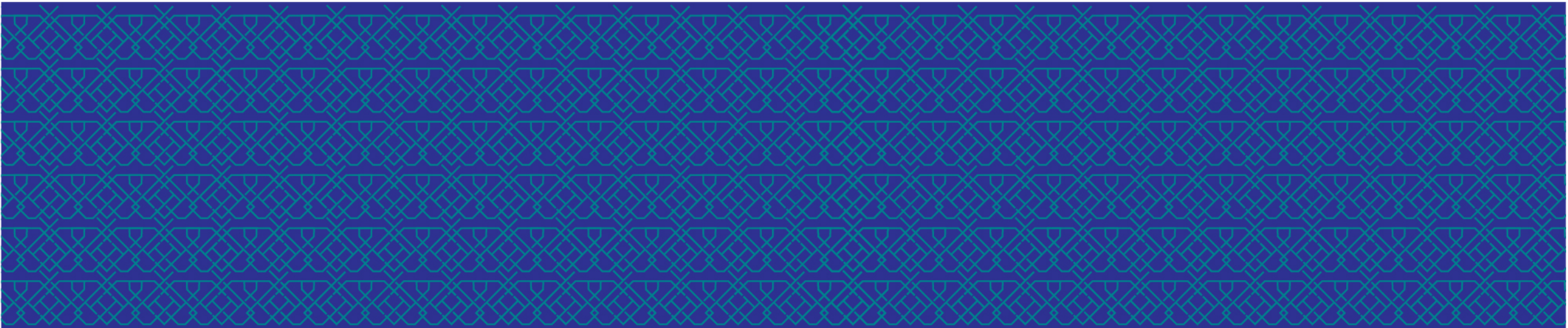


# J.B. NAGAR STUDY CIRCLE

## IMPORTANT ISSUES IN TAX AUDIT



# CL 10 – NATURE OF BUSINESS

- Keep in mind various tax issues that may be relevant to the assessee while mentioning the nature of business
- If interest income is offered to tax as business income or if loans given are to be claimed as bad debts – do not miss out to mention financing business as one of the businesses
- If rental income is to be offered to tax as business income and not as income from house property, then, do not miss out mentioning letting out of properties as one of the businesses
- Need not be very specific – try to be general in describing the activities – “buy, sell, manufacture, market or otherwise deal in ....”. Especially when new business is being set up, this may be helpful
- In case claiming 80IA on captive power or captive railways, mention running of power plant / operating, maintaining of rail systems / power plants as one of the businesses.
- In case of 115BAB companies, mention only “manufacture and production of ....”
- In case assessee is claiming deduction u/s. 36(1)(viii), make sure that the “eligible business” applicable in your case is mentioned for sure
- In case assessee is claiming deduction u/s. 35AD, make sure that the “specified business” applicable in your case is mentioned for sure
- In transfer pricing cases, make sure that the nature of business properly matches with the business profile of the comparables that have chosen

## CL. 13: ICDS

- Cl. 13(d): *Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)?*
- Para 25.11 of GN: For the purpose of replying clause (d), the tax auditor should obtain draft computation of total income and disclosures required under ICDS. Based on information and books of account, the tax auditor should consider whether any adjustment is required to be made to the profit or loss and if the answer is in affirmative, to state 'yes' otherwise to state 'no'. While reporting, auditor has to consider draft of income computation provided by the assessee, this fact should be mentioned in Audit report in paragraph 3 of Form No. 3CA and paragraph 5 of Form No. 3CB.
- Cl. 13(e): *if answer to (d) above is in the affirmative, give details of such adjustments:*

ICDS No.	ICDS Particulars	Increase in profits	Decrease in profits	Net effect

# CL. 13: ICDS - ISSUES

- Meaning of “Accounting Policies” for the purposes of disclosure
  - Technical Guide on ICDS: Para 3.6. The term “accounting policies” in ICDS I should be read as “computation policies”. This would make the provisions of ICDS I relating to substance over form and non-recognition of mark-to-market losses, applicable only for computation of income, and not for accounting purposes. Such an interpretation would also mean that the “accounting policies” required to be disclosed by this ICDS would mean the policies followed in the computation of income, and not those followed for the purposes of maintenance of books of account.
  - Para 5.3. In the context of this ICDS, accounting policies would mean the principles and methods of computation of total income. Different alternative methods may be prescribed by other specific ICDS – those methods adopted by an assessee would also be regarded as accounting policies for the purposes of this ICDS.
  - ICDS 1: One of the fundamental accounting assumption – “Accrual”. Revenues and costs are recognised as they are “earned” or “incurred” AND recorded in the PY to which they relate.

