

## **Background**

Notification No. 87/2016 dated 29.09.2016 was issued by the CBDT in exercise of powers available under Section 145(2) of the Income Tax Act, 1961 and the Government notified 10 Income Computation and Disclosure Standards (ICDS) to be followed by Assesseees following mercantile system of accounting for the purpose of computation of income under ‘business or profession’ or ‘other sources’. Certain clarifications were issued in March 2017. The amended Section 145; the notification and the circular were challenged before the Delhi High Court by the Chamber of Tax Consultants. The Delhi High Court has rendered a landmark judgment and the summary of the findings are given below.

## **Delhi High Court Decision dated 08.11.2017**

### **ICDS**

- (i) Section 145(2) has to be read down to restrict the power of the Central Government to notify ICDS that do not seek to override binding judicial precedents or the provisions of the Act.
- (ii) Power to enact a validation law can be done only by the Parliament and not by the Executive.
- (iii) ICDS is not meant to overrule the Act or the Rules or judicial precedence.

### **Prudence**

ICDS - I which does away with the concept of ‘**prudence**’ is contrary to the Act and judicial precedence and hence unsustainable.

### **Valuation of Inventories**

ICDS – II which contemplates ‘**valuation of inventories**’ and eliminates the distinction between a continuing partnership business after dissolution and a business which is discontinued after dissolution is contrary to the decision of the

Supreme Court in the case of *Shakti Trading Co. Vs. CIT (2001) 250 ITR 871. ICDS – II is ultra vires the Act and is hereby struck down.*

### Retention Money

Treatment of **retention money** should be on case to case basis by applying settled principles of accrual of income. Taxation of retention money at the earliest possible stage irrespective of facts is contrary to the decisions on the issue and hence *Para 10(a) of ICDS – III is ultra vires.*

### Borrowing Cost

Para 12 of ICDS – III read with Para 5 of ICDS – IX dealing with borrowing cost makes it clear that no incidental income can be reduced from borrowing cost. As this is contrary to the decision of the Supreme Court in *CIT Vs. Bokaro Steels Ltd. (1999) 236 ITR 315*, the said para is struck down.

### Export Incentive

Para 5 of ICDS – IV requires an assessee to recognize income from **export incentive** in the year of making the claim if there is reasonable certainty of its ultimate collection. This is contrary to the decision of the Supreme Court in *CIT Vs. Excel Industries Ltd. (2015) 358 ITR 295* and is therefore struck down.

### Construction – Method of Accounting

**Proportionate Completion method** as well as contract completion method have been recognised as valid method of accounting by the Supreme Court in *CIT Vs. Bilhari Investment Pvt. Ltd. (2008) 299 ITR 1* and Delhi High Court in the case of *Manish Buildwell Pvt. Ltd.* and *Paras Builtech India Pvt. Ltd.* Para 6 of ICDS – IV which permits only proportionate completion method *is ultra vires the Act and is therefore struck down.*

## Interest

Para 8(1) of ICDS IV is not been shown to be contrary to any judicial precedent. There is also no challenge to Section 36(1)(vii) of the Act. Accordingly, Para 8(1) of ICDS-IV is held to be not *ultra vires* the Act. Its validity is upheld.

## Foreign Currency Derivatives

ICDS – VI which states that marked to market loss / gain in case of **foreign currency derivatives** held for trading or speculation purposes are not to be allowed is not in consonance with the ratio laid down by the Supreme Court in *Sutlej Cotton Mills Ltd. Vs. CIT (1999) 116 ITR 1* and hence *ultra vires of the Act and struck down as such*.

## Government Grants

ICDS – VII which provides that recognition of **Government Grants** cannot be postponed beyond the date of accrual receipt is in conflict with accrual system of accounting. To that extent, it is *ultra vires and struct down*.

## Valuation of Securities

ICDS – VIII pertains to valuation of securities. For those entities not governed by the RBI to whom Part A of ICDS VIII is applicable, the accounting prescribed the AS has to be followed which is different from the ICDS. In effect, such entities will be required to maintain separate records for income tax purposes for every year since the closing value of the securities would be valued separately for income tax purposes and for accounting purposes. To this extent Part A of ICDS – VIII is held to be *ultra vires the Act and is struck down as such*.

***Disclaimer:** - This Direct Tax Alert is only for the purpose of information and does not constitute or purport to be an advice or opinion in any manner. The information provided is not intended to create an attorney-client relationship and is not for advertising or soliciting. K. Vaitheeswaran & Co. do not intend in any manner to solicit work through this Tax Alert. The Tax Alert is only to share information based on recent developments and regulatory changes. K. Vaitheeswaran & Co. is not responsible for any error or mistake or omission in this Tax Alert or for any action taken or not taken based on the contents of this Tax Alert.*

<b>CHENNAI</b>	<b>BENGALURU</b>
Flat No.3, First Floor, No.9, Thanikachalam Road, T. Nagar, Chennai – 600 017. Tel.: 044 + 2433 1029 / 2433 4048	402, Front Wing, House of Lords, 15 / 16, St. Marks Road, Bengaluru – 560 001. Tel.: 092421 78157

*Email:* [vaithilegal@gmail.com](mailto:vaithilegal@gmail.com)    [vaithilegal@yahoo.co.in](mailto:vaithilegal@yahoo.co.in)