



Income Tax Department

Ministry of Finance, Government of India

Income Computation and Disclosure Standards (ICDS)

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Introduction

The Central Board of Direct Taxes (CBDT) has notified Income Computation and Disclosure Standards (ICDS) under Section 145(2) of the Income-tax Act, 1961, to ensure uniformity in tax computation and reduce litigation. ICDS is relevant only for tax computation, not for maintaining books of accounts.

Applicability

ICDS applies to all taxpayers earning income under the head "Profits and Gains from Business or Profession" or "Income from Other Sources", provided they follow the mercantile system of accounting. There is no turnover or income threshold for its applicability. However, it does not apply in the following cases:

- (a) Individuals and HUFs are not required to get their accounts audited under Section 44AB.
- (b) Taxpayers opting for presumptive taxation schemes. However, relevant provisions of ICDS may apply to determine turnover or receipts under such schemes.
- (c) Computation of Minimum Alternate Tax (MAT) under Section 115JB (ICDS applies for Alternative Minimum Tax (AMT) under Section 115JC).

List of Notified ICDS

The following 10 ICDS are notified:

- (a) ICDS I – Accounting Policies
- (b) ICDS II – Valuation of Inventories
- (c) ICDS III – Construction Contracts
- (d) ICDS IV – Revenue Recognition
- (e) ICDS V – Tangible Fixed Assets
- (f) ICDS VI – The Effects of Changes in Foreign Exchange Rates
- (g) ICDS VII – Government Grants
- (h) ICDS VIII – Securities
- (i) ICDS IX – Borrowing Costs
- (j) ICDS X – Provisions, Contingent Liabilities, and Contingent Assets

ICDS vs. Generally Accepted Accounting Principles (GAAP)

ICDS is based on the Accounting Standards (AS), which were notified by the Ministry of Corporate Affairs (MCA). It applies irrespective of whether a company follows AS or Ind-AS. However, in the event of a conflict, the provisions of the Income-tax Act and Rules prevail.

Income Computation and Disclosure Standard (ICDS) I – Accounting Policies

Income Computation and Disclosure Standard (ICDS) I – Accounting Policies

ICDS-I governs the significant accounting policies for computing taxable income under the heads "Profits and Gains of Business or Profession" and "Income from Other Sources." It does not apply to the maintenance of books of account. In case of a conflict with the provisions of the Income-tax Act, the Act prevails.

• **Fundamental Accounting Assumptions** - Unless stated otherwise, the following assumptions are presumed to be followed:

- **Going Concern:** The entity is expected to continue its operations in the foreseeable future.
- **Consistency:** Accounting policies must be consistently applied over the years unless changed for a valid reason.
- **Accrual:** Income and expenses should be recognized when they accrue, not when received or paid, except where specific provisions of the Income-tax Act apply (e.g., Section 43B, Section 40, and Section 40A).

If any of these assumptions are not followed, disclosure is required.

• **Significant Accounting Policies**

- **Definition:** Accounting policies refer to the principles and methods applied in financial statements. However, for taxation purposes, deviations due to ICDS are considered **adjustments** rather than changes in accounting policies.
- **Selection Criteria:** Policies should reflect the true and fair view of income and financial position. Transactions must be accounted for based on their **substance over form** principle.
- **Mark-to-Market Losses:** These are not recognized unless permitted by another ICDS (e.g., ICDS VIII on securities).



- **Change in Accounting Policy** - An entity can change its accounting policy only for a reasonable cause. ICDS does not specify whether the change should be applied prospectively or retrospectively. However, it is generally applied prospectively since the income of a past year cannot be recomputed once reported.
- **Disclosure Requirements** - As per **Form 3CD**, the following must be disclosed:
 - Significant accounting policies adopted.
 - Changes in accounting policies with material impact, including the financial effect if quantifiable.
 - Changes expected to impact future years, even if they do not materially affect the current year.
 - Non-compliance with fundamental accounting assumptions, if any.