## CL. 13: ISSUES (CONT'D)

### Should INDAS adjustments be reported under Cl. 13?

- ICDS 1: One of the fundamental accounting assumption – “Accrual”. Revenues and costs are recognised as they are “earned” or “incurred” AND recorded in the PY to which they relate.
- “Accrual” – E.D. Sassoon & Co. Ltd. v CIT (1954) 26 ITR 27 (SC) – “right to receive”:
  - The assessee should have “earned” it; and
  - There "arises a corresponding liability of the other party from whom the income becomes due to pay that amount."
- ICDS 1 is in line with the above principles – “earned” and “recorded in the PY to which it relates”. Thus, all recognition based on discounted present values is ruled out. Thus:
  - FVTPL – not earned. No accrual.
  - Effective interest rate adjustments – not relating to the PY – hence no accrual
- ICDS 1 – does not permit mark to market losses – except where specific ICDS permits them.

# CL. 13: ISSUES (CONT'D)

## Subsidy – recognition criteria

- S. 2(24)(xviii): All subsidies except those that are granted to meet the cost of fixed asset treated as “income”.
- ICDS 7: Para 4 – Government grants should not be recognised until there is reasonable assurance that (i) the person shall comply with the conditions attached to them; and (ii) the grants shall be received. Recognition shall not be postponed beyond the date of actual receipt.
- Para 14 – Disclosure of nature and extent of grants Recognised and Not recognised. If not recognised, the reasons thereof.
- Q: How to satisfy ourselves as regards “reasonable assurance”?
  - Past records; An objective assessment of the conditions attached;
  - Can mere delays in the past be the basis for not recognising? Accrual – PY to which it relates - Para 6: recognise as income over the same period over which the cost of meeting the obligation is charged; Para 9: recognise over the period necessary to match with related costs which are compensated.

## CL. 14: SECTION 145A

Cl. 14. (a) Method of valuation of closing stock employed in the previous year.

(b) In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss, please furnish : Increase in profits / Decrease in profits.

S. 145A(ii) provides that: “the valuation of purchase and sale of goods **or services** and of inventory shall be adjusted to include the amount of tax, duty, cess or fee actually paid....”

Q: Whether clause 14(b) requires disclosure of GST on:

- services also to be reported?
- Expenses debited to the P&L account also to be reported?

GN - does not throw any light on this.

Reading Cl (a) and (b) together, it is not required to be reported.

## CL. 14: SECTION 145A (CONT'D)

- Note of disclosure in Form 3CA/3CD – as a matter of clarification:

Section 145A also requires to adjust the valuation of purchase and sale of services to include the amount of any tax, duty or cess or fee actually paid or incurred by the assessee, that is, adjustments are also to be made for Input Tax Credit ("ITC") availed and utilised or taken for GST in respect of purchase and sale of services. ITC (for all types of items of services purchased) are reflected in the books of account on an aggregate basis in ledger accounts maintained therefor and are not based on the nature and / or type of expense or service. Further, cost of services could have been included either in the cost of goods produced or as administrative or any other expense. Considering such significant complexities involved to determine the amount of ITC for purchase of services, it is not possible to work out separate impact thereof. It may be noted that as explained earlier, the net impact in the profit and loss account is NIL>



## CL. 16: AMOUNTS NOT CREDITED TO THE P&L ACCOUNT

- GN Exposure Draft requires disclosure of Subsidy specific to fixed asset – which is reduced from the cost of the fixed asset – to be separately disclosed. New Para 28.16 (e)
- Possible downside: Automatic addition in 143(1). Though a capital receipt cannot be so added, in law.
- One may give a note that “Subsidies that are reduced from the cost of fixed assets are not included in reporting under clause 16 and these are duly disclosed in Clause 18 against the relevant block of asset.”

