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15th December, 2015

To,

The Director (Tax Policy & Legislation) – III
Central Board of Direct Taxes
Room No. 147-G,
North Block,
New Delhi – 110001.

Dear Sir,

Sub : Issues / Points and Suggestions in respect of Income Computation and Disclosure Standards [ICDS]

We refer to the Press Release dated 26th November, 2015 requesting to bring out issues/points in respect of ICDS, to enable the CDBT to issue a comprehensive guidance / clarification in respect of the same.

We enclose herewith various Issues / Points and Suggestions in respect of ICDS, for your consideration.Our suggestions are for bringing clarity on various issues and reducing burdensome cost of compliances for the assessees. We sincerely hope that after careful consideration, a comprehensive guidance / clarification shall be issued or amendments shall be carried out in respect of the same, at the earliest.

We will be happy to present ourselves for any explanation and clarification that may be required by your honour.

Thanking you,

We remain,

Yours truly,

For **BOMBAY CHARTERED ACCOUNTANTS' SOCIETY**

Raman H. Jokhakar	**Sanjeev R. Pandit**	**Ameet N. Patel**
President	Chairman - Taxation Committee	Co-Chairman - Taxation Committee

Copy to:

1. Shri A. K. Jain, Chairman, CBDT.

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Suggestions to modify and clarify Income Computation and Disclosure Standards

The Government of India on 31st of March 2015 notified ten Income Computation and Disclosure Standards (ICDS). Although it is our opinion and belief that notification of the ICDS was uncalled for, we refrain from making any representation on those lines before this Committee and restrict our representation to suggestions for modifying certain aspects of the ICDS and seek clarifications on issues arising in implementation of the ICDS.

While we laud the objective of bringing certainty in computation of income, we believe that not putting excessive burden on the tax payers while requiring them to comply with the provisions of the ICDS should also be an important objective while having a relook at the various ICDS. While achieving this, in few cases, it may result in not being able to advance the revenue recognition, as many of the changes brought about by ICDS seek to do.

It is true that in the case of **Kedarnath Jute Mfg. Co. vs CIT 82 ITR 363**, the Supreme Court held that whether the assessee was entitled to a particular deduction or not depended on the provision of law relating thereto and the existence or absence of entries in the books of account could not be decisive or conclusive in the matter. While the ratio of the above decision of the Supreme Court can be a legal argument in drafting ICDS to make provisions which are at variance with the generally accepted accounting practices, such provisions are not desirable unless there are specific reasons to do so. Such provisions only increase variances between the accounting income and taxable income by creating timing differences. This causes hardships to assessees, increases compliance costs without any increase in revenue and may expose assessees to MAT liability, which was never the purpose of MAT provisions. Such provisions do not promote ease of doing business.

It is generally felt that compliance with the ICDS will result in substantial increase in administrative cost and burden on tax payers. The process of computing the income based on ICDS and reconciliation of the same with the accounting figures will be extremely cumbersome and will add to the already

heavy burden on the tax paying community. This would be more so in case of individuals and smallbusinessmen who are also covered by the ICDS. It is also a common belief that even after spending considerable time and efforts in complying with the ICDS, the resultant impact on the tax collections over a period of two succeeding years (and in certain cases, few succeeding years) taken together will be negligible.

Our suggestions to modify and clarify Income Computation and Disclosure Standards are as under:

1. General

1.1 Do ICDS apply to assessees who are not required to maintain books of account and consequentially do not maintain books of account?

1.2 Do any of the ICDS apply to assessees who are offering income to tax on a presumptive basis under section 44AD or any other presumptive taxation section?

1.3 Do ICDS apply to assessees who are liable to tax on gross basis under section 115A?

1.4 In the event of conflict between the Income-tax Rules and ICDS, which would prevail? For example, would rule 6EB prevail over the revenue recognition principles in ICDS IV?

1.5 Considering that the ICDS apply also tocomputation of income under the head Income from Other Sources, nearly all individual assessees will be covered. They will have to comply with various computation provisions and disclosure requirement under the ICDS. This should be avoided. One way to do so is to apply ICDS only to those assessees who have income under the head `Profits and gains from business or profession'. In case of such assessees ICDS may apply in computing income under the head `Income for other sources', as well.