Income Computation and Disclosure Standard (ICDS) II – Valuation of Inventories

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ICDS-II governs the valuation of inventories for income computation under the head "Profits and Gains of Business or Profession." As per Section 145A, inventories must be valued at the lower of cost or net realisable value (NRV) in accordance with ICDS.

- **Scope** - ICDS-II applies to the valuation of inventories, except for:
 - Work-in-progress covered under ICDS-III (Construction Contracts).
 - Work-in-progress dealt with by other ICDS.
 - Securities held as stock-in-trade (covered under ICDS-VIII).
 - Inventories of producers of livestock, agriculture, mineral oils, ores, and gases measurable at NRV.
 - Machinery spares used only for fixed assets.
- **Valuation of Inventories** - Inventories must be valued at the lower of cost or NRV, *except* in the case of:
 - **Dissolution of Firm/AOP/BOI:** Inventory is valued at NRV, irrespective of business continuation.
 - **Raw Material & Supplies:** If finished goods are expected to be sold at or above cost, raw materials need not be written down. However, if their cost exceeds NRV, they should be valued at replacement cost.
 - **By-products, Scrap, Waste:** If immaterial, they should be measured at NRV and deducted from the main product's cost.
 - NRV is the estimated selling price reduced by costs of completion and selling expenses. Inventories should be written down item-by-item, unless similar items belong to the same product line.
- **Reversal of Write-downs** - ICDS-II allows reversal of inventory write-downs if NRV increases beyond the previously recorded cost.
- **Cost of Inventories** includes:
 - **Cost of Purchase:** Purchase price, non-refundable taxes, freight, and directly attributable costs (net of trade discounts).
 - **Cost of Services:** Labour and other costs incurred in acquiring or manufacturing inventories.
 - **Cost of Conversion:** Direct production costs, allocated fixed and variable overheads.
 - **Other Costs:** Any necessary expenses to bring inventories to their current condition and location.and excludes:
 - Abnormal wastage.
 - Storage costs (unless necessary for production).
 - Administrative overheads unrelated to production.
 - Selling costs.
- **Methods for Cost Measurement** - ICDS-II allows:
 - **Specific Identification Method:** Used for unique or segregated items.
 - **FIFO (First-In-First-Out) Method:** Assumes earliest purchases are sold first.
 - **Weighted Average Cost Method:** Averages cost over time.
 - LIFO (Last-In-First-Out) is not permitted.
- **Alternative Cost Measurement Techniques**
 - **Standard Costing Method:** Based on normal consumption, efficiency, and capacity.
 - **Retail Method:** Used in the retail industry by applying gross margins to selling prices.
 - Once a method is adopted, it cannot be changed without reasonable cause.
- **Disclosures in Form 3CD**



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- Accounting policies for inventory valuation.
- Cost formula used.
- If standard costing is applied, confirmation that it approximates actual cost.
- Total inventory value and classification.

Income Computation and Disclosure Standard (ICDS) III – Construction Contracts

Income Computation and Disclosure Standard (ICDS) III – Construction Contracts

ICDS-III governs the recognition of revenue and costs associated with construction contracts using the Percentage of Completion Method (POCM). As per Section 43CB, profits and gains from construction contracts must be computed using POCM.

• Scope - ICDS-III applies to all construction contracts, including:

- Contracts for constructing assets or interdependent asset groups.
- Contracts for services directly related to construction (e.g., architects, project managers).
- Contracts for demolition or restoration of assets.

• Classification of Construction Contracts

- **Fixed Price Contracts:** The contractor agrees to a fixed price, with or without cost escalation clauses.
- **Cost-Plus Contracts:** The contractor is reimbursed for actual costs plus a markup or fixed fee.

• Determination of Contract Revenue and Cost –

Contract Revenue Includes:

- Agreed contract price, including retentions.
- Variations, claims, and incentive payments if reliably measurable.

Contract Cost Includes:

- **Direct Costs:** Labour, materials, and other directly attributable costs.
- **Attributable Costs:** Costs allocable to contract activities from inception to completion.
- **Contract Securing Costs:** Recognized only if the contract is likely to be obtained.
- **Borrowing Costs:** Capitalized if related to contract work as per ICDS-IX.

