

Case studies relevant for TAX AUDIT

For JB Nagar Study Circle

11th September 2022

Case studies

Case Study 1: Clause 34A & 21(b)

- Proviso to sec 40(a)(ia) - report only the amount on which TDS needs to be deducted

- A Co. has to pay ₹ 4 cr as professional fees to 4 different entities and has deducted TDS only towards 3 deductees and deposited to Government.

- As regards to the 4th deductee, since the amount of tax along with interest was deposited by deductee and certificate was also issued to the deductor, A Co was not in default

- While reporting under clause 34A of the Tax audit report A Co reported TDS deductible and TDS deducted which resulted into reporting of short deduction of TDS which factually is not the case

- The consequences of the same can be on disallowance u/s 40(a)(ia) reported in clause 21(b)

- How to report the said compliance of 40(a)(ia) of the Act

Case Study 2: Clause 11: Discrepancy in MIS & Bank stock statement and accounts

- While conducting an audit, it was observed that the stock statement submitted to the bank and stock statement as per MIS report submitted to the management was not reconciling with the stock value recorded in the books of accounts.
- Whether an Auditor should rely on such a statement submitted to the Bank? - -maintained / prescribed / examined
- As per the GN the auditor has to check whether the auditor has maintained the prescribed books of accounts?
- So does this Bank Statements and MIS reports forms part of prescribed books of accounts under the law?
- Whether an Auditor has to rely on information beyond books of accounts?

Suggestion:

The auditor should either check ,wherever possible , by himself the accuracy of such data.

The auditor should check the level of examination done by consultant from such statement

The Auditor should check the capabilities and competence of such consultant.

But still after all these the Auditor's Responsibility to arrive at opinion will not reduce.

Case study 3: GAAR clause 30C Demerger of a loss making company and merging it with the Profit making company

A Ltd: A logistics company having network in major parts of India

B Ltd: Logistics company, subsidiary company of A Ltd. formed for acquiring business of different networks

B Ltd. had different units and all loss making units. A Ltd wants to acquire the business from B Ltd. of a certain network where A Ltd. is not still have reached which will in turn benefit them after acquisition.

The Scheme was approved on 27.10.2019 with effective from 01.04.2018

Co. A & Co B filed its return before the scheme was approved and claimed the losses of the undertaking independently without giving an effect to demerger.

Whether Co. A will be able to claim the loss of demerged Co. for the previous assessment years as same is reported in c/f scheduled of Co. B in past years

Whether Co. A will be able to claim TDS credits in respect to income on which TDS is deducted in Co B and reflected in 26AS of Co B?

Whether Co. B will be able to reduce the losses already claimed?

Considering following commercial substance which are attached to the said arrangement whether GAAR provisions can be attracted and whether reporting is required under clause 30C

This Scheme of Arrangement is expected to enable better realisation of potential of the businesses and yield beneficial results and enhanced value creation for the Companies, their respective shareholders, creditors, lenders, consumers and employees.

The rationale for the Scheme is set out below:

- a) The proposed demerger will result in consolidation of logistics business of Co. A and Co. B in a single entity;
- b) It will facilitate in streamlining the operating structure, pave way for expansion and smooth conduct of Co. A's current operations by adding similar lines of business;
- c) It will help in achieving and sustaining competitiveness and development of internal core competencies of the Companies in the long term;
- d) Synergies arising from the proposed demerger are expected to bring in cost savings in marketing, selling and distribution expenses as well as give benefit of economies of scale to Co. A.

Case study 4: GAAR clause 30C

AB PVT LTD. – OWNED BY A & B

CD PVT LTD. – OWNED BY WIVES OF A & B i.e. C & D

AB PVT. LTD. has huge amount of accumulated profits

Whether loan given by ABPL to CDPL will be considered as Deemed Dividend?

Whether SAAR will apply or GAAR?

In this case if there are two options with ABPL to pay off this accumulated profits i.e. either buyback the shares wherein the Co. will pay taxes @ 20 % and to pay dividend wherein the owners will pay tax @ 30%? Whether can this be GAAR?

Case study 5: GAAR clause 30C

A Ltd. – Holding Co.

B Ltd. – Subs Co. (listed entity)

A Ltd. transfers shares of B Ltd through exchange paying STT making it eligible to claim lower tax rate benefit

Major asset of B Ltd comprises of Land of 25 acres.

Whether such transaction can be a impermissible transaction

Case study 6: GST reconciliation clause 44

- Whether Breakup of total expenditure is required to be given or can be restricted to revenue and capital expenses
- Revenue and capital expenditure may be given (i.e. Head-wise / nature wise expenditure details not reqd).

- Whether the following expenses should be reported?
 - Depreciation
 - Bad debts
 - Expenses like Salary as per SCH III which are not supply as per GST
 - Ad hoc provision of expenses like Brokerage and commission
 - Whether Doctors whose services is exempt are oblige to report?

Type of Expenses	Reportable or Not?	If Yes where?	Remarks
Salary	NO	NA	As no supply as per SCH III

Depreciation	NO	NA	Not an expenses, it's an allowance
Bad Debts	NO	NA	Not an expenses,
Provision for Commission or any other expenses where payee is not known	YES	Unregistered Column	Auditor should add an observation that such amount included in this column which pertains to this category.
Loss due to theft like of stock or cash	NO	NA	Auditor should add an observation that such amount is not included in this column which pertains to this category.
Expenses paid by the Employees and reimbursed to them and paid by the employees to regd. dealer	YES	Registered Dealers	NA

Case study 7: Section 14A - Clause- 21h: Amount of deduction inadmissible in term of section 14A:

An explanation is inserted to clarify that- disallowance of expenditure be made even in case where there is no Exempt income

This Amendment no way states the disallowance is to be done even in case there is no expenditure.

