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Direct Tax Reform in India: A Panoramic Study on Income Computation and Disclosure Standards (ICDS)

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ABSTRACT

One of the major challenges while computing tax liability is determination of income. Dilemma arises when identifying which item has to be treated as chargeable and which is not. Income computation and disclosure standards are more efficient than any other standards which help to ascertain accurate income for the computation of tax amount and it reduces deviations between taxable income and accounting income. The organization doesn't require to maintain any additional books of accounts while computing taxable income by using ICDS but the major condition is, the income must be generated from the 'Profits and gains of business and professions (PGBP)' and 'Income from other sources (IFOS)'. The present study is focusing upon the impact of ICDS on key areas of business transactions and it tries to give a clear picture about ICDS. It's a descriptive study purely based on secondary data.

Keyword: *Income computation and disclosure standards (ICDS); Ind-AS; Business income; Income determination; Tax reforms.*

1.0 Introduction

The Government of India (GOI) has initiated various reforms like Make in India, Skill India, Digital India, Demonetisation of high denominated currency notes, introduction of GST, Implementation of Ind-As etc., to globalize its economy. Due to all these reforms now India is the second fastest growing economy in the world. Tax revenue is one of the major sources of income for the government. Development of a nation always depends on income which is earned by that nation so India has made tax reforms to increase its tax revenues as well as to make tax compliance easier.

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ICDS is one of the vital parts of that changing face. ICDS is an emerging trend in the field of direct taxation, these standards are applied to determine the Income earned from the 'Profits and gains of business and professions' and 'Income from other sources' under Income Tax Act of 1961. When you avail ICDS there is no need of preparation and maintenance of a separate set of books of accounts for the purpose of taxation. 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 per Ind-As in confirmation with Companies Act, 2013 and Companies Rules Act, 2014.

2.0 Literature Review

Abhishek *et al.*, (2018) have done a research and stated that ICDS is still 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 zero percent difference and make tax compliance easier to benefit the tax payers in this regard. Shackelford and Shevlin (2001) have analysed tax accounting archival researches. Opines that most of the researches in this respect are merges the microeconomics with finance. And identify the necessity of focus on the finance and macroeconomic aspects as a research gap.

Kirchler *et al.,* (2007) examined the standard model of income tax evasion by reviewing the earlier studies on these matters and recommended in this paper. They only concentrated on compliance of taxation. Saravanan and Muthu Lakshmi (2017) have persuade the study to analyse the individual income tax planning and to know about the instruments of tax savings. Research reveals that Provident Fund and Life Insurance policy are the major tax saving instrument adopted by the assesses.

Mirrlees and Adam (2010) have analysed the different taxation design can be made by the government and consequences of each design and have contributed some recommendations to remove the barriers of income tax, business tax and environmental tax. Kumar and Anees (2014*)* explained about the benefits of e-filing of tax to the authorities, e-filing intermediaries, policy making bodies, tax payers, financial software engineers and academicians. This paper is focused on the benefits derived from the various divisions of the society due to income tax e- filings.

Chawla *et al.*, (2013) studied to examine the awareness and satisfaction level of taxpayers toward e-filing of income tax returns. The respondents (162 males and 138 females) filled 300 questionnaires and they were used mean score for ranking to analyse the results and a Likert scale of 5, SPSS chi-square test and ANOVA was also used.

2.1 Research gap

The review of above literature reveals that the majority of the studies carried on personal income tax related aspects, tax planning matters and no research is 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.

2.2 Research questions

- What are ICDSs?
- What areas of business transactions have the impact of ICDS?
- What are the challenges involved in implementation of ICDS?

2.3 Research objectives

- To enhance the basic knowledge about ICDS
- To evaluate the key impact areas of ICDS on business transactions
- To examine the implementation challenges of ICDS.

2.4 Research methodology

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

3.0 Needs for ICDS

CBDT constituted a committee to look the Accounting Standards for the computation of taxable income rather than just of accounting purpose named as TAS (Tax Accounting Standards) Committee in 2010 later it's changed into ICDS.

The needs for ICDS as follows:

- To reduce the divergence between the accounting income and taxable income.
- To overcome the litigation and try to avoid the tax disputes.
- CBDT clarified that ICDS is only applicable to the assesse having income under the head of "Profits and Gains of Business and Professions (PGBP) or Income from other sources (IFOS)".
- There are many areas where current accounting practice differs from the taxation practices hence there is a need for ICDS to unify the practices.