• Percentage of Completion Determination

- **Cost Proportionate Method:** Based on actual contract costs incurred as a percentage of estimated total costs.
- **Survey of Work Method:** Based on work certified by a qualified surveyor.
- **Physical Completion Method:** Based on actual physical progress of the contract.

• Revenue and Cost Recognition

- Revenue is recognized based on the contract's percentage of completion.
- Costs are recognized in proportion to contract completion.
- If revenue becomes uncollectible, it is written off as an expense.
- In early contract stages (up to 25% completion), revenue is recognized only to the extent of incurred costs.

• Change in Estimates - Changes in contract revenue or cost estimates must be incorporated in the period they occur, and adjustments are made cumulatively.

• Combining or Segmenting Contracts

- **Segmenting:** A single contract is treated as multiple contracts if different parts can be separately negotiated and priced.
- **Combining:** Multiple contracts are treated as one if they are closely interrelated and part of a single project.

• Disclosures in Form 3CD

- Revenue recognized in the reporting period.
- Method used to determine contract completion.
- Costs incurred, profits recognized, advances received, and retentions.

Income Computation and Disclosure Standard (ICDS) IV – Revenue Recognition

Income Computation and Disclosure Standard (ICDS) IV – Revenue Recognition



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ICDS-IV prescribes the recognition of revenue from the sale of goods, rendering of services, interest, royalties, and dividends. Revenue from construction contracts is governed separately by ICDS-III.

- **Scope** - ICDS-IV applies to revenue arising from:

- *Sale of Goods*
- *Rendering of Services*
- *Use of a Person's Resources (yielding interest, royalties, or dividends)*

It also applies to non-residents earning income taxable on a gross basis under Section 115A.

- **Revenue Recognition from Sale of Goods**

- Revenue is recognized when significant risks and rewards of ownership are transferred to the buyer.
- Legal title retention solely for securing payment does not delay revenue recognition.
- If collection is uncertain, revenue recognition is postponed until reasonable certainty exists.

- **Revenue Recognition from Rendering of Services**

- Revenue is recognized on a Percentage of Completion Method (POCM).
- In continuous service contracts, revenue may be recognized on a straight-line basis over time.
- Short-term service contracts (≤ 90 days) may follow the Completed Service Contract Method instead of POCM.

- **Recognition of Other Revenue**

- **Interest:** Recognized on an accrual basis, except for interest on tax refunds, which is recognized on receipt basis.
- **Royalty:** Recognized as per the terms of the agreement or on another systematic basis, if more appropriate.
- **Dividend:** Recognised in the year of declaration or payment, as per Section 8 of the Income-tax Act.

- **Disclosures in Form 3CD**

- Revenue not recognized due to uncertainty in collection.
- Revenue recognized from service transactions.
- Method used to determine the stage of completion of services.
- Costs incurred, profits recognized, advances received, and retentions for contracts in progress.

Income Computation and Disclosure Standard (ICDS) V – Tangible Fixed Assets

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ICDS-V provides guidance on classification, cost determination, and treatment of tangible fixed assets, including land, buildings, machinery, plant, and furniture, used for business purposes.

- **Classification of Tangible Fixed Assets**

- Assets held for use in the production or supply of goods/services and not for sale in the ordinary course of business.
- Stand-by equipment and servicing equipment must be capitalized.
- Spare parts are expensed unless used for a specific fixed asset with irregular replacement, in which case they are capitalized.

- **Determination of Actual Cost**

- **Purchased Assets:** Cost includes purchase price, non-recoverable taxes, freight, installation costs, and trial runs, net of trade discounts.
- **Self-Constructed Assets:** Cost includes direct costs, attributable general expenses, and depreciation of machinery used.
- **Assets Acquired in Exchange:** Cost is the fair market value (FMV) of the acquired asset.
- **Jointly-Owned Assets:** Cost is apportioned based on agreement or payment contribution.
- **Group Purchases:** Cost is allocated based on FMV.

