



OVERVIEW AND ISSUES

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Background

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It was introduced by Finance Act 1984, Memorandum explained as under:

- ❖ “a proper audit for tax purposes would ensure that the ***books of account and other records are properly maintained***....It can also ***facilitate the administration of tax laws***.....The time of assessing officers thus saved could be utilised for attending to more important investigational aspects of a case”.

❖ Developments

- AY 1984-85 - Introduction of Tax Audit Provisions
- AY 1998-99 – Widened the scope under presumptive tax referred to in Section 44AD /44 EE / 44 AF

Background

- AY 1999-00 - Form 3CE and 3CC eliminated
 - Revision of Rule 6G of Income-Tax Rules, 1962
 - Revision of Forms 3CA, 3CB and 3CD
- AY 2004-05 - Scope enlarged for the business under presumptive tax referred to in Section 44 BB /44 BBB
- AY 2004-05 - Revision of all Forms
- AY 2006-07 - Significant change in Form 3CD
- AY 2008-09 - Deletion of requirement to furnish report with return
- AY 2013-14 - Mandatory E-filing of Tax Audit Report
- AY 2014-15 – Considerable changes in Form 3CD
- AY 2017-18 - Scope enlarged for the business under presumptive tax referred to in Section 44 ADA

Applicability



Applicability

- ❖ In case of business where total sales, turnover or gross receipt exceeds 1 crore.
- ❖ In case of profession total gross receipts exceeds 25 lakh (50 lakh A.Y. 207-18).
- ❖ Cases where taxable income is claimed lower than deemed income under sections 44AD, 44ADA, 44AE, 44BB or 44BBB.

Applicability

- ❖ 44AD: Eligible Business
- ❖ 44ADA: Profession
- ❖ 44AE: Special provisions for plying hiring or leasing of carriage goods.
- ❖ 44BB: Special provisions for non-resident shipping business
- ❖ 44BBB: Special provisions for non resident business of exploration, etc., of mineral oils.

Penalties



Penalties

Section 271B – *Failure to get accounts audited*

- ❖ Penalty lower of –
 - **0.5%** of sales, turnover or gross receipts of the relevant PY; or
 - Rs. 1,50,000
- ❖ Assessee not absolved of his obligation to get the accounts audited after payment of penalty
- ❖ Assessee required to get his books audited after default