2. ICDS I - Accounting Policies

2.1 As is generally understood, Accounting Policies refer to policies followed in maintenance of books of account. ICDS I is same as the draft Tax Accounting Standard (TAS) I which was drafted when Section 145 of the Income-tax Act, 1961 (the Act) contained the provision for notifying `accounting standards'. While the power to issue accounting standards was replaced by power to notify Income Computation and Disclosure Standards, the draft TAS I has been merely renamed as ICDS I. This being so, a large number of questions arise. In fact, it would be appropriate if this ICDS is withdrawn and a new ICDS which is in line with the power granted by the amended section 145(2) is issued to avoid disputes and bring about clarity rather than issuing clarifications to resolve various issues. Subject to this, some of the issues arising out of ICDS I are enumerated below.

2.2 All the ICDS specifically mention that the ICDS are applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purpose of maintenance of books of account.

If this is so, whether the considerations in selecting accounting policies referred to in the ICDS I are to be followed while maintaining books of account?

As mentioned above, Accounting Policies refer to policies followed in maintenance of books of account. The considerations in the selection of accounting policies as specified in the ICDS I are significantly different than those specified in the Accounting Standards issued by the Ministry of Corporate Affairs (which are binding on all the companies) and also Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI). Books of account maintained by selecting accounting policies based on the considerations specified in the ICDS I will not be incompliance with the mandatory accounting standards.

For example, paragraph 4(ii) requires that marked to market losses shall not be recognised unless recognition of such losses is in accordance with the provisions of any other ICDS. If marked to market losses are not recognised, the accounts of assessees will not be in compliance with the applicable Accounting Standards.

If the considerations in selecting accounting policies referred to in the ICDS I are not to be followed while maintaining books of account, then which are the accounting policies (contemplated in the ICDS I) in selection of which the considerations specified in the ICDS I are to be taken into account?

2.3 Presuming that marked to market losses are not to be considered while computing the income chargeable to tax, the provision is not equitable and fair. In accordance with the provisions of this ICDS and other ICDS, marked to market losses are not to be allowed. However, marked to market gains when recognised in the accounts following the accounting standards or ICDS will be taxed. The ICDS do not have anyprovision for excludingfrom the taxable income,gains resulting from marked to market process.

2.4 Apart from the above, marked to market losses have been permitted as a deduction in computing the taxable income all along. Various courts have held that such losses are deductible. Commercial profits are determined only after considering such losses. There is no reason for changing the settled position except for advancing the collection of revenue due to timing difference. The change is sought to be made without corresponding change in the Act. This aspect may be reconsidered.

2.5 Please confirm that the accounting policies to be disclosed as per para 6 of ICDS I are the accounting policies followed in the books of account maintained by the assessee. Similarly, please confirm that the disclosure required under para 9 of ICDS I is only when the

fundamental accounting assumptions are not followed while maintaining the books of account.

2.6 Prudence and materiality are important concepts based on which accounts are prepared by assessees. Under the provisions of section 145 of the Act, these accounts are the starting point of computation of income.While the concept of materiality is indirectly accepted in ICDS II relating to valuation of inventories, its exclusion in ICDS I may lead to disputes, litigation and possible harassment of assessees on minor issues.The resources of the assessees as well as the Department will be wasted if the concept of materiality is not retained.

In our suggestions on other ICDS we have made specific suggestions for introducing materiality concept while applying some of provisions of the ICDS.

Similarly, prudence is an important consideration in preparing financial statements. Where it is specifically felt that the concept of prudence, thoughemployed and required to be employed by the assessees under the applicable Accounting Standards in maintaining accounts, is not in consonance with the provisions of the Act, provision to that extent may be made in specific ICDSs rather than excluding the concept of prudence altogether.

Considering this, the concepts of materiality and prudence should be incorporated in ICDS I.

3. ICDS II – Valuation of Inventories

3.1 ICDS II does not apply to shares, debentures and other financial instruments held as stock-in-trade which are dealt with by ICDS VIII relating to Securities. ICDS VIII relating to Securities does not apply to securities held by persons engaged in insurance business, by mutual

funds, venture capital funds, banks and public financial institutions. Considering this, please clarify that ICDS II will apply to shares, debentures and other financial instruments held as stock-in-trade by mutual funds, venture capital funds, banks and public financial institutions. It may be noted that mutual funds do not hold securities as stock in trade.

3.2 Definition of "securities" contained in para 3(1)(a) of ICDS VIII adopts the definition of "securities" contained in clause (h) of section 2 of the Securities Contract (Regulation) Act, 1956, but excludes derivatives from the meaning of the term securities for the purpose of ICDS.