- **Treatment of Repairs and Maintenance**

- **Capitalized:** If expenses increase economic benefits beyond the asset's original standard.
- **Expensed:** If they only maintain existing benefits.

- **Depreciation & Asset Transfer**

- Depreciation is computed as per the Income-tax Act, 1961, using either the WDV method or the SLM (for power generation units).
- No depreciation is allowed on goodwill.
- Asset transfers: If the block ceases to exist, gains/losses are taxed under capital gains. Otherwise, sale proceeds reduce the block value.



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• Disclosures in Form 3CD

- Description, rate of depreciation, cost, and WDV of assets.
- Additions/deductions, including GST credit, forex gains/losses, and subsidies.
- Depreciation claimed during the year.

Income Computation and Disclosure Standard (ICDS) VI - The Effects of Changes in Foreign Exchange Rates

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ICDS-VI governs the computation of income from foreign currency transactions, translation of financial statements of foreign operations, and accounting for forward exchange contracts.

• Scope- The standard covers:

- Treatment of foreign currency transactions
- Translation of foreign operation financials
- Forward exchange contracts

It does not apply to capital assets governed by Section 43A. Foreign exchange gains/losses (excluding those under Section 43A) are taxed under Section 28 or allowed under Section 37(1), and computed in accordance with ICDS-VI.

• Definitions

- **Foreign Currency Transaction:** Transaction denominated or settled in foreign currency.
- **Monetary Items:** Cash, receivables, payables, etc.
- **Non-Monetary Items:** Fixed assets, inventory, equity investments, etc.

• Capital Account Fluctuations [Section 43A]

- Arise when capital assets (depreciable or not) are acquired from outside India for business/profession and are not paid for immediately.
- Exchange differences arising at the time of payment or loan repayment are adjusted in the asset's actual cost or WDV.
- Adjustments are made in the year of payment, regardless of accounting method.

Revenue Account Fluctuations [Section 43AA with ICDS-VI]

Revenue Account Fluctuations [Section 43AA with ICDS-VI]

This ICDS applies to foreign exchange differences on revenue items.

- **Initial Recognition:** Recorded at the rate on the transaction date. The average rate can be used unless the rate fluctuates significantly.
- **Year-End Translation:**
 - *Monetary items:* Reinstated using closing rate; differences recognised as income/expense
 - *Non-monetary items:* Not restated; continue at original rate
 - *Inventory at NRV:* Translated using the rate at the date of NRV determination

• Special Cases:

- **Interest on Securities:** Converted using the month-end rate before income due
- **Business Income:** Converted using year-end rate
- **Other Income:** Converted using year-end rate
- **Dividend:** Month-end rate prior to declaration/payment
- **TDS Income:** Rate on the date tax was required to be deducted

• Forward Exchange Contracts

- **Forward Contract:** Agreement to exchange currencies at a future date and a fixed rate
- **Premium/Discount:** Amortised over contract tenure
- **Exchange Difference:**
 - *Same year settlement:* Difference from contract inception to settlement
 - *Different year settlement:* Difference from last year-end or inception to settlement
- **Cancellation/Renewal:** Gain/loss recognised in the year of occurrence
- Not applicable to contracts for speculative/trading purposes or hedges of firm commitments/highly probable forecast transactions.



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- **Translation of Foreign Operations** - Financials of foreign operations are translated using the same method as other foreign currency transactions, treating them as part of the assessee's own operations.
- **For Block of Assets**- Foreign exchange gains/losses affecting capital asset cost under Section 43A are adjusted to WDV, regardless of whether capitalised in books.

Income Computation and Disclosure Standard (ICDS) VII – Government Grants

Income Computation and Disclosure Standard (ICDS) VII – Government Grants

ICDS-VII governs the recognition, measurement, and treatment of government grants, including subsidies, incentives, duty drawbacks, waivers, concessions, and reimbursements.

- **Scope** - ICDS-VII applies to government grants but excludes:

- Government assistance not classified as grants.
- Government participation in the ownership of enterprises.

- **Recognition of Government Grants**

- Grants are recognized when reasonable assurance exists that the conditions will be met and the grant will be received.
- Recognition cannot be postponed beyond the date of receipt.

