

CBDT issues Draft ICDS on real estate transactions: public comments invited by 26 May, 2017

May 15, 2017

In brief

On 29 September, 2016, the Ministry of Finance notified 10 Income Computation and Disclosure Standards¹ (ICDS) to be effective from Assessment Year (AY) 2017-18. The current set of ICDS does not apply to real estate transactions.

The Finance Minister had constituted a committee comprising of representatives from various fields to provide suggestions for introducing ICDS for real estate transactions. Based on the committee's suggestions, the Central Board of Direct Taxes has released draft ICDS on real estate transactions for public comments. The draft ICDS takes into account the Guidance Note on accounting for real estate transactions (Guidance Note) issued by the Institute of Chartered Accountants of India (ICAI). The last date for providing comments is 26 May, 2017.

In detail

Draft ICDS

Applicability

- Consistent with other ICDS, the draft ICDS is applicable for computation of income chargeable under the head "profits and gains of business or profession" or "income from other sources." Further, in case of conflict between the provisions of the Income-tax Act, 1961 (Act) and the draft ICDS, the provisions of the Act shall prevail to that extent.
- The draft ICDS shall be

applicable for determining the income from all forms of real estate (land, buildings and rights in relation thereto) transactions. This will include:

- Sale of plots of land (including long-term sale type leases) without any developments/ with development in the form of common facilities;
- Development and sale of residential and commercial units, row houses, independent houses, with or without an undivided share in

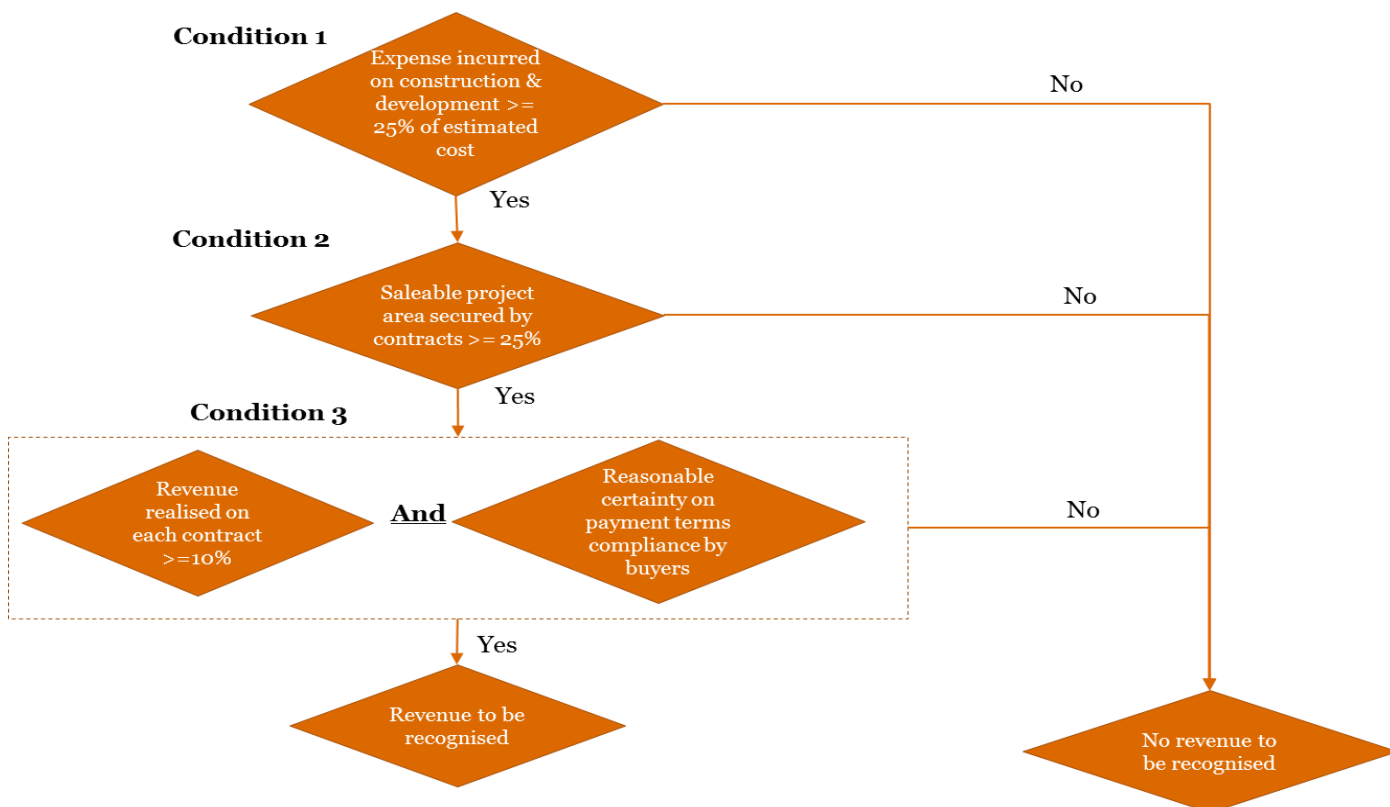
land;

- Acquisition, utilisation and transfer of development rights;
- Redevelopment of existing buildings and structures;
- Joint development agreements for any of the above activities.