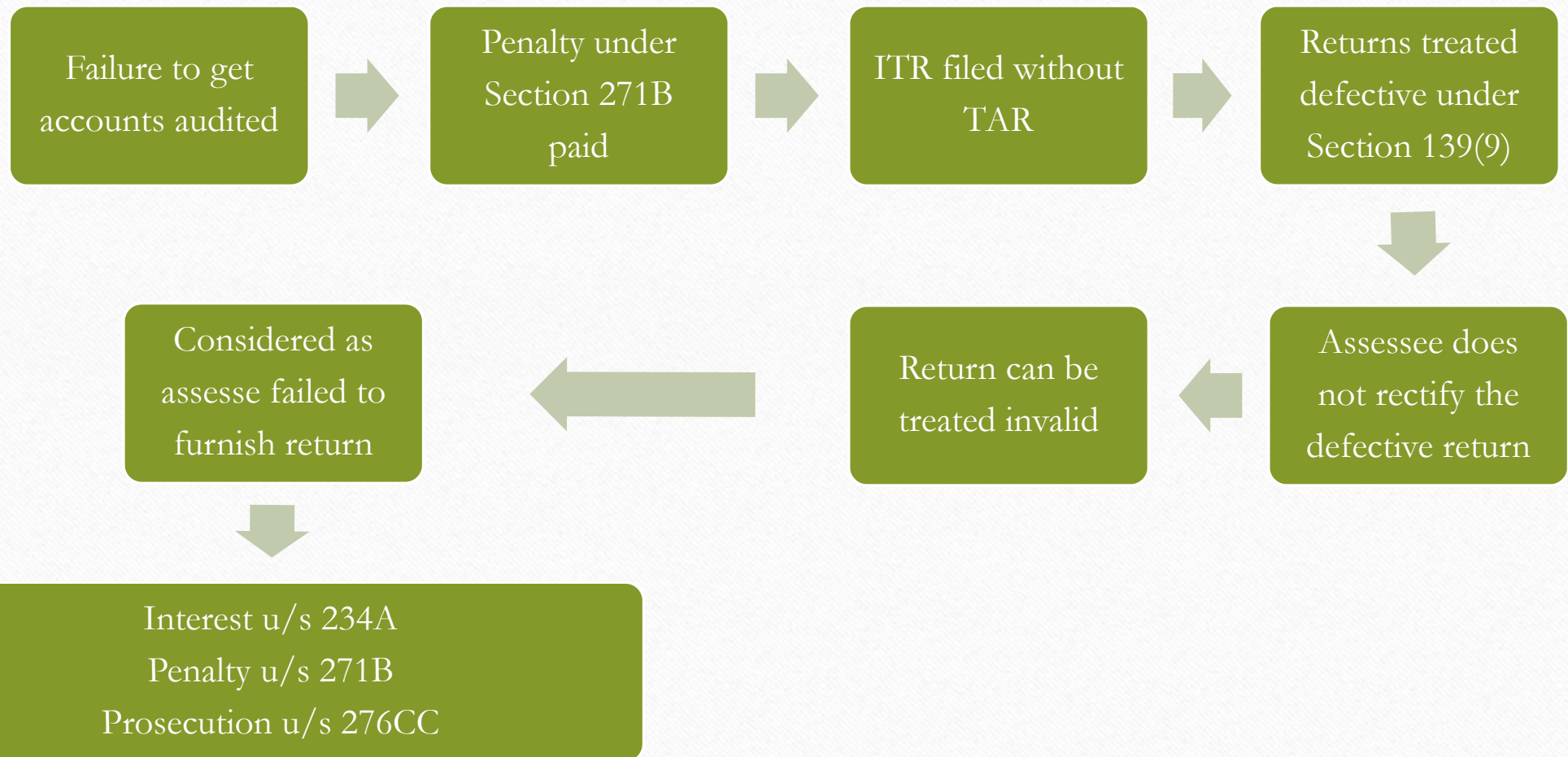
Penalties

Section 273B – *Penalty not to be imposed in certain cases*

- ❖ If assessee proves that there was a **reasonable cause** for default

- ❖ Situational examples –
 - Delay due to resignation of Tax auditor
 - *Bonafide* interpretation of the term “Turnover”
 - Death or physical inability of partner-in-charge of accounts
 - Natural calamities

Flow – Accounts failed to be Audited



Reporting requirements

| Sr no | Particulars | Forms |
|-------|--|-------|
| 1 | Person carrying on business or profession and required to under any other law to get his accounts audited. | 3CA |
| 2 | Person carrying on business or profession and not covered in point 1 | 3CB |
| 3 | Particulars to be furnished under section 44AB shall be in this form | 3CD |
| | | |

Issues



Applicability - Illustration

- ❖ An assessee has 3 businesses. The turnover of business A, B and C being Rs 90 lakh, Rs 80 lakh and Rs 65 lakh, respectively. Separate books of accounts are maintained for all businesses.
- ❖ Will tax audit under Section 44AB be applicable?
- ❖ Limits of sales / turnover / gross receipts for an assessee to be calculated for all businesses carried on by him
- ❖ The aggregate turnover from all businesses exceeds the Rs 1 crore limit, hence, tax audit applicable
- ❖ Particulars of all businesses be reported in a single Form No. 3CD?
- ❖ Two possibilities -
 - Separate Tax Auditor appointed for individual businesses
 - One Tax Auditor for audit of all businesses

Applicability - Illustration

- ❖ A foreign company has a business income of Rs 1.5 crore in India. It does not have a permanent establishment in India.
- ❖ Whether the company is required to get its books audited under Section 44AB?
- ❖ Para 6.3 of the GN – Section 44AB does not distinguish between a resident or a non-resident
- ❖ Non-resident assessee is required to get his accounts audited and furnish report under Section 44AB, if its turnover exceeds the prescribed limits
- ❖ Since, the business income of non-resident exceeds limit of Rs. 1 crore, provisions of Section 44AB to apply