# CL. 17 & 18: IMMOVABLE PROPERTY + DEPRECIATION

Q: If stamp duty value of a building / office etc. sold is lower than the consideration as per the agreement, what is the amount to be reduced in computing the depreciation on the relevant block of asset in clause 18?

- S. 43(6): “WDV” – requires reduction of “moneys payable” in respect of assets sold, discarded, demolished or destroyed”
- S. 50: Where “full value of consideration” exceeds the WDV, then, deemed STCG is leviable
- S. 50C applies to cases of S. 50 profits as well – ITO v. United Marine Academy 130 ITD 113 (Mum-SB)
- A: If reduction of SDV does not result in profit u/s. 50, then, reduce moneys payable in computing the WDV of the block.

## CL 20(B): S. 36(1)(VA)

Cl. 20(b) Details of contributions received from employees for various funds as referred to in section 36(1)(va):

S. No.	Nature of Fund	Sums received from employees	Due date of payment	The actual amount paid	Actual date of payment to Concerned authorities

S. 2(24)(x): sums received by an employer as contribution to PF, SAF, ESI Fund, or any other fund for the welfare of the employees

S. 36(1)(va): sums taxable u/s. 2(24)(x) – deductible if credited to the fund “on or before the due date”. “Due date” means dd under “Act, rule, order or notification, standing order, award, contract of service or otherwise”.

## CL 20(B): S. 36(1)(VA) (CONT'D)

- Consider the employees contribution towards the following:
  - NPS
  - Staff Welfare Fund (not under any law)
  - SAF
- S. 2(24)(x) applies – scope very wide
- No “due date” mentioned. Hence S. 36(1)(va) not capable of being applied.
- Allowable u/s. 37 – whether provided or paid
- Interplay with S. 43B – Clause 26:
  - S. 43B(b) - “any sum payable by the assessee as an employer by way of contributin to PF, SAF, GF etc”
  - S. 36(1)(iv) - “any sum paid by the assessee as an employer by way of contribution towards PF or SAF...”



## CL 20(B): S. 36(1)(VA) (CONT'D)



- Thus, S. 43B(b) applies only to employer's contribution and not to employee's contribution – Explanation 5
- This view is also supported by Checkmate Services v. CIT (CA no 2833 of 2016 dt. Oct 12, 2022).
- Therefore, S. 43B is not applicable to the employee's contribution to:
  - NPS;
  - Staff Welfare Fund (not under any law)
  - SAF
- Consequently, amounts provided in books towards employees' contribution for these items is allowable even if not actually paid.
- Interplay with S. 40A(9) – Cl. 21(f): 40A(9) applies only to sums paid by the assessee **as an employer ... as contribution to ....funds**". This no reporting of the employee contributions also in Cl. 21(f).

## CL 20(B): S. 36(1)(VA) (CONT'D)

### **Whether PF obligation of the Labour contractor is to be disclosed?**

- Company has paid the contractor full amount and has done TDS u/s. 194C;
- Such contractor's charges are allowable u/s. 37 and disallowable (partially) if TDS is not done;
- The contractor would have deducted PF from the the employees' salaries – so it becomes his income u/s. 2(24)(x);
- It is allowable to him u/s. 36(1)(va) if paid before due date;
- It is for the contractor to disclose in Cl. 20(b) if he is laible to tax audit – and not the Company;
- If Company has provided for it, it may have to be reported as “contingent liability debited to P&L Account” under Clause 21(g).