- **Treatment of Government Grants**

- **Grants for Depreciable Assets:**

- Deducted from the actual cost of the asset or the written down value (WDV) of the block.
- If not asset-specific, apportioned proportionately across assets.

- **Grants for Non-Depreciable Assets:** Recognized as income over the period in which related costs are incurred.

- **Grants Received as Compensation for Expenses or Losses:** Recognized as income in the year receivable if meant for past losses or immediate financial support.

- **Other Monetary Grants:** Recognized as income over the period in which associated costs are incurred.

- **Non-Monetary Grants (e.g., free equipment):** Recognized based on acquisition cost (nominal value if free, or actual payment if concessional).

- **Refund of Government Grants** - If a grant is refunded, the treatment depends on its original purpose:

- **For Depreciable Assets:** Added back to the actual cost or WDV, and depreciation is recalculated.
- **For Other Grants:** Adjusted against any unamortized deferred credit; the excess is charged to the profit and loss account.

- **Disclosures in Form 3CD**

- Grants deducted from asset cost or WDV.
- Grants recognized as income during the year.
- Unrecognized grants and reasons for non-recognition.

Income Computation and Disclosure Standard (ICDS) VIII – Securities

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ICDS-VIII governs the valuation of securities held as stock-in-trade. It does not apply to securities held as capital assets, which are governed by capital gains provisions.

- **Scope** - ICDS-VIII applies to securities as defined under Section 2(h) of the Securities Contracts (Regulation) Act, 1956, including shares (listed or unlisted), bonds, debentures, government securities, mutual fund units, and rights or interests in securities. It excludes derivatives and does not apply to:

- Recognition of interest and dividends (covered under ICDS-IV).
- Securities held by insurance companies, banks, public financial institutions, mutual funds, and venture capital funds.

- **Valuation of Securities Held as Stock-in-Trade**

- *At the Time of Acquisition*

- Securities are recorded at actual cost, including purchase price, brokerage, fees, duties, and taxes.
- If acquired in exchange, the cost is the fair value of the acquired security.
- If acquired as a gift or inheritance, the cost is the original cost to the previous owner.
- Pre-acquisition interest on interest-bearing securities must be deducted from the cost.

- *At the End of the Year (Subsequent Valuation)*



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- Listed Securities: Valued at the lower of cost or net realisable value (NRV).
- Unlisted Securities: Valued at cost only (marked-to-market losses are not allowed).
- Valuation must be done category-wise (shares, debt securities, convertible securities, etc.), not individually.
- **Methods of Valuation**
 - Specific Identification Method (preferred).
 - If impractical, FIFO (First-In-First-Out) or Weighted Average Method may be used.
- **Special Provisions for Banks** - Scheduled banks and public financial institutions must classify, recognize, and measure securities as per the RBI guidelines. ICDS-VI on foreign exchange does not apply to forward contracts related to securities acquired in foreign currency.

• Tax Treatment of Marked-to-Market Losses

- Marked-to-market losses on listed securities (computed as per ICDS) are allowed as a deduction under Section 36(1)(xviii).
- If not computed as per ICDS, such losses are disallowed under Section 40A(13).
- Marked-to-market gains are taxable as business income under Section 28.

• Disclosures in Form 3CD

- Valuation method used for securities.
- Category-wise cost and NRV for listed securities.
- Any deviation from ICDS and the reasons thereof.

Income Computation and Disclosure Standard (ICDS) IX – Borrowing Costs

Income Computation and Disclosure Standard (ICDS) IX – Borrowing Costs

ICDS-IX provides guidelines for the recognition, measurement, and treatment of borrowing costs. It specifies when such costs should be capitalized as part of an asset's cost and when they should be charged to profit and loss.

• Scope - Borrowing costs include:

- Interest expense on loans and borrowings.
- Commitment charges, processing fees, and finance lease charges.
- Amortized discounts/premiums on borrowings.
- Bill discounting charges (as clarified by CBDT Circular No. 10/2017, dated 23-03-2017).

