure on education, healthcare and social security than to cut taxes. Mirrlees et al., (2010) have analysed the different taxation design can be made by the government and consequences of each design and had contributed some

recommendations to remove the barriers of income tax, business tax and environmental tax.

Erich Kirchler et al. (2007) examined the standard model of income tax evasion by reviewing the earlier studies on these matter and recommended that compliance decisions can only partly be explained by the rational choice approach. They only concentrated on compliance of taxation.

Shackelford and Shevlin (2001) have analysed the archival researches on tax accounting. Opines that most of the researches in this respect are merges the microeconomics, finance and concludes that there is a necessity of focus on the finance and macroeconomic aspects in future research.

2.1 Research gap

The review of existing literature reveals that the majority of the studies carried on personal income tax related matters, tax planning matters and no study conducted on the technical aspect such as income determination and payment of tax so the present study intended to analyse Income Computation Disclosure Standards and its impact on various business aspects and also examine the relationship between ICDS and Ind As and this research will contribute something to the academics because it is the first study in India to concentrate on the impact of ICDS .

2.2 Research questions

- (i) What are ICDSs?
- (ii) What are the ICDSs impact areas on business transactions?
- (iii) What are the challenges involved in implementing ICDS?

2.3 Research objectives

- (i) To analyse the key impact areas of ICDS on business transactions and its implementation challenges.
- (ii) To analyse the implementation challenges of ICDS.

2.4 Research methodology

The study is purely based on secondary sources of data collected through websites, journal, newspapers, text books and the descriptive analysis is used to carry the research because ICDS is still in infancy stage and it is necessary to build some conceptual framework.

3.0 Impact Of ICDS on Key Areas Of Business Transactions

ICDS are impact on various key areas of business that are analysed as under:

3.1 Impact on accounting policies

This new standard impact on accounting policies because it is not confirmed with important accounting principles such as conservatism, materiality. So it is not allowed to record future losses or liabilities in advance. This is the major thing to be considered for accounting purpose. And also this new income determination standard does not allow to adjust with the change in accounting policies. If the business wants to adjust with changes then it has to follow the judgement given by tax department and management people.

3.2 Impact on valuation of inventories

As per Ind-As inventories are valued based on standard cost or retail cost to determine the expected actual cost but following of standard cost for valuation of inventory is not allowed under ICDS as per income tax Act 1961. The method followed in AS is not applicable to income tax purpose because it will create dilemma and litigations so it is necessary to avoid this ICDS has allowed to value the inventory as:

- (i) The same value prevailing at the end of the previous year and
- (ii) The cost of inventory prevailing the day on which business is commenced from the previous year.
- (iii) If once the method is applied to value, the inventory it is not allowed to change the method without scientific cause.
- (iv) This rules is not applicable in case of dissolution of firm, AOP, BOI for this case inventory is valued based on the net realizable value.

3.3 Impact on construction contracts transactions

- (i) As per ICDS revenue from construction contracts must be recognized by applying percentage completion method and it does not allow to recognize under completion contract method. This provision is very difficult to follow by individual assesses because it is crucial to implement.
- (ii) Any income generated from pre-construction contract that is interest, dividend, capital gains etc., are cannot be set off against the construction cost and they will liable for tax under applicable provisions.

- (iii) It is allowed to recognize the revenue generated from contract when the results are not possible to determine. But the early stage revenue should not exceed 25% of contract price. This provision is not prevailing in the accounting standard.
- (iv) Any loss incurred during the contract should be recovered from the revenue to the extent of completion of contract. Any future loss which is not setoff that cannot be recovered until unless they are actually incurred.
- (v) Retention money also considered for the purpose of computing based on percentage completion method but the retention money is not at all treated as revenue until and unless contractor actually receives after promising the conditions arise from the contract.

3.4 Impact on revenue recognition

- (i) There is no difference between ICDS provisions and provisions of accounting standards-9 for recognition of revenue but there must be a reasonable guarantee of recovery of revenue in cash.
- (ii) Under ICDS revenue in relation to service contract must be recognized based on percentage completion method. Here revenue is identified with that of expenses incurred for rendering the services.

3.5 Impact on intangible fixed assets

ICDS emphasizes that the intangible assets must be valued at their actual cost incurred at the time of acquisition. But in accounting standard it is totally different because it considers the fair market value. ICDS is not gives any provisions for the treatment of re-valuation of asset, disposal. For this purpose, provisions of Income tax will continue to apply.

3.6 Impact on government grants transactions

When the assessee complies with the conditions in relation to the government grant and he shall be received the government grant along with this for the purpose of income determination ICDS is also lays down certain condition that the recognition of government grant must be on the date in which it is actually received and cannot be allowed to postponement of its recognition.