# CL. 21(B): TDS - ISSUES

## TDS on “Provisions”:

- Requirements of the Law:
  - Section 37: Allowance of expenditure “laid out or expended” for the purposes of business
  - ICDS X: Para 5: “Provision to be recognised when: (a) present obligation as a result of past event; (b) outflow of resources is reasonably certain; and (c) reliable estimate can be made.”
  - Chapter XVIIIB: (generally) TDS at the time of credit or payment whichever is earlier
  - Cl 21(b) of Form 3CD: Section 40(a)(i)/(ia): 30% Disallowance if TDS not done
- Provision for site or mine restoration, warranty on products sold etc. :
  - Provision allowable u/s. 37 rw ICDS X
  - Amount credited to a “provision” account – payee not identifiable
  - TDS – not workable
  - Disclosures in Form 3CD – by way of a note to Form 3CA/3CD: Give citations of cases where TDS is not required where the payees are not identified: e.g. IDBI v. ITO, City III (1) [2007] 107 ITD 45.

## CL. 21(B): TDS – ISSUES (CONT'D)

### Where TDS is not done on payments in kind:

- S. 194R: where the benefit is in kind, “ensure that the tax required to be deducted has been paid in respect of the benefit...”
- S. 194B/BA: where the winnings are in kind, “ensure that tax has been paid in respect of the winnings”
- S. 201: “where any person who is required to deduct any sum in accordance with the provisions of the Act **does not deduct** or does not pay, **or after deduction fails to pay**” – then assessee in default
- S. 40(a)(ia): “30% of sum payable on which tax is deductible at source under Chapter XVII-B and such tax **has not been deducted or, after deduction has not been paid...**”
- In S. 201, “does not pay” introduced w.e.f. 1-6-2002. Prior to that language same as S. 40(a)(ia). **CIT v. Hindustan Lever Ltd. 361 ITR 1 (Kar)** held that S. 201 is NA for TDS in kind. There is no deduction possible. Only payment has to be ensured. Same rationale may be applied to S. 40(a)(ia). Adequate disclosure in F. 3CA/3CD



## CL. 21(B): TDS – ISSUES (CONT'D)

### Whether reporting is required in case of short deduction?

- S. 201: “where any person who is required to deduct any sum in accordance with the provisions of the Act does not deduct or does not pay, or after deduction fails to pay **the whole or any part of the tax...**” – then assessee in default
- S. 40(a)(ia): “30% of sum payable on which tax is deductible at source under Chapter XVII-B and **such tax** has not been deducted or, after deduction has not been paid...”
- The words “whole or ay part of tax” missing in S. 40(a)(ia). Hence – disallowance is NA in case of short deduction. It applies only to complete non deduction.
- This view supported by: CIT v. S.K. Tekriwal (361 ITR 432)(Cal); CIT v. Chandabhoy & Jassobhoy (49 SOT 448) (Mum), UE Trade Corporation (India) Ltd. v. CIT (54 SOT 596) (Del) and Three Star Granites (P.) Ltd. v. CIT (49 taxmann.com 578) (Coch.) have held that short-deduction of tax is not subject to disallowance u/s. 40(a)(ia) of the Act.
- Disclosure note to Form 3CA/3CD is required.

# CL. 26: S. 43B

## Bonus or Commission – S. 36(1)(ii)

- S. 43B(c) – any sum referred to in S. 36(1)(ii)
- S. 36(1)(ii) – any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable as profits or dividend if it had not been paid as bonus.
- Q. often asked: Whether ex-gratia in the nature of “bonus”?
  - Exposure Draft of the GN on Tax Audit: Para 46.20: It may be noted that emoluments in the nature of good work reward, incentives or ex-gratia are not bonus or commission as contemplated under section 36(1)(ii) but are deductible under section 37 of the Act as held by *Delhi High Court in Shri Ram Pistons and Rings Ltd. 307 ITR 363 and Autopins (India) Ltd. 192 ITR 161.*
- Relevant Case Laws:
  - Subodhchandra Popatlal v. CIT [1953] 24 ITR 566 (Bom)
  - Raja Ram Kumar Bhargava v. CIT [1963] 47 ITR 680 (All)
  - Shahzada Nand & Sons v. CIT [1977] 108 ITR 358 (SC)