Section 44AD

- ❖ Profits and gains of eligible business of eligible assessee deemed to be 8% of :
 - Total turnover, or Higher income claimed to have been earned
- ❖ Applicable to : Assessee, who is resident in India
 - Individual, HUF and Partnership Firm but not Limited Liability Partnership (LLP)
- ❖ Not claimed deductions under Sections 10A, 10AA, 10B, 10BA or Part C of Chapter VIA in relevant year
- ❖ Not applicable to :
 - Person carrying profession referred to in Section 44AA(1)
 - Person earning / carrying commission or brokerage or agency business
 - Those engaged in any business except plying, hiring or leasing goods carriages referred to in Section 44AE

Section 44AD – CBDT Circular 20 June 2016

- ❖ *Section 44AB of the Income-tax Act ('the Act') makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed one crore rupees.*
- ❖ *However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1) of the Act, **he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed two crore rupees.** The higher threshold for non-audit of accounts has been given only to assesseees opting for presumptive taxation scheme under section 44AD*

Section 44AD

❖ *From AY 2017-18 – Bar of 5 years*

- ❖ Presumptive taxation scheme not available for 5 FYs subsequent to FY in which the assessee voluntarily does not offer his income to tax under Section 44AD
- ❖ Non-applicability of Section 44AD on account of turnover exceeding threshold limit in any year – not to be considered as default so as to exclude the assessee from benefit of presumptive taxation in later year, if applicable
- ❖ In any of the 5 subsequent years where Section 44AD is not applicable, assessee to maintain books of accounts and tax audit applicable

Section 44AD - Issues

- ❖ When should first year of declaration under Section 44AD be – only after amendment or even before?
- ❖ How 5 years period to be computed – starting from each year, or as block?
- ❖ How should 5 years of exclusion be computed - Each year or block?

Section 44AD - Illustration

| Assessment Year | Taxation Scheme adopted by assessee |
|-----------------------|--|
| 2017-18 | Opts for presumptive taxation scheme |
| 2018-19 | Opts for presumptive taxation scheme |
| 2019-20 | Voluntarily Opts <i>OUT</i> of presumptive taxation scheme |
| <i>2020-21</i> | <i>Presumptive taxation scheme not available for AYs 2020-21 to 2024-25</i> |

Documentation

- ❖ Important for Peer Review as Tax Audit is an attest function
- ❖ Primary responsibility of Management
- ❖ To be certified by the management
- ❖ Checklist for 3CD to be separate
- ❖ SA 230
- ❖ Write what you do and do what you write

Revised Form 3CD

- ❖ General Notes and Disclaimers
- ❖ Particulars in F.3CD to be compiled, prepared and quantified by the assessee
- ❖ We have reported on the particulars given in F. 3CD by the A, applying test checks considered appropriate to the books of account generated by the computer program and the relevant documents under clause 11 and as certified by the A where considered necessary
- ❖ The figures in F. 3CD alongwith Annexures have been verified by us with the books of account and other records, but not investigated to ascertain any transactions outside the books or to examine genuineness of the entries in the books which prima facie appear to be genuine.

Clause 3

- ❖ In case of business reorganization during the P.Y., new PAN should be stated.
- ❖ Clause 4
- ❖ Whether A is liable to pay Indirect taxes like Excise Duty, Service tax, sales tax, customs duty, etc., if so, Reg. No. is required to be furnished.
- ❖ Broadly, all Indirect taxes covered. Tax auditor may not be an expert in all IDTs. He may not know whether A is liable to pay IDT. In such a case, can he rely on expert opinion?
- ❖ Clause 5 Status

Clause 8

- ❖ Relevant clause of S. 44AB under which the audit has been conducted-
- ❖ Total turnover, sales or gross receipts as the case may be exceeds Rs. 1 crore
- ❖ In the case of a person carrying on profession, gross receipts exceed Rs. 25 lakhs(50 lakhs from A.Y. 2017-18)
- ❖ Person covered by presumptive tax declaring lesser income than deemed income under the applicable section
- ❖ A person may be covered under more than one clause