3.1 Process of implementation

- Former Finance Minister Arun Jaitley shows his intention in his maiden Budget Speech to notify these standards in July 2014.
- For the public comment the Ministry of Finance issued 12 ICDS for a month on 8th of January, 2015.
- Later, CBDT (Central Board of Direct Tax) notified 10 standards under section 145(2) of Income tax Act, 1961 with the vide Notification No. 33/2015 [F. No. 134/48/2014- TPL]/SO 892(E) on 31st March 2015.
- This notification is applicable for both Corporate and Non-Corporate Assesse from Assessment year 2016-17.

3.2 Key features of ICDS

- ICDS comes into effect from the 1st April, 2015, and it shall be applied from the assessment year 2016-17.
- It applies to all assesses who is following the mercantile system of accounting (whether resident or non-resident)
- It is applicable for the income chargeable under the head 'Profits and Gains of Business and Professions' or 'Income from other sources'.
- There is no income or turnover threshold limit for applicability of ICDS.
- All ICDS (except on Securities) provide to facilitate the first time adoption and consideration for transitional provisions of the resultant impact.
- When conflict between the provisions of the Act and ICDS, the provisions of the Act shall be considered.
- Words and expressions used and defined in the Act but not defined in ICDS shall have the same meaning assigned to them in the Act.
- 'Book profit' will continue to be computed as per the existing AS/ Ind AS as per Accounts prepared for the purpose of MAT.
- In general the ICDS don't have prudence as a basic assumption.
- If there is a failure when computing income under ICDS the Assessing Officer has a power to make assessment under section 145(3) as amended by the Finance (No. 2) Act, 2014 u/s144.

3.3 Nature of ICDS

- Income computation disclosure standards are the standards which give 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 is applicable to all groups of taxpayers whether they are belonging to business communities or non-business communities or whether resident or non-residents who are following mercantile systems of accounting.
- This standard is only for computation of taxable income and not for maintaining the books of accounts and if any differences arise 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 recognition of the outstanding transactions and contracts as on 1st April 2015 as per the provisions of ICDS by taking 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 income and turnover criterion for the applicability 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 ascertained 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.

3.4 Applicability of ICDSs

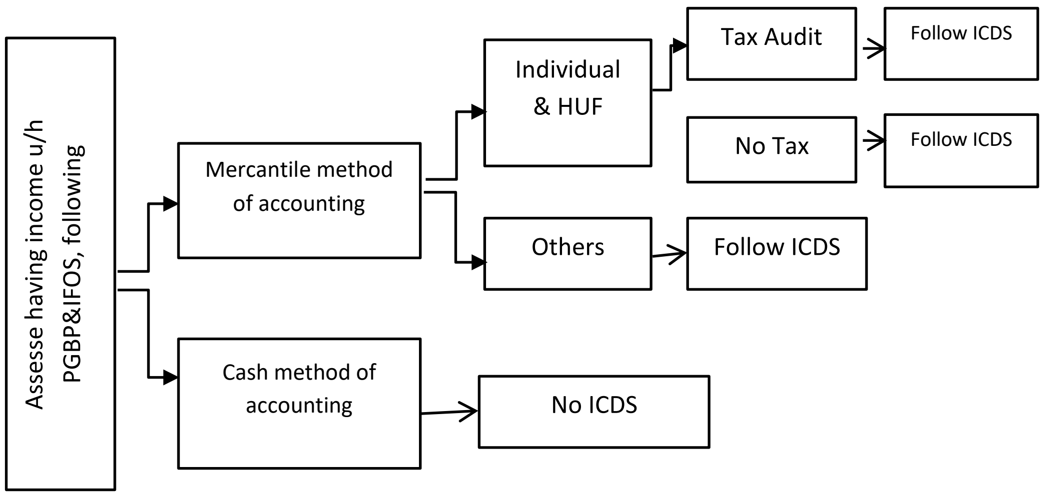
ICDSs are applicable for all the assessees from the Assessment Year 2017-18. For ICDSs purpose there is no distinction among the assessees which means it is applicable to all assesses whether they are corporate or non -corporate, resident or non-residents who follow accrual system of accounting and which 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 are compulsory for all the assesses whether they are following accounting standards are not. If the assesses pay 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 (Figure 1).

ICDS applies to an assessee:

- following mercantile system of accounting.
- computing taxable income under the heads of Profit and gains of business and professions (PGBP) or Income from other sources (IFOS).

There is no prescribed criteria on net worth or turnover for applicability. However, individuals and HUFs are not subject to tax audit exempted u/s 44AB. ICDS are mandatory in nature. Whenever there is conflict between ICDS and Act, the Act shall be considered.