With a view to avoid confusion, please clarify that ICDS II shall apply to derivatives held as stock-in-trade.

3.3 While Accounting Standard 2 specifically excludes inventory of service providers, ICDS II purports to include the same.

ICDS IV relating to Revenue Recognition provides that revenue from service transactions shall be recognised by the percentage of completion method and makes requirements of ICDS III relating to construction contracts applicable to service transactions. ICDS III relating to construction contracts is in a sense a self-contained code and that is why work-in-progress of construction contracts is excluded from the applicability of ICDS II. Once requirements of ICDS III become applicable to service transactions, there will not be any occasion to value costs of services under ICDS II.

Considering this, please clarify under what circumstances provisions of ICDS II shall apply requiring valuation of `Costs of Services'.

3.4 Neither the `Scope' in para 1 nor the definition of Inventories in para 2(1)(a) of the ICDScovers `costs of services' as part of inventory. In fact, definition of inventory in ICDS does not indicate `costs of services' are part of inventory since such costs are neither assets held

for sale nor assets (held) in the production of such sale nor assets in form of materials or supplies to be consumed.

Considering this, if at all there are circumstances requiring valuation of `Costs of Services', then the definition of inventories needs to be amended and appropriate provision as to when the `costs of services' shall form part of inventories needs to be included in the ICDS.

3.5 Further, it may be pointed out that in many cases it would be extremely difficult to determine the costs of services as required by the ICDS. For example, in case of courier service company it will be extremely difficult to arrive at the valuation of costs of services in respect of costs incurred in respect of couriered items delivery of which is not complete. This difficulty will be faced even in applying percentage of completion method as required under ICDS IV read with ICDS III.

3.6 Similar difficulty will arise in case of services where revenue is receivable only in case of success. For example, a real estate broker may incur costs, but is not entitled to any fee unless the transaction of sale of property goes through. **Please clarify whether in such cases, there will be any realisable value at all for the costs incurred.**

3.7 It is submitted that the provision for including `costs of service' as a part of inventory is fraught with problems and uncertainty which is bound to result in disputes and litigation. Therefore the provision should be omitted.

Para 8 rightly provides that allocation of fixed production overheads shall be based on normal capacity of production facility. It further provides that actual level of production*shall* be used when it approximates to normal capacity. We understand that in many places in ICDS word `may' in the accounting standards has been replaced by

`will’ or `shall’ to bring about certainty. However in this particular case, the word shall, in fact, introduces uncertainty. An assessee may allocate fixed overheads based on normal capacity, which is the principle of allocation. On the other hand, the assessing officer may take a view that actual production approximates the normal capacity (this being a subjective matter) and overheads should have been apportioned accordingly. **Considering this, the word `may’ should replace `shall’ in ICDS at the relevant place in para 12.**

3.8 ICDS II, unlike AS 2 – Valuation of Inventories, has dropped reference to `standard costs’. While there is no specific prohibition to use standard costs as a technique, the TAS Committee has dropped the reference purportedly to avoid litigation. There has not been any substantial litigation on the issue of using standard costing as a technique to arrive at the cost. So the reason for omitting the reference is not a valid one.

Most large companies, particularly those using ERP software like SAP use standard costing. Under AS 2 – Valuation of Inventories, like ICDS II, the costs of inventory has to be arrived at on FIFO basis or on Weighted Average basis. Companies using standard costing are in compliance with AS 2. Standard costing requires periodic revision of costs, analysis of variance and adjusting it to inventories and cost of goods manufactured. This leads to reflecting fairest possible approximation to the costs incurred which is the requirement of ICDS II.

Considering this, standard costs should be specifically permitted as a technique to arrive at the cost of inventory.

3.9 Para 22 of ICDS provides that when business is commenced during the previous year, the cost of inventory available on the day of commencement of business is to be taken as the value of inventory as at the beginning of the previous year. When business is commenced by converting capital assets held into stock in trade, the difference

between the fair market value as on the date of conversion and the indexed cost of acquisition is taxed as capital gain under section 45(2) of the Act.

Considering this, in such cases, the fair market value of such assets on the date of conversion should be taken as the value of inventory held at the beginning of the previous year.