Clause 13 – Method of accounting

- ❖ The effect on Financial Results owing to the change in method of accounting or given disclaimer should be quantified
- ❖ No method of Accounting prescribed in AS prescribed under section 145
- ❖ **Suggested Note** - *We have been informed by the Assessee that, the Central Government has not prescribed the Accounting Standard in relation to the method of accounting to be followed by any class of assesses or in respect of any class of income. However, we may add that, the Assessee has complied with the provisions of the Accounting Standards prescribed pursuant to 145, viz.*
 - A. *Accounting Standard I relating to disclosure of accounting policies and*
 - B. *Accounting Standard II relating to disclosure of prior period and Extraordinary items and changes in accounting policies.*

Clause 14 – Method of valuation of stock

- ❖ Section 145A - “Inclusive method” as against “Exclusive method” - AS 2
- ❖ ICAI Guidance Note on “Tax Audit u/s. 44AB” mentions (with an illustration) that in both methods, impact on profit/loss is Nil

Clause 15 - Capital asset converted into stock in trade

- ❖ The cost of acquisition is required to be reported. The cost of acquisition as per books of account is to be mentioned.
- ❖ While verifying the cost of acquisition, principles in AS 10 should be considered.
- ❖ The amount recorded in the books of account at which asset is converted into stock-in-trade should be stated.
- ❖ The valuation of stock-in-trade is to be examined with reference to AS 2.
- ❖ Non-compliance with AS 10 or AS 2 is to be suitably reported in the main audit report.

Clause 15 - Capital asset converted into stock in trade

- ❖ To verify the basis of arriving the FMV and a suitable disclosure to be made, like –

“During the year under consideration, a land admeasuring ____ is converted into stock-in-trade and the fair market value of the same as on date of conversion is based on the valuation report obtained from _____”

- ❖ Compliance with SA 500 – Audit Evidence should be considered.

Clause 16 - Amounts not credited to Profit & Loss Account

- ❖ Section 28 shall also include any sum received for not carrying on any activity under an agreement in relation to any business *or profession.* (w.e.f. AY 2017-18).
- ❖ The words ‘admitted by the concerned authorities’ would mean ‘admitted within the relevant previous year’. However, if the assessee follows cash basis of accounting the admittance of claim without actual receipt will have no significance.
- ❖ Where assessee follows cash basis of accounting, whether details of escalation claims accepted without actual receipt is to be reported?

Clause 16 -Amounts not credited to Profit & Loss Account

- ❖ Whether the following escalation claims constitute claims accepted -
 - Claims merely made by the assessee
 - Claims under negotiations
 - Claims which are sub-judice
- ❖ Case law to be referred CIT v. Hindustan Housing & Land Development Trust Ltd. (1986) 161 ITR 524 (SC)

Clause 16 - Amounts not credited to Profit & Loss Account

- ❖ Does the phrase 'Capital Receipts, if any' includes capital contribution like gifts, share capital etc?
- ❖ Does 'any other income' include even 'income from other sources'?
- ❖ In case of incomes exempt for individuals, should the same be disclosed under 'any other income'?
- ❖ Should interest on Fixed Deposits or Other Incomes (like rentals) which are reduced from cost of fixed assets /Capital WIP be mentioned?

Clause 17 - Transfer of Land & Building at a value lesser than Stamp duty value

- ❖ The auditor should obtain a list of all properties held and transferred during the year. The same should be verified from statement of profit and loss or Balance Sheet.
- ❖ Amount of consideration received or accrued should be as disclosed in the books of account.
- ❖ The auditor should also obtain a copy of registered sale deed for reporting the value adopted or assessed or assessable.
- ❖ Where the property is not registered, the auditor may have to rely on third party experts like lawyer or solicitor representation. In such cases, compliance with SA 620 – Using the Work of an Auditor's Expert needs to be kept in mind.

Clause 17 - Transfer of Land & Building at a value lesser than Stamp duty value

- ❖ What should be the manner in which provisions of Section 43CA is to be applied in case of builder adopting Percentage completion method for recognition of revenue ?
- ❖ Whether the comparison of Stamp duty Value with Actual consideration for revenue recognition based on percentage completion method should be at each stage and for each year as on date of transfer or any other date ?
- ❖ Whether leasehold right / development rights / TDR / FSI etc would be covered under this clause?