Figure 1: Who Can Follow ICDS?



Source: Author's compilation

3.5 ICDS development committee

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.

3.6 Recommendations

The Tax Accounting Standard (TAS) Committee recommended implementing the following tax accounting standards in the name of 'Income Computation and Disclosure Standards'.

Name of the ICDS issued as follows:

- ICDS I - Accounting policies
- ICDS II - Valuation of inventories
- ICDS III - Construction contracts
- ICDS IV - Revenue recognition
- ICDS V - Tangible fixed assets
- ICDS VI - Effects of changes in foreign exchange rates
- ICDS VII - Government grants
- ICDS VIII - Securities
- ICDS IX - Borrowing costs
- ICDS X - Provisions, contingent liabilities and contingent assets.

There are few ICDS for which the drafts were circulated but they have not been notified yet such as ‘leases’, ‘intangible asset’, ‘prior period expense’ and ‘events occurring after the end of Previous Year’.

The ICDS have been derived from the existing Accounting Standards with some specific changes (Table 1). No examples and explanations are given in the ICDS unlike as given in AS.

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

ICDS Number	ICDSs	Corresponding Accounting standard	Corresponding Ind-AS
1	Valuation of inventories	AS-1 Disclosure of accounting policy	Ind-AS 1 and 8
2	Accounting policies	AS-2 Valuation of inventories	Ind AS 2
3	Construction contracts	AS-7 Construction contracts	Ind AS 11
4	Revenue recognition	AS-9 Revenue Recognition	Ind AS 115
5	Tangible fixed assets	AS-10 Property, Plant and Equipment	Ind AS 16
6	Effects of changes in foreign exchange rates	AS-11 The effects of changes in foreign exchange contracts	Ind AS 21
7	Government grants	AS-12 Accounting for government grants	Ind AS 20
8	Securities	AS-13 Accounting for investments	Ind AS 32, 107 and 109
9	Borrowing costs	AS-16 Borrowing costs	Ind AS 23
10	Provisions for contingent liabilities and contingent assets	AS-29 Provisions for contingent liabilities and contingent assets	Ind AS 37

Source: Author's compilation

4.0 Key Impact Areas

4.1 Accounting policies

- ICDS does not thought about the conception of prudence. Prudence is one of the fundamental conservatism practice used, whereas choosing the suitable accounting policies and principles. Therefore, ICDS disallows the recognition of expected losses or market loss unless it comes below the any other ICDS. However, ICDS is silent concerning the treatment of market unrealized gain.
- ICDS is additionally not talked concerning the materiality conception which is taken into account in presentation of financial statements. Reason behind this is often ICDS isn't talked concerning the upkeep of books or creating company results.
- ICDS doesn't allow the modification in accounting policies unless there's any affordable cause.

4.2 Valuation of inventories

- In AS-2 ICAI specify the technique for measure of price of inventories. It suggests the quality price or Retail price for the results approximate the particular price. However, use of normal price in measure of price of inventory isn't counselled in ICDS.
- To get rid of the confusion and take a look at to avoid the proceedings, ICDS provided the provisions in ICDS-2 that's price of inventory of any business within the starting of previous year i.e. 1st April 2015 shall be
    - Because the price of inventory as on the shut of now preceding previous year.
    - The price of inventory accessible, if any, on the day of commencement of the business once business has commenced from the previous year.
- One in every of the key problems during this, once assesse adopt the strategy of valuation of inventory shall not modification in any previous year unless till assesse have any affordable cause however affordable cause isn't outlined anyplace in ICDS.
- Associate in nursing expected provision, just in case of partnership or association of persons or body of individual dissolution, inventory as on date shall be price at net realizable price (NRV).

4.3 Construction contracts

- ICDS disallows the accounting below completion contract technique, and only percentage of completion method should be applied for recognition of revenue from construction contracts and rendering services.

- Pre-construction income in the form of capital gains, dividend and interest shall not be off from the construction cost and chargeable as income as per the Income tax provisions.
- Revenue recognition of contact at beginning stage to the extent of contract cost expended only when outcome of the contract can't reliably estimate. But the early stage shall not exceed beyond 25% of the completion. There is no such kind of provision present in AS-7.
- Losses incurred shall be allowed solely within the percentage to a stage of construction completed. Expected loss or future losses is disallowed, till those losses are actually incurred.
- Retention shall be taken for revenue computation based on the percentage of completion method. Retention money cannot be income until the right to receive after the fulfilment of specified conditions.