## CL. 26: S. 43B (CONT'D)

- CIT v. B. Ghosal [1980] 125 ITR 744 (Ker)
- CIT v. IISCO Ujjain Pipe & Foundry Co. Ltd. [1992] 196 ITR 707 (Cal)
- Shriram Pistons & Rings Ltd. v. CIT [2008] 307 ITR 363 (Del)
- Principles emerging out of the above decisions:
  - If Bonus or Commission forms part of the contract of employment AND is based on the employee's performance, it is Salary proper and not bonus or commission
  - If Bonus or Commission forms part of the contract of employment AND is based on the benefit to the employer (like profits or turnover), it is in the nature of bonus or commission
  - If Bonus or Commission does not form part of the contract of employment, generally it is bonus or commission. Delhi HC – facts not clear whether it formed part of contract of employment or not.

### **Professional Tax of employees – whether needs to be disclosed?**

- It is “tax” and hence, prima facie, covered;
- But, it is not a deduction otherwise allowable, hence not covered;
- It is deduction from employee salary, but not covered u/s. 2(24)(x) – not covered u/s. 36(1)(va) as well.

## CL. 26: S. 43B (CONT'D)

### Whether GST liability to be disclosed Gross of ITC or Net of ITC?

- In accounts, Liability account would show net of ITC;
- Actual payment in April will be net of ITC;
- If full effect of S. 145A is given, the deduction claimed for GST is also net of ITC:

	<u>Gross basis</u>	<u>Net basis</u>
■ Income $100+18 = 118$		100
■ Expense $50+9 = 59$		50
■ GST Payable. =. 9		0
■ Net Profit =. 50		50

- Correct disclosure – should be net basis.

## CL. 26: S. 43B (CONT'D)

### Whether S. 43B(f) applies to provision based on actuarial valuation?

- S. 43B(f): Any sum **payable** by the assessee as an employer in lieu of any leave at the credit of his employees:
- Amount debited to the P&L Account based on actuarial valuation
- Q: Is that “any sum payable”?
- Explanation 2 – For the purpose of clause (a), ..., “any sum payable” means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law.
- Tribunal decisions – Explanation 2 only for clause (a) and not for clause (f). Therefore clause (f) applies only to provision made for retired employees
- SC – Excide’s case – considered only the constitutional validity. The interpretation of the phrase “any sum payable” not subject matter before the SC.
- Disclosure of citations important in Form 3CD.

# CL. 27(A): CENVAT CREDIT

**Clause 27(a):** Amount of CENVAT credit availed or utilised during the year and its treatment in the profit and loss account and treatment of outstanding CENVAT credits in accounts:

- GN-Exposure Draft – Para 47.9:

It is pertinent to note that since implementation of GST from July 1, 2017, central excise duty has been subsumed in GST and is leviable only on six products viz. petroleum crude, diesel, petrol, aviation turbine fuel, natural gas and tobacco. Hence, reporting under this clause is restricted for only those assesseees who deal in these products.

- AY 22-23 GN does not have this paragraph
- Thus, information as regards GST credits is not to be supplied (if the exposure draft gets finalised)

# CL. 30C: GAAR

## **Clause 30C:**

***a) Whether the assessee has entered into an impermissible avoidance arrangement, as referred to in section 96, during the previous year? (Yes/No.)***

***(b) If yes, please specify:—***

***(i) Nature of impermissible avoidance arrangement:***

***(ii) Amount (in Rs.) of tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement:***

## **Guidance Note:**

- Para 56.5: The primary onus to establish that the transaction is an IAA is on the Revenue
- Para 56.13: The provisions are complex. Tax benefit arising to ALL parties together should be more than Rs. 3 crores
- Whether main purpose is tax benefit is an opinion
- Para 56.14: Suggested draft

## CL. 30C – GAAR (CONT'D)

- Para 56.14:

*“In the absence of access to the books of account and other records of various parties to arrangement and want of elaborate investigations beyond ordinary process of audit involved in determining whether the arrangement is an impermissible avoidance arrangement, and in determining the tax benefit in the assessment year relevant to the previous year under audit arising, in aggregate, to all the parties to the arrangement, we are unable to determine the view of the assessee regarding its/his entrance into any impermissible avoidance agreement as contemplated under section 96 of the Act, during the previous year”.*