Clause 19 - Amounts admissible as deductions from 32AC to 35E

- ❖ The amount debited to the Profit & Loss Account and the amount actually admissible in accordance with the said sections should be mentioned.
- ❖ The eligibility of the expenditure/payment for deduction and compliance of conditions prescribed in the said sections should be ensured.
- ❖ Amounts not debited to Profit & Loss Account but admissible under any sections mentioned in the clause have to be stated.

Clause 19 - Amounts admissible as deductions from 32AC to 35E

- ❖ Is it enough to rely on such auditor's report where audit is required under certain sections to claim deduction and separate auditor is appointed for this purpose, ?
- ❖ How will the auditor rely on the work done by such other auditors / experts for the work done by them?
- ❖ What should be the extent of reliance to be placed?
- ❖ What would be the stand of a Tax Auditor in case such report is unavailable?
- ❖ Where auditors have changed, can the auditor rely on previous year's computation and audit report with respect to sec 35D, 35DD, 35DDA etc or should scrutinize expenses incurred in earlier years?

Clause 20 - Employee benefit

- ❖ The auditor should obtain a list of various contributions recovered from employees. The ledger account of contributions should also be reviewed.
- ❖ The documents relating to provident fund and other welfare funds as well as agreements under which employees have to make contributions should be verified.
- ❖ The auditor should maintain the details regarding nature of fund, amounts deducted, due date of payment, actual amount paid and actual date of payment in his working papers.

Clause 20 - Employee benefit

- ❖ Is it mandatory to disclose that employers have not deducted/ collected Provident Funds from Employees?
- ❖ In case of Non-Corporate assessee following cash system of accounting , if provident fund contributions are deposited before end of relevant Previous year but remitted within statutory due dates, will the same be allowed as deductions?
- ❖ How can a Tax Auditor verify the details of payments of Provident Fund etc. in Tax Audit of sub-contractor particularly when liability is on main employer?
- ❖ As mentioned in the previous slide, different views have been taken by various courts as to the meaning of 'due date'. A note specifying the reliance placed on any case law may be added to avoid ambiguity.

Clause 21 - Admissibility of certain deductions

- ❖ Capital expenditure is not defined in the Act. However, different tests have been applied by courts to decide whether the nature of expenditure is capital or not.
- ❖ The Tax Auditor may not be aware about all the laws of the land. Also, he is not an expert to decide the nature of payment (as to whether it is prohibited by any other law or not). The Tax auditor should distinguish between compensation and penalty.
- ❖ Compensation are allowable business expenditure, whereas penalty is not. -[**Malwa Vanaspati & Chemical Co. v CIT**]
- ❖ Section 36(1)(iii) : While determining the allowability of interest, the requirements of Accounting Standard 16 - Borrowing costs is required to be kept in mind..

Clause 21 - Admissibility of certain deductions

- ❖ Payments to non Residents under Section 40(a)(ia): Can the Tax Auditor rely on CA certificate for foreign remittances or should decide for each and every foreign payment based on underlying documents/agreements ?
- ❖ The provisions of section 40(a)(ia) can be invoked only in the event of non-deduction of tax at source but not for lesser deduction (**DCIT vs Chandabhoy & Jassabhoy**)
- ❖ Disallowance under section 14A: While carrying out the examination of the details furnished by the assessee, the tax auditor can rely on Management Representation letter. Standard on Auditing 580 on 'Written representation' needs to be looked into.
- ❖ The Auditor should verify the list of cash payments in respect of expenditure of more than Rs. 20,000/- and should include list of payments exempted under Rule 6DD.