3.10 Para 24 provides that on dissolution of a partnership firm or an association of persons or body of individuals, the inventory on the date of valuation shall be valued at net realisable value (NRV) whether or not the business is discontinued. Valuing inventory at NRV even when business has not been discontinued is not fair and not in accordance with the decision of the **Supreme Court in the case ofSakthi Trading Co. vs CIT 250 ITR 871**. **However, if the provision is to be continued then specific provision should also be made to enable the successor of the business or the persons getting the inventory to claim the NRV adopted in the hands of the dissolved partnership firm or the association of persons or the body of individuals, as the case may be, as the cost.**

4. ICDS III – Construction Contracts

4.1 ICDS III provides for recognising contract costs and contract revenues by reference to the stage of completion of the contract activity. During the implementation of a contract, losses may be incurred due to various factors which may or may not be directly connected with the contract activity. For example losses may be incurred due to natural calamities like heavy rain, earthquake, destruction of the asset under construction etc. It appears that under ICDS, such losses are also to be recognised by reference to the stage of completion of the contract activity, although the losses have been actually incurred and are over

and above the profit or loss the assessee may incur in the contract activity.

4.2 Recognition and allowability of such losses should not be linked to the stage of completion of the contract activity and such losses should be allowed in the year in which suffered.

4.3 Para 22 of the ICDS dealing with transitional provisions provides that contract revenue and contract costs in respect of construction contracts that have commenced on or before 31st March 2015 but not complete should be accounted as per this ICDS. It also states that expected loss, if any, recognised shall be taken into account. This wouldmean that expected loss, if any, that may have been recognised and allowed in any earlier year,will have to be reversed in the previous year ending on 31stMarch 2016 to the extent such loss is in excess of loss computed based on the stage of completion of the contract. This would bring to tax a substantial amount in a single year even though the contract is expected to result in a loss. This will result in the assessee having to pay tax in the A.Y. 2016-17 and reporting losses in the subsequent assessment years.

The transitional provisions should be amended to provide that, in such a case, no further loss shall be recognised till losses already recognised are in excess of losses that would be recognised based on the stage of completion of the contract, based on the current estimates of costs and revenues.

4.4 Due to divergence between the Accounting Standard 7 and ICDS III, particularly on the issue of providing for losses, there will be a timing difference. Under AS 7, the loss will be provided at an earlier point of time as compared to ICDS. An assessee having income, in addition to such loss making contract, will be taxed on the income without setting off the loss since such loss is not permissibleunder ICDS. In subsequent years when suchloss is computed as per the provisions of ICDS, the financial statements will report book profits. This will result

in levy of MAT. MAT was never intended to be levied in such cases of timing difference. This will effectively result in double taxation of the same income.

An appropriate amendment to the provisions relating to MAT in the Act be made to avoid this unintended consequence.

5. ICDS IV – Revenue Recognition

5.1 Para 4(1) of ICDS I provides that the treatment and presentation of transactions and events shall be governed by their substance and not merely by the legal form. Para 3 of ICDS IV provides that in a situation, when transfer of property in goods does not coincide with the transfer of significant risks and rewards of ownership, revenue in such a situation shall be recognised at the time of transfer of significant risks and rewards of ownership to the buyer. Further, the definition of 'Borrowing Costs' contained in paragraph 2(a) of ICDS IX includes finance charges in respect of assets acquired under finance leases or under other similar arrangements as a part of borrowing costs. The **Supreme Court in the case of I.C.D.S. Ltd. Vs CIT 350 ITR 527** has held that in case of lease arrangements, the lessor,who is the owner of the asset,is entitled to depreciation u/s 32 of the Act. **Considering these together, please clarify how leasing arrangements, which are in the nature of finance leases, will be recognised in the hands of the lessor as well as the lessee.**

5.2 Paragraph 6 of the ICDS provides that revenue from service contracts shall be recognised by the percentage of completion method. It also provides that the requirements of ICDS III relating to Construction Contracts shall apply *mutatis mutandis* to the recognition of revenue and the associated expenses for a service transaction.

Application of percentage of completion method for recognising revenue from service transaction may be possible in case of certain

large service transactions where there is substantial correlation between the service revenue and the costs incurred. However, in a very large number of transactions, where revenue is from services, it is practically impossible to apply this method. In paragraphs 3.5 and 3.6 above, some examples have been cited. This includes cases where revenue is in form of success based fees, services where determining the stage of completion and costs incurred to reach that stage of completion would be difficult. Assessees will need to have an elaborate system of recording person hours at various stages. It would entail incurring substantial additional administrative efforts and costs on the part of the assessees.

