



The Delhi High Court decision on the constitutional validity of ICDS

Recently, the Delhi High Court in the case of the Chamber of Tax Consultants and Anr¹ (Petitioners) dealt with the constitutional validity of the Income Tax Computation Standards (ICDS). The High Court held that in order to preserve its constitutionality, Section 145(2) of the Income-tax Act, 1961 (the Act), as amended, has to be read down to restrict power of the Central Government to notify ICDS that do not seek to override binding judicial precedents or provisions of the Act. The power to enact a validation law is an essential legislative power that can be exercised in the context of the Act, only by the Parliament and not by the executive. If Section 145(2) of the Act as amended is not so read down it would be *ultra vires* the Act².

The High Court dealt with the specific provisions of the ICDS which are contrary to or seek to overcome binding judicial precedents and held that such provisions are to be struck down as the same are contrary to the law settled by the various decisions of the Supreme Court and High Court and the same are *ultra vires* the Act. The High Court's observations with respect to each ICDS are summarised as follows:

ICDS	Issue/Contentions	High Court Decision
ICDS I – Accounting Policies	<ul style="list-style-type: none"> The Petitioners contended that prudence has been completely done away with by CBDT, which was present in the earlier AS 1. The ICDS now stipulates that prudence is not to be followed unless specified, and it is contrary to certain decisions³. 	<ul style="list-style-type: none"> ICDS I which has done away with the concept of 'prudence' is contrary to the Act and binding judicial precedents and is therefore unsustainable in law.
ICDS II – Valuation of Inventories	<ul style="list-style-type: none"> ICDS II eliminates the distinction between a continuing partnership business after dissolution from one which is discontinued upon dissolution. It is contrary to the Supreme Court decision in the case of Shakti Trading Co⁴. It fails to acknowledge that the valuation of inventory at the market value upon settlement of accounts of the outgoing partner is distinct from valuation of the inventory in the books of the business which is continuing. 	<ul style="list-style-type: none"> ICDS II is also an attempt to overreach the binding judicial precedents by the device of notifications issued by the central government. It is an exercise of excessive delegation of legislative power which is impermissible in law. ICDS II is held to be <i>ultra vires</i> the Act and struck down as such.
ICDS III - Construction Contracts	<ul style="list-style-type: none"> Paragraph 10(a) of ICDS III states that retention money would be a part of the contract and the same has to be assessed to tax based on 'proportionate computation' 	<ul style="list-style-type: none"> To the extent ICDS III is interpreted and applied in a manner contrary to the law settled by various decisions of the

¹ The Chamber of Tax Consultants & Anr v. UOI [W. P. (C) 5595/2017 & CM APL 23467/2017] – Taxsutra.com

² It would also *ultra vires* Article 141 read with Article 144 and 265 of the Constitution

³ CIT v. Triveni Engineering & Industries Ltd [2011] 49 DTR 253 (Del), CIT v. Advance Construction Co. Pvt. Ltd. [2005] 275 ITR 30 (Guj).

⁴ Shakti Trading Co. v. CIT [2001] 250 ITR 871 (SC)

	<p>method. This is reiterated in answer to Question No. 11 in Circular No. 10 of 2017.</p> <ul style="list-style-type: none"> This is contrary to certain decisions⁵ where it has been held that the retention money does not accrue to the taxpayer unless and until the defect liability period is over and the Engineer-in-Charge certifies that no liability is attached to the taxpayer. Further paragraph 12 of ICDS III read with paragraph 5 of ICDS IX, dealing with borrowing costs, makes it clear that no incidental income can be reduced from borrowing cost. This is contrary to the Supreme Court decision in the case of Bokaro Steel Limited⁶ wherein it was held that if the taxpayer receives any amounts which are inextricably linked with the process of setting up of its plant and machinery, such receipts would go to reduce the cost of its assets. 	<p>Supreme Court and the High Courts, it cannot be sustained.</p> <ul style="list-style-type: none"> The treatment to retention money under Paragraph 10(a) in ICDS-III will have to be determined on a case to case basis by applying settled principles of accrual of income. Paragraph 12 of ICDS III is to be struck down.
ICDS IV - Revenue Recognition	<ul style="list-style-type: none"> Paragraph 5 of ICDS IV requires the taxpayer to recognise income from export incentive in the year of making of the claim if there is 'reasonable certainty' of its ultimate collection. This is contrary to the Supreme Court decision in the case of Excel Industries⁷ where it has been held that it is only in the year in which the claim is accepted by the Government that a right to receive the payment accrues in favour of the taxpayer and the corresponding obligation to pay arises in the hands of the Government. Only in such year the income from export incentive can be said to have accrued and can be recognised as income. As per paragraph 6 of ICDS IV, revenue from service transactions shall be recognised by the percentage completion method. This is contrary to certain decisions⁸ where the proportionate completion method as well as the contract completion method have been recognised as valid method of accounting under mercantile system of accounting. Paragraph 8(1) of the ICDS IV is challenged on the ground that non-performing assets of NBFCs would also become taxable on accrual basis even though such interest is not recoverable. 	<ul style="list-style-type: none"> Para 5 of ICDS-IV is <i>ultra vires</i> the Act and struck down as such. To the extent paragraph 6 of ICDS-IV permits only one of the methods, i.e. proportionate completion method, it is contrary to the relevant decisions. Therefore, it is held to be <i>ultra vires</i> the Act and struck down as such. Paragraph 8(1) of ICDS IV has not been shown to be contrary to any judicial precedent. There is also no challenge to Section 36(1)(vii) of the Act. Accordingly, paragraph 8(1) of ICDS-IV is held to be not <i>ultra vires</i> the Act. Its validity is upheld.
ICDS VI - Effects of Changes in Foreign Exchange Rates	<ul style="list-style-type: none"> 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. This is contrary to the Supreme Court decision in the case of Sulej Cotton Mills Limited⁹. 	<ul style="list-style-type: none"> This is <i>ultra vires</i> the Act and struck down as such.