Treatment of Government Grants: for the purpose of treatment of government grants Accounting Standard-12 had given two techniques such as Deferred Income Approach and Deduction approach.

But for the purpose of income determination ICDS allowed only to recognize revenue under deduction approach only. Under this approach depreciable asset is shown

in the books after deducting the amount of government grants received. For instance, if A company purchased an asset worth Rs. 2, 00,000 and received grant for its purchase Rs. 50,000 then in the books of account asset must be shown at Rs. 1, 50,000 and not at Rs. 2, 00,000 as per ICDS norms.

In case of the grants received in respect of non-depreciable asset in such a case the entire amount of grants must be transferred to capital reserve account as per accounting standards. But as per ICDS entire amount of grants received in respect of non-depreciable assets are considered as income.

3.7 Impact of ICDS on borrowing cost transactions

There is no specified period for classification of assets which qualifying for borrowing cost purposes except on inventories under ICDS but in AS-16 there are specific period to classify the assets for qualification purpose.

ICDS classifies the borrowing costs into two categories such as Specific borrowing costs and General borrowing costs. If there is a specific borrowing cost that must be capitalized from the date on which borrowing is made. If there is general borrowing cost then it should be capitalized from the date of utilization of borrowed fund.

3.8 Impact of ICDS on provision for contingent assets and liabilities

Contingent assets are the assets which arise unexpectedly and raise the unexpected incomes. For this purpose convention of conservatism is used to recognize the revenue but in ICDS the income of these assets in advance.

3.9 Impact of ICDS on computation of income

It takes two processes to determine the income first accounting income should be calculated and adjustments to be made as per ICDS to get taxable income. And based on this computed income tax is determined separately at normal and at MAT rates then compared with tax amount computed as per MAT provisions and among these two tax amounts that is one as per ICDS and another as per MAT whichever is high that will be considered for the payment of tax that is shown in Table 2.

4.0 Challenges Involved in Implementing the ICDS

There are several challenges involved in implementing ICDS are discussed as under:

- ICDS is not required to maintain separate set of books of accounts but it is necessary to record income for the purpose of taxation in the form of reconciliation statements and this will create a burden on compliance and additional reporting costs.

Table 2: Showing Income Computation After the Implementation of ICDS

Particulars	Amount Rs.	Amount in Rs.
Income determination as per normal provisions		
Profit shown as per profit and loss account	xxxx	
Add/Less: adjustments to be made as per ICDS	xxx	
NET PROFIT AS PER ICDS		XXXX
Add/Less: separate adjustments under the income tax Act.	xxx	
TAXABLE INCOME UNDER ICDS		XXXXX
AMOUNT OF TAX PAYABLE AT THE NORMAL RATE		XXXXX
Income determination as per MAT provisions		
Profit shown as per profit and loss account	xxxx	
Add/Less: adjustments to be made as per section 115JB	xxx	
Book Profit		XXXX
MAT payable at the normal rate		XXXX
Amount of tax payable 1 or 2 whichever is more		XXXXX

Source: Author's compilation

- The ICDS created gap between taxation income and accounting profits by not compromising with prudence concept so it will create the burden on the taxable person to regular check on deferred tax items.
- ICDS does not affect the provisions of requirements of minimum alternative tax it will continue as it is and affects the double taxation and which cannot be traceable and it is one of the challenges to the taxpayers.
- ICDS are issued by CG under delegated legislation and it will not create burden to the main legislation but it may create the additional provisions to the existing income tax Act.

5.0 Conclusion

Income computation and disclosure standard is one of the competent standard which minimizes the divergence between accounting income and tax income. This standard does not require any additional books of accounts to be maintained by the business organizations but only the thing is the manner of computation of income for the purpose levying of tax under the head of 'Profit or gains from business or profession' and 'Income from other sources'. ICDS are similar to accounting standards in certain cases but in some special cases it is totally opposite to the fundamental accounting principles such as prudence. This opposition is the major drawback and creates the

additional burden to the reporters to prepare separate statement of reconciliation and this creates the additional cost burden. Finally we can conclude that ICDS is still in infancy stage in infancy stage there is a necessity of more advanced academic research on this aspect to match with both accounting and income tax standards with 0% difference and make the tax payers as beneficial in this regard. If this will be the reality then it will become one of the great contributions towards the government 'Ease of doing business' concept.

5.1 Limitations

Study also suffers from limitations such as it adopted secondary sources of data and studied in conceptual manner and it does not analysed in practical scenario. This can become the area for future research in the current topic.

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