In such cases, recognising revenue based on percentage of completion method will lead to disputes and hardship to the assessees without any revenue gain.

It is therefore suggested that the percentage of completion method be made applicable only to those transactions fulfilling both the following conditions:

(i) Revenue from a single service transaction exceeds a reasonablemonetary threshold limit; and

(ii) Service transaction is expected to be completed over a period exceeding twelve months.

5.3 Para 18 of the ICDS III which will be applicable while recognising revenue from services, prescribes only three criteria for determining the percentage of completion. In cases of many services, neither of these three criteria will be appropriate or may require incurrence of substantial costs to use one of those criteria. Often services are rendered more or less evenly over the period of time covered by service agreement. Examples of such service agreements are annual maintenance contracts, coaching classes, internet service providers,

etc. In such cases, percentage of completion may be more appropriately, objectively and easily determined based on time.

It is therefore suggested that so far as the services are concerned, `time' should be one of the criteriafor determining the percentage of completion.

5.4 Para 7 of ICDS provides that interest shall accrue on the time basis determined by the amount outstanding and the rate applicable. The ICDS is applicable while computing income from business or profession as well as income from other sources. Nearly every small individual assessee has savings bank account. Such assessees, with a view to avoid mismatch between tax deducted at source as appearing in Form 26AS and the claim for deduction of tax in the return of income, have been offering interest on fixed deposits on accrual basis. Such assessees will now be required to offer even interest in respect of balance in savings bank account based on amount outstanding at the rate applicable. Several banks credit interest for the period up to February every year. In such a case, the assessees will have to compute interest for the balance one month and offerthe same for taxation. **This will only cause hardship to the assessees without any gain to the revenue (except for advancing the recognition of small amounts). This should be avoided as it will adversely affect thousands of small tax payers.**

5.5 Even in the case of assessees following accrual system, interest on securities was offered when it was due according to the terms of issue of securities. **The Bombay High Court in the case ofDIT vs Credit Suisse First Boston (Cyprus) Ltd. 351 ITR 323** has also held that interest accrues on the due date. The concept of accrual under the Act is a legal concept. On the other hand, the ICDS provides that interest shall accrue on the time basis. Apparently, the provision of the ICDS is therefore in conflict with the provisions of the Act as interpreted by the courts.

In cases where interest is not due on 31st March, assessees will have to compute the interest and offer it for taxation. There will also be problems in claiming credit for tax deducted at source. Assessees will have to pay tax in the year in which they have to offer the interest for taxation in terms of provisions of the ICDS, while the tax will be deducted by the payer in the subsequent year. The assessee may have also sold the security by the time interest becomes due and payable, in which case he will never receive the income by way of interest while he wouldhave paid tax on interest calculated on time basis. There is no provision for reducing the consideration on sale of securityby the amount of interest offered for tax in the past.

There is already a major issue in claiming credit for tax deducted at source and thousands of applications for rectifications are pending all over the country on this issue. The provisions of ICDS to tax interest on time basis will only add to this chaos.

It is suggested that the concept that interest on securities accrues on the due date as per the terms of issue of the securities be accepted and the ICDS be modified to avoid the problems mentioned above.

6. ICDS V - Tangible Fixed Assets

6.1 It needs to be clarified that the ratio of the decisions holding that the nature of the software would determine whether the expenditure on the software is capital or revenue in nature would continue to hold good, even after introduction of ICDS V.

6.2 Capitalisation of minor improvements and repairs merely on the ground that they increase future benefits beyond the assessed standard of performance would result in unnecessary disputes and litigation as to whether the increase is beyond the assessed standard

in respect of minor items. It would also result in unnecessary paperwork. **It is therefore necessary that improvements and repairs of minor items (for instance, replacement of a computer part such as RAM or a hard disk with that of a higher capacity) costing up to Rs. 25,000 be excluded from the purview of capitalisation.**

7. ICDS VI – The Effects of Changes in Foreign Exchange Rates

7.1 Paragraph 9(1)(a) of ICDS VI provides that assets and liabilities, both monetary and non-monetary, of a non-integral foreign operations have to be translated at the closing rate. This will result in a significant one time as well as a subsequent regular artificial income arising for those entities who have set up non-integral foreign operations many years ago, since even the fixed assets acquired many years ago, would now be converted at the current exchange rate.