Clause 22 - Amounts inadmissible under Section 23 Micro Small Medium Enterprise Development Act, 2006

- ❖ Where the auditor is issuing report in Form 3CB, if no disclosure is made by the auditee in financial statements about the information as prescribed u/s 22 of MSMED Act, an appropriate qualification in Form 3CB should be given.
- ❖ The auditor should obtain and review the full list of suppliers which fall within the definition of 'supplier'. It is the responsibility of the auditee to classify and identify the suppliers who are covered by this Act.
- ❖ Verify the interest paid or payable under section 16 of MSMED Act from books of account on test check basis

Clause 22 - Amounts inadmissible under Section 23 Micro Small Medium Enterprise Development Act, 2006

- ❖ What would be the disallowance in case the auditor is liable to pay any interest under MSMED Act, 2016 but he has not provided the interest in his accounts?
- ❖ In such a case, what would be the situation when he actually pays and claims such interest?
- ❖ Where the auditor has relied on the auditee for classifying and identifying the suppliers covered under the MSMED Act, 2006 whether such reliance placed on the auditee is enough to discharge the onus?

Clause 23 - Payments to Related Parties

- ❖ Whether the payments which is in nature of capital expenditure made to Related Parties are covered in reporting ?
- ❖ How can a tax auditor ascertain the details of the related parties and how can such transactions be verified ?
- ❖ Domestic Transfer Pricing provisions.

Clause 26 - Disallowance under section 43B of the Act

- ❖ Is Profession tax liability required to be reported under section 43B ?
- ❖ Where taxes, duties etc. referred to in Section 43B are paid after tax audit is completed but before due date of filing returns, how should the same be dealt with by a Tax Auditor ?
- ❖ Whether the employee contribution to the registered Provident Fund or superannuation fund or gratuity fund or any other fund are covered the said clause?

Clause 28 - Purchase of shares of company for inadequate consideration

- ❖ Standard on Auditing – 620 “Using the work of an Auditor’s expert” may also apply in case where a valuation report is obtained to determine the FMV of the shares in case of unquoted instruments.
- ❖ The Auditor should obtain a list of shares received and verify the same with the books of accounts. Such shares will be reflected in the books of accounts under “Investments” or “Stock in trade”.
- ❖ When the shares are issued for no consideration, then the Tax Auditor can verify the same by share certificates, demat account statements etc. as the same will not be reflected in the books of accounts.

Clause 29 - Issue of shares at a price higher than the FMV

❖ The following information should be maintained in the working papers:

- Name and status of person to whom shares have been issued
- PAN of the person, if available
- Nature of shares (Quoted in RSE / URSE / unquoted)
- No. of shares issued
- Consideration received
- Fair Market Value as per Rule 11UA(1)(c) / 11UA(2)
- Face value of shares
- Amount taxable u/s 56(2)(viib)

Clause 29 - Issue of shares at a price higher than the FMV

- ❖ What would be the consequences if the company has issued shares to residents and non-residents under private placement at a price which is higher than the FMV of the shares?

Clause 32 - Details of brought forward loss or depreciation

- ❖ Is it correct to merely state ‘information is not readily available and hence not furnished’, in case where the assessments are pending at various stages of litigation,
- ❖ Any assessment, rectification, revision or appeal proceedings pending at the time of tax audit have to be disclosed under remarks column under sub-clause (a). If orders are yet to be passed, the same can be disclosed along with impact thereof, if material.

Clause 36 - Tax on distributed profits u/s 115-O

- ❖ Details of tax on dividend declared, distributed or paid during the Financial Year under audit i.e. F.Y. 2015-16 should be reported.
- ❖ The gross amount of dividend is to be reported in sub-clause (a) and the reduced amount is to be reported in sub-clause (b) and (c)
- ❖ Information about the date of declaration/distribution of dividend or payment of dividend is not required to be given.
- ❖ How to report if dividend is declared for the relevant previous year after the tax audit is completed?

Clause 36 - Tax on distributed profits u/s 115-O

Calculation of dividend

| | |
|---|---------|
| Amount of dividend | INR 100 |
| Less: Amount of tax on dividend (Taxable @ 15%) | INR 15 |
| Amount of outflow | INR 85 |

Tax on dividend is on gross basis i.e. $\text{Amount of tax on dividend} / \text{Amount of outflow} (15/85) = 17.647\%$

| | |
|---------------------------|---------|
| Tax on gross basis | 17.647% |
| Add : Surcharge | 12% |
| Add : Cess | 3% |
| Effective Tax on Dividend | 20.357% |



Thank You!