Borrowing costs disallowed under specific provisions of the Income-tax Act (e.g., expenses related to exempt income under Section 14A) cannot be capitalized.

• Capitalization of Borrowing Costs - Borrowing costs are capitalized if they are directly attributable to the acquisition, construction, or production of a qualifying asset, including:

- **Tangible Assets** – Land, building, plant, and machinery, etc.
- **Intangible Assets** – Patents, trademarks, copyrights, etc.
- **Inventories** – If they require 12 months or more for saleable condition.

• Computation of Capitalization Amount

- **For Specific Borrowings:** The entire borrowing cost incurred on funds directly used for a qualifying asset is capitalized.
- **For General Borrowings:** The amount to be capitalized is computed using the following formula:
Capitalized Borrowing Cost = Total General Borrowing Cost × Average Cost of Qualifying Assets / Average Cost of Total Assets

Where:

- Average Cost of Qualifying Assets depends on whether the asset was in existence at the beginning of the year, acquired during the year, or put to use during the year.
- Average Cost of Total Assets is calculated excluding assets funded through specific borrowings.

• Period of Capitalization

- **For Specific Borrowings:** From the date funds are borrowed until the asset is **first put to use**.
- **For General Borrowings:** From the date funds are utilized for a qualifying asset until the asset is first put to use.
- **For Inventories:** Until all activities necessary to make them saleable are substantially completed.
- **For Construction in Phases:** Capitalization stops individually for each phase when it is put to use.

• Disclosures in Form 3CD



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- Accounting policy for borrowing costs.
- Amount of borrowing costs capitalized during the year.

Income Computation and Disclosure Standard (ICDS) X – Provisions, Contingent Liabilities, and Contingent Assets

Income Computation and Disclosure Standard (ICDS) X – Provisions, Contingent Liabilities, and Contingent Assets

ICDS-X provides guidelines for recognizing and measuring provisions, contingent liabilities, and contingent assets for tax computation purposes.

- **Scope** - ICDS-X applies to all provisions, contingent liabilities, and contingent assets except those arising from:

- *Financial instruments*
- *Executory contracts*
- *Insurance contracts with policyholders*
- *Revenue recognition (covered under ICDS-IV)*
- *Depreciation, asset impairment, and doubtful debts (covered under ICDS-V)*
- *Employee benefits (as clarified by CBDT Circular No. 10/2017).*

• Key Definitions

- **Provision:** A liability of uncertain amount or timing.
- **Liability:** A present obligation arising from past events, requiring an outflow of resources.
- **Executory contracts:** Executory Contracts are contracts under which both the party has not performed any of their obligations or both parties have partially performed their obligations to an equal extent.
- **Contingent Liability:** A possible obligation dependent on uncertain future events or a present obligation with uncertain settlement.
- **Contingent Asset:** A possible asset whose existence depends on future events beyond the taxpayer's control.

• Recognition and Measurement

- **Provisions:** A provision is recognized when:
 - A present obligation exists due to a past event.
 - An outflow of economic benefits is reasonably certain.
 - The liability amount can be reliably estimated.
- **Exceptions:**
 - Future operating costs are not allowed as provisions.
 - Compliance costs for proposed laws cannot be provisioned until the law is enacted.
- **Measurement of Provisions**
 - Provisions are measured based on best estimates at the year-end.
 - Discounting to present value is not permitted.
 - Provisions must be reviewed annually and adjusted based on updated estimates.

- **Use of Provisions** - Provisions can only be used for expenses for which they were originally recognized.

- **Reimbursement of Expenses** - Recognised as income only when receipt is reasonably certain after the liability is settled.

- **Contingent Liabilities** - Not recognized as they depend on uncertain future events.

• Contingent Assets

- Not recognized initially but should be assessed regularly.
- Once reasonable certainty of inflow arises, the asset and related income must be recognized in that year.

• Disclosures in Form 3CD

- **Provisions:** Nature, carrying amount, additional provisions, reversals, and reimbursements.
- **Contingent Assets:** Nature, carrying amount, and recognized income.