The very concept of non-integral foreign operations is that such operations are not a part and parcel of the main business, and therefore a separate treatment has been prescribed under accounting standards both under the Company Law as well as by the ICAI.

To tax an artificial gain on such assets, even though such assets are never intended to be sold, merely on account of depreciation of the Indian currency would result in a significant tax liability for many Indian companies. Further, they would not be able to claim depreciation on such enhanced cost, resulting in a double hit.

It is therefore suggested that the provision for restatement should not apply to non-monetary items of non-integral operations.

7.2 Transitional provisions contained in para 12(1) and 12(2) both can govern translation of financial statements of foreign operations. **It**

should be clarified that only para 12(2) shall apply in case of translation differences in case of foreign operations.

8. ICDS VII – Government Grants

8.1 Para 12 of the ICDS provides that in case of refund of government grant related to a depreciable fixed asset, the actual cost or the written down value of the concerned block of asset shall be increased. Written down value (WDV) of block of assets as defined in section 43(6) provides that WDV is to be increased by the actual cost of asset `acquired during the year'. The refund of grant relatable to a fixed asset, it appears, will not meet this criteria. The refund will not be the actual cost and certainly not of an asset acquired during the previous year. **The provision of the ICDS seems to be in conflict with the provision of the Act. This will result in assessee not getting depreciation in respect of the amount of grant refunded.**

8.2 It is also likely that before the refund of the grant is made, the block may cease to exist or sale consideration of one or more assets comprised in the block may exceed the WDV of the block. **In such a case, how will the refund of the grant be dealt with, since there will not be any WDV of the block of asset. The provision of the ICDS seems to be in conflict with the provision of the Act.**

9. ICDS VIII – Securities

9.1 This ICDS does not apply to securities held as stock in trade by banks, public financial institutions, mutual funds, venture capital funds and persons engaged in business of insurance. It applies to NBFCs and other persons. This is discriminatory and there is no justification for the same.

9.2 Para 10 of the ICDS provides that for the purpose of para 9 of the ICDS, comparison of actual cost and NRV shall be done category wise and not for each individual security. There is no valid reason for departing from the accepted commercial practice. Certainly, the method prescribed by ICDS does not provide for any additional certainty in computation. It will only tax unrealised valuation gains by setting them off against valuation losses.

Stock in trade is valued at lower of cost and NRV and NRV is arrived at on item by item basis. This principle has been accepted in ICDS II dealing with inventory valuation of items other than those covered by ICDS VIII.It is therefore suggested that the same principle may be adopted in this ICDS.

9.3 Under ICDS IV dealing with revenue recognition, interest has to be recognised on time basis. When a security is sold, the assessee will have to recognise the interest accrued till the date of sale, but there is no provision for reducing the sale consideration by the interest recognised as income.

However, para 8 of ICDS makes provision for reducing cost by interest for pre-acquisition period. Similar provision needs to be made for reducing the sale consideration.

9.4 Para 11 of the ICDS provides that when business is commenced during the previous year, the cost of securities available on the day of commencement of business is to be taken as the value of securities held at the beginning of the previous year. When business is commenced by converting securities held as capital asset into stock in trade, the difference between the fair market value as on the date of conversion and the indexed cost of acquisition is taxed as capital gain under section 45(2) of the Act.

Considering this, in such cases, the fair market value of such securities on the date of conversion should be taken as the value of securities held at the beginning of the previous year.

10. ICDS IX - Borrowing Costs

10.1 In the case of stock in trade, capitalisation means addition to cost of inventory. The purpose of valuing the stock in trade as at the end of the previous year is to bring on the credit side of the profit and loss account the cost of goods purchased/manufactured but not sold andthe cost for which has been incurred and debited to the profit and loss account. Thus, the borrowing cost to be capitalised to inventory is out of interest charged to profit and loss account and allowed under section 36(1)(iii). In order to ensure that assessing officers do not take the view that addition is to be made to the cost of inventory without allowance of the interest as a deduction, **it needs to be clarified that in such cases, the interest would be allowed under section 36(1)(iii) and simultaneously added to the valuation of the closing stock.**

10.2 Since ICDS applies only for the purposes of computation of income under the heads "Profits and Gains of Business or Profession" and "Income from Other Sources", the borrowing costs which are to be capitalised under ICDS IX may not be allowed as a deduction in computing capital gains. This would result in a complete disallowance of such borrowing costs, which is not the intention. **A clarification is required that such borrowing costs which are to be capitalised under ICDS IX are also to be considered as forming part of the cost for the purposes of computation of capital gains, though ICDS does not apply for the purposes of computation of capital gains.**

If required, necessary amendment may be recommended to the definition of cost of acquisition in section 55(2).