4.4 Revenue recognition

- There's no specific amendment in ICDS with regards to revenue recognition till there's an affordable certainty of final assortment.
- ICDS suggests that revenue from Construction contracts and rendering of services shall be recognised by the percentage of completion method.

4.5 Tangible fixed assets

- Wordings of AS-10, Whenever the qualities non-inherited in exchange of another assets or shares or the other securities then the worth of asset recorded are lower of being
  - Fair market value (FMV) of acquired asset; or
  - Fair market value (FMV) of issued share or securities.
- Whichever is clearly evident.
- In its preamble ICDS clarified that apply for the maintenance of books of accounts is not subjected and fixed assets registration is the part of books of accounts. Still is a matter of issue.

ICDS is not clear about revaluation of assets and retirement or its disposal and thus it continues to be considered as per the act.

4.6 Government grants

- Recognition of grant is predicated on the
  - the assesse shall abide by conditions hooked up to that grant; and

  - the grant shall be received
  - ICDS impose an additional condition that's grant recognition shall not be exceeds the date of its actual receipt.
- AS-12, offers Deferred Income approach and Deduction Approach for treatment of government grants. However, ICDS permits deduction approach for depreciable assets. Within the deduction approach, assets are recorded in books after net amount of government grant.
- Wherever the grant is related to non-depreciable assets, the treatment of its in AS is to transfer the entire amount into capital reserve but in income computation standards the amount is considered as income and deferred in the same period of against the value of meeting such expenses.

4.7 Borrowing cost

- ICDS doesn't define any minimum period for classification of asset as a qualifying asset (Except Inventories). ICDS includes each tangible and intangible asset while not defining the substantial period.
- Just in case of specific borrowing, borrowing cost capitalization ought be begin from the date of borrowing.
- Just in case of general borrowing, from the date of utilization of funds.
- ICDS is silent regarding the borrowing cost capitalization even once active development of qualifying assets is interrupted. Hence, assesse will continue to capitalize the borrowing cost.
- Income from temporary deployment of borrowed funds wouldn't be subtracted from the capitalized borrowing cost.
- A replacement borrowing cost has been introduced.

4.8 Provisions for contingent liabilities and contingent assets

- Contingent assets usually arise from unplanned events that concede rise in flow of the edges. AS-29 follows the conception of Prudence thus, no early recognition of income or gain before their realisation. However ICDS overrides the concept of Prudence. The corresponding income and contingent assets ought to be recognised.
- It's a matter of legal proceedings or additional clarification about the concept of "Reasonable Certainty".
- Onerous contract is being taken away from the provisions of ICDS.

5.0 Challenges Involved in Implementing the ICDS

There are several challenges involved in implementing ICDS that have been discussed below:

- *Additional compliance reporting costs*: ICDS is not required to maintain a 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.
- *Prudence concept*: The ICDS creates a gap between taxation income and accounting profits by not compromising with prudence concept so it will create the burden on the taxable person to regularly check on deferred tax items.
- *Minimum alternative tax and double taxation:* 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.
- *Additional provisions*: ICDS are issued by the central government 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.

6.0 Impact of ICDS on Income Computation

Table 2: Income Computation after the Implementation of ICDS

S. No	Particulars	Amount in Rs.	Amount in Rs
1	Ascertainment of income 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		XXXX
2	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	
	MAT PAYABLE AT THE NORMAL RATE		XXXX
	Amount of tax payable as per ICDS(1)	xxxx	
	MAT payable at the normal rate(2)	xxxx	
	AMOUNT OF TAX PAYABLE (1 or 2 whichever is more)		XXXX

Source: Author's compilation

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. 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. Among these two tax amounts, that is one as per ICDS and another as per MAT, whichever is high will be considered for the payment of tax as shown in Table 2.

7.0 Conclusion

Income Computation and Disclosure Standards are similar to accounting standards in certain aspects 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 statements of reconciliation and this creates the additional cost burden.

ICDS is reality now, CBDT has taken many steps for the easy implementation of Ind-AS and try to reduce the litigations as much as they can, still there are various areas which need clarification. Hence, there is a necessity of more advanced academic research on this aspect to match with both accounting and income tax standards with zero percent difference and to make the tax compliance more easier to benefit taxpayers. If this will be the reality then it will become one of the great contributions towards the ‘Ease of doing business concept' of our government. In overall, the government of India with CBDT had played a highly proactive role to provide clarity on ICDS and minimized the potential areas of litigation.

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