Applying the percentage of completion method (POCM)

- **When** - Point of recognition of revenue under POCM

¹ F.No.133/ 23/ 2015-TPL/ SO 3079(E)



- **How Much** - Revenue shall be recognised proportionately based on POCM in respect of units that satisfy Condition 3 above.

Real estate projects – recognition of project revenue and project cost

- In case of projects in which the economic substance is similar to that of a construction contract, the project revenue and cost shall be recognised based on POCM.
- In case the economic substance is not similar to a construction contract, revenue shall be recognised in accordance with ICDS IV relating to Revenue Recognition.

Transferable development rights (TDR)

- The cost of acquisition of the TDR shall be as follows.

TDR acquired by way of	Cost of acquisition
Direct purchase	Purchase cost
Development and construction of built-up area	Cost incurred on development or construction of built-up area
Giving up rights over existing structures or open land	Fair value ² of development rights acquired

- In case of sale of TDR, revenue shall be recognised when the following conditions are satisfied.

- Title to the TDR is transferred to the buyer; and
- It is reasonable to expect that the revenue will be ultimately collected.

Transactions with multiple elements

- In case the contract with a buyer provides for delivery of goods or services in addition to construction or development of real estate, the contract consideration shall be split into separately identifiable components. The consideration received or receivable for each component shall be allocated based on fair value of each component.

Transitional provisions

- The draft ICDS shall apply to projects that will commence on or after 01 April, 201X.

² "Fair value" is defined as the amount for which an asset could be exchanged between a knowledgeable, willing buyer

and a knowledgeable, willing seller in an arm's length transaction.

- In respect of projects that have commenced on or before 31 March, 201X but not completed by the said date, project revenue and project cost shall be recognised based on the method regularly followed prior to the previous year beginning on 01 April, 201X.

Significant changes in draft ICDS v. Guidance Note on real estate transactions issued by ICAI

Sr No.	Particulars	As per Guidance Note	As per draft ICDS	PricewaterhouseCoopers view
1	Definition of "project"	Units connected with a common set of amenities constitute a single project.	Units connected with a common set of basic facilities constitute a single project.	Under ICDS, a large project may be broken down into smaller projects. <i>Difference in trigger point of POCM</i> There could be a scenario, in which, as per the Guidance Note, the POCM may not have been triggered (considering large projects), and hence, no revenue would be recognised in the financial statements. However, as per ICDS, POCM may trigger; thereby, requiring the taxpayer to maintain accounts as per ICDS to compute taxable income.
2	POCM for real estate projects	Four conditions are prescribed for application of the POCM. The conditions include obtaining all critical approvals .	Only three conditions are prescribed for application of the POCM. The condition of obtaining critical approval is not applicable under ICDS. The rationale for excluding the criteria for obtaining critical approval is that the recognition of revenue is deferred up to the incurrance of 25% of construction and development cost (which does not include land cost). In view of the recently enacted "Real Estate (Regulation and Development) Act, 2016," the said criteria may not be relevant.	Although construction and development cost does not include land cost, other incidental costs such as land conversion costs, betterment charges, municipal sanction fee and other charges for obtaining building permission would fall under "construction and development cost." Thus, while obtaining the requisite approvals would not be relevant for the application of POCM under ICDS; however, the costs incurred for obtaining approvals would be taken into account for determining the application of POCM. This may result in difference in the trigger point of the POCM. Please refer to our comments in point no. 1.
3	TDR	In case TDR is acquired by giving up rights over existing structures or open land, the TDR shall be recorded at the fair market value or net book value .	In such case, TDR shall be recorded at fair value of rights so acquired .	<i>For companies following Ind AS</i> As per the Guidance Note read with paragraphs 45 to 47 of Ind AS 38, Intangible Assets, TDR is recorded at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the TDR is not recorded at fair value, the cost is measured at the carrying amount of the asset given up.

Sr No.	Particulars	As per Guidance Note	As per draft ICDS	PricewaterhouseCoopers view
				<p>Under ICDS, even if the transaction lacks commercial substance, the TDR shall be recorded at fair value. Further, the ICDS does not deal with a scenario in which the fair value of rights given up or acquired cannot be reliably measured.</p> <p><i>For companies following Indian GAAP</i></p> <p>As per the Guidance Note, TDR is recorded at fair value (of asset given up or asset acquired, whichever is more evident) or net book value of the asset given up, whichever is less.</p> <p>Thus, if the TDR is recorded at net book value (being lower than the fair value) for tax purposes, the project cost would still be computed based on fair value of TDR.</p>
4	Definition of “project cost”	Contains an illustrative list of items to be included, allocated or excluded in the project cost.	The illustrative list has been excluded, while the principles have been retained.	No significant impact
5	Real estate projects	Revenue is to be recognised based on the principles of AS 9 or AS 7, depending on the economic substance of the project.	Same principles retained without the use of illustrative language.	No significant impact

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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