10.3 There is no time period prescribed in relation to preparation of an asset for its intended use in order to fall within the definition of qualifying asset. This will create significant practical difficulty of record-keeping and of production of proof, particularly in respect of assets which can be put to use immediately on purchase, such as computers, office equipment, books, motor cars, etc. It will also involve substantial paperwork even for small businesses. **It is therefore suggested that only assets which require at least 6 months to make them ready for their intended use should fall within the definition of qualifying assets, and not all fixed assets. This will significantly ease the burdensome requirement of record-keepingto comply with the ICDS as it stands today.**

10.4 The computation formula in respect of **capitalisation of general borrowings is not clear, and is capable of multiple interpretations**. The following need clarification:

a. Has the formula to be applied for each qualifying asset separately? If so, this would create great difficulty for large businesses, where thousands of assets are added each year. Thousands of computations would have to be made, one for each asset. This is impracticable.

b. Would borrowing costs include or exclude borrowing costs disallowable under section 14A read with rule 8D(2)(ii), section 43B, section 40A(2), or section 40(b)? Which is to be computed first - the disallowance/allowance under these sections or the capitalisation under ICDS IX?

c. Is revaluation to be considered or ignored when taking the figure of total assets as well as qualifying asset?

10.5 Further, the working of the formula needs to be explained.As we understand, the amounts arrived at applying the formulae given in ICDS are only the `eligible amounts' and not the actual amounts to be capitalised, since these formulae do not take into account the commencement date or cessation date of capitalisation. To arrive at the amount to be `actually' capitalised during the previous year, the eligible amount arrived at applying the formula in para 5 or para 6, as the case may be, is to be prorated for the period comprised between the date of commencement of capitalisation or the first day of the previous year, whichever is later (asset may be under construction even in the earlier previous year) and the date of cessation of capitalisation or the last day of the previous year, whichever is earlier. **It should be explained with examples, so as to avoid any ambiguity. In absence of such clarification, it is possible to take a view that the `eligible amounts' arrived at under para 5 and para 6 of ICDS are the actual amounts to be capitalised, making the dates of commencement and cessation of capitalisation redundant. That is neither logical nor intended.**

10.6 ICDS deals with two scenarios – (i) where a qualifying asset is acquired using specific borrowing; and (ii) where asset is acquired utilising general borrowings. In practice, a qualifying asset may be acquired partly financed through specific borrowing and partly through general borrowing and own funds of the assessee. In such cases, please clarify how will the eligible amounts under para 5 and para 6 be calculated.**It needs to be clarified what will be the average cost of the qualifying asset (i.e. `B' in the formula in para 6) – average of cost or average of cost as reduced by amount of specific borrowing for the asset. Similar clarification is required for average of total assets (i.e. `C' in the formula in para 6).**

10.7 Transitional provision contained in para 10 of the ICDS is confusing and in fact, is unnecessary. Para 10 of the ICDS states that it applies to borrowing costs incurred on or after 1st April, 2015. In such a case, there is no question of taking into account what was capitalised in the

earlier previous years in respect of the same borrowing in accordance with the law as applicable in such earlier previous years. Para 10 of ICDS may be deleted.**It is suggested that this ICDS should not disturb what has been capitalised or not capitalised in the earlier years out of borrowing costs of those years according to the law in those years, since it will affect interest allowed in such earlier years.**

11. ICDS X - Provisions, Contingent Liabilities and Contingent Assets

11.1 Clarification is required regarding allowability of provision for warranty claims and similar claims made on a scientific basis, which are allowable in view of the **Supreme Court decision in the case of Rotork Controls 314 ITR 62 (SC)**, since such claims relate to sales taking place during the period, though the claim has to be settled in a subsequent year.

11.2 A clarification is also required regarding claims for and against the assessee in litigations, where the litigation is continuing at higher courts, as to what would constitute 'reasonable certainty' in such cases. This will avoid unnecessary disputes where the assessing officer disagrees with the assessee's estimate of reasonable certainty.

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