## CL. 30C – GAAR (CONT'D)

### **What should the auditor report – as per GN?**

- Para 56.15(i): Whether the Department has considered any transaction as IAA? If any transaction in connection with that is made, the auditor is supposed to report.
- Para 56.15(ii): Whether any reference has been made to declare any transaction as IAA? If so, auditor has to report.
- Para 56.15(iii): Assessee's responses to show cause notices, filing of appeals, outcome thereof – should be considered by the auditor while reporting.

# CL. 31: S. 269SS/T/ST

## Section 269SS:

- Take or accept – loan or deposit [Cl. 31(a)]
- Take or accept – “specified sum” i.e. sum for transfer of immovable property (whether or not transfer takes place) [Cl. 31(b)]

## Section 269ST:

- Receipt otherwise than by cheque/bank draft [Cl. 31(ba)]
- Receipt by cheque not being account payee cheque/bank draft [Cl. 31(bb)]
- Payment otherwise than by cheque/bank draft [Cl. 31(bc)]
- Payment by cheque not being account payee cheque/bank draft [Cl. 31(bd)]

## Section 269T:

- Repayment of loan or deposit or specified advance made [Cl. 31(c)]
- Repayment of loan or deposit or specified advance received otherwise than by cheque [Cl. 31(d)]
- Repayment of loan or deposit or specified advance received by cheque which is not account payee [Cl. 31(e)]

## CL. 31: S. 269SS/T/ST (CONT'D)

- Practical difficulties – extensive notes to Form 3CA/3CD necessary.

### **However, Due Diligence by the Auditors essential:**

- Scrutiny of “Cash Account” / “Cash Book” – both receipts and payments. If found – reporting required
- On cash account / cash book scrutiny, if suspicious entries seen e.g. several entries of Rs.19,000 each for S. 269SS/T or Rs. 190000 each of S. 269ST (or the like) – make further enquiries and keep working papers
- S. 269ST – sorting of cash account / cash book dump based on:
  - the name of the payer (for aggregate from a person in a day);
  - Invoice number / P.O. number / party’s name / product description / PAN / Address (for a single transaction or single event)
- Quick Review of bank statements – whether any indication of a debit entry is other than NEFT / Clg / UPI. Should make enquiries and keep file notes of each type of transaction description in the bank statement.
- Take a system note, study internal audit report on the payment systems followed / cash withdrawals and deposits – keep extracts as part of working paper
- Review of transfer entries by way of JVs – part of ledger scrutiny of all advances / loans / deposits accounts
- Disclaimers / Limitations – Note to Form 3CA/3CD.

# CL. 44 - GST

## Reporting Requirement:

### Break-up of total expenditure of entities registered or not registered under GST

- S. No.
- Total Amount of Expenditure incurred during the year
- Expenditure in respect of entities registered under GST
  - Relating to Goods or services exempt from GST [ Nil rate+ exempt u/s. 11, 6 + non taxable supply]
  - Relating to entities falling under composition scheme
  - Relating to other registered entities
  - Total payment to registered entities
- Expenditure relating to entities not registered under GST

## CL. 44 – GST (CONT'D)

- Head wise / nature wise details of expenditure not intended to be given. Total expenditure (including purchases) to be given
- Non cash items like depreciation / bad debts – not to be reported.
- Transactions that tantamount to “supply” only to be reported. E.g. employee cost not to be reported
- Reconciliation with the revenue and capital expenditure as per audited accounts need to be maintained as part of working papers. The reporting will be of items for which invoices are received and recorded. There cannot be reporting of provisions made. This makes reconciliation more relevant.
- Disclosure by the Auditor:
  - Interpretation of “expenditure” – invoice wise or payment wise, fact that provisions are excluded, other interpretation issues
  - If client unable to furnish details – disclaimer and if possible reasons as stated by the assessee

**THANK YOU!**