⁵ CIT v. Simplex Concrete Piles India (P) Ltd [1988] 179 ITR 8 (Cal), CIT v. P & C Constructions (P) Ltd [2009] 318 ITR 113 (Mad), Amarshiv Construction (P) Ltd v. DCIT [2014] 367 ITR 659 (Guj), DIT v. Ballast Nedam International [2013] 355 ITR 300 (Guj)

⁶ CIT v. Bokaro Steel Limited [1999] 236 ITR 315 (SC)

⁷ CIT v. Excel Industries Limited [2015] 358 ITR 295 (SC)

⁸ CIT v. Bilhari Investment Pvt. Ltd. [2008] 299 ITR 1 (SC), CIT v. Manish Buildwell Pvt. Ltd. [2011] 245 ITR 397 (Del), Paras Buildtech India Pvt. Ltd. v. CIT [2016] 382 ITR 630 (Del).

⁹ Sulej Cotton Mills Limited v. CIT [1979] 116 ITR 1 (SC)

ICDS VII - Government Grants	<ul style="list-style-type: none"> • ICDS VII provides that recognition of government grants cannot be postponed beyond the date of actual receipt. In other words, income has to be recognised on receipt basis which may not have accrued. • Many a times, conditions are attached to the receipt of government grant, non-fulfilment of which may lead to return of such amount. In such instance, it cannot be said that there is any accrual of income although the money has been received in advance. 	<ul style="list-style-type: none"> • Such provisions are contrary to and in conflict with the accrual system of accounting. To that extent it is held to be <i>ultra vires</i> the Act and struck down as such.
ICDS VIII - Valuation of Securities	<ul style="list-style-type: none"> • For those entities not governed by the RBI to whom Part A of ICDS VIII is applicable, the accounting prescribed by the Accounting Standards has to be followed. This 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. • Under similar circumstances, ICDS II which deals with valuation of inventories does not prescribe such a 'bucket approach'. 	<ul style="list-style-type: none"> • CBDT adopted separate approaches at different places for the purpose of valuation of securities. This change is therefore not possible to be effectuated without a corresponding amendment to the Act. To that extent Part A of ICDS VIII is <i>ultra vires</i> the Act and is to be struck down as such.

Our comments

After ICDS have been notified by the Government, various representations have been made by stakeholders. The constitutional validity of ICDS has been challenged before the Delhi High Court. The Delhi High Court observed that the power to enact a valid law is legislative power of the Parliament and not of the executive. Further the High Court observed that Section 145(2) of the Act, has to be read down to restrict power of the Central Government to notify ICDS that do not seek to override binding judicial precedents or provisions of the Act.

Under the Act, there has been a considerable litigation on various issues before the Courts. ICDS seek to overcome various judicial precedents pronounced by the Supreme Court and High Courts. The Delhi High Court has provided relief to the taxpayer by upholding that ICDS which are contrary to binding Supreme Court and High Court decisions are *ultra vires* the Act.

The Delhi High Court has dealt with some of the specific instances where the ICDS seek to overcome Supreme Court as well as High Court decisions. There are many more instances where ICDS seek to overcome the judicial principles laid down by the Courts. This decision may provide relief in such instances. However, it would be interesting to see how this decision will apply with respect to jurisdictional Tribunal decisions or a Special Bench of Tribunal decision.

The issue may arise that whether the decision of the Delhi High Court is binding precedent outside the Delhi jurisdiction. The Bombay High Court in the case of *Ballarpur Ind. Co. v. Union of India*¹⁰ held that a decision rendered by any High Court must be held binding unless there is a differing decision of the jurisdictional High Court or the Supreme Court.

¹⁰ *Ballarpur Ind. Co. v. Union of India* (Writ Petition 1735 of 2001)

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