EXEMPT INCOME	EXPENSES DIRECTLY REALTED TO EXEMPT INCOME	DISSALLOWANCE OF EXPENSES	REMARKS
80,000/-	1,00,000/-	1,00,000/- plus 1 per cent of the annual average of the average of opening and closing balances of the investment	AS PER SEC 14A
NIL	50,000/-	50,000/- plus 1 per cent of the annual average of the average of opening and closing balances of the investment	AS PER SEC 14A
1,00,000/-	NIL	1 per cent of the annual average of the average of	AS PER RULE 8DD

		opening and closing balances of the investment	
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Case study 8: C/f of loss of Virtual Digital Assets

Whether losses can be carried forward or not?

(As the amendments are applicable from 1st July 2022)

A.Y.	TOTAL GAIN	TOTAL LOSS	TAXBLE GAIN/(LOSS)
2020-21	1,00,000/-	50,000/-	50,000/-
2021-22	1,00,000/-	2,00,000/-	(1,00,000/-) CAN BE C/F AS PER APPLICABLE LOSSES
2022-23	50,000/-	1,00,000/- (UPTO 30.06.2022)***	(50,000/-) CAN BE C/F AS PER APPLICABLE LOSSES

***AS THE NEW PROVISIONS ARE APPLICABLE FROM 01.07.2022

Case study 9: Whether Business and profession T/O to be considered separate or not?

If a professional is into business of selling books and also into profession training

Profession T/O = 40L

Books selling business T/O = 70L

Whether audit is applicable since T/O is > 1.00 Cr.

If books selling business T/O exceeds 1.1 cr then there will be an Audit applicable for both profession and business

Case study 10: Change in method of valuation of options T/O for tax audit by ICAI pg. 17 as follows.

Table 1 : Example of calculation of turnover of Futures:

Future	Units	Buying Rate (C)	Selling Rate (D)	Total Sell (E=BxD)	Total Buy (F=BXC)	Turnover (G)
Nifty	50	₹ 16,800	₹ 16,250	₹ 8,12,500	₹ 8,40,000	₹ -27,500
Tata Steel	425	₹1,048	₹ 1,290	₹ 5,48,250	₹ 4,45,400	₹ 1,02,850
Bank Nifty	50	₹ 35,000	₹ 35,000	₹ 17,50,000	₹ 17,50,000	₹ –
Total Turnover						₹ 1,30,350

For Options is now same as Futures after changes in Guidance Note

(for PPT yellow colour are highlighted are answers which should be animated)

Script Name	Option type	Lot Size	Purchase Value	Sales Value (premium recd on sale)	Gain/(Loss)	Turnover	Turnover as per GN 2014
(1)	2	3	4	5	6	7 = 5 - 4	8 = 5 - 6
ABC	CALL OPTION	500	40,000	50,000	10,000	10,000 (Note - 1)	60,000 (Note-2)
PQR	PUT OPTION	500	25,000	22,500	(2500)	2500	25,000
XYZ	CALL OTION (NOT SQUARED OFF)	500	-	30,000	-	30,000 (Note-3)	30,000
Total						42,500	1,15,000

(i) Premium received on sale of options is also to be included in turnover. **However, where the premium received is included for determining net profit for transactions, the same should not be separately included.**

(ii) In respect of any reverse trades entered, the difference thereon, should also form part of the turnover.

Note -1: Turnover = As premium received is included for determining profit/loss so it's not included in turnover i.e. Absolute Profit/Loss = 10,000/-

Note -2: Turnover = Premium received on sale 50,000 + Absolute Profit/Loss Rs. 10,000 = 60,000

Note -3: Turnover = Premium received on the deemed sale of that contract on the expiry date, premium received is not included in determining profit/loss. {SEBI mandates physical settlement if a trader holds a position in any of the stock F&O contracts on the expiry date if the contract is not squared off.}

Case study 11:
Deemed dividend

Mr. A is a managing director in a company. Mr. A had provided his personal properties as collateral to banks and financial institutions of the company for borrowing loans by company for furtherance of its business. Mr. A also provided his personal guarantee. The company borrowed loans worth Rs. 200 crores which were utilized for its working capital requirements. The company paid certain amount to Mr. A as security deposit against mortgage of his personal properties which was disclosed under recoverable advances in the accounts of the company.

The Assessing Officer was of view that the amounts received by Mr. A from the company were liable to be taxed under section 2(22)(e) as deemed dividend in the hands of the assessee.

Do you think AO correctly treated Mr. A in adding such amounts received by him as deemed dividend?

Whether commercial substance and unintended tax evasion due to tax planning is acceptable?

Case study 12:
Capital Rights Taxability

Mr A got BA degree from Stanford University in computer science in 2015, he has developed mobile application “MGYAN” which is used by 2.00 lacs users and is accepted by State Government.

Over the period of years Mr. A had an idea of developing digital tutoring platform and personalize learning experience for young students. Mr. B (“partner “) approached Mr. A and both principally agreed in verbal terms to develop such application by incorporating AB MGYAN Pvt. Ltd where Mr. A was major shareholder.

However, since both could not come to agreement of common terms Mr. B formed a separate entity and transferred 1180 confidential files fraudulently (which includes education content, product designs, business, HR & marketing plans, etc) without knowledge of Mr. A. The matter went for investigation before Economic offence wing of Police, in mid of raid to shock of querist, investigation was transferred to Cyber Cell. Mr. A therefore approached H’ble Bombay High Court for issuance of writ of mandamus under Article 226 of Constitution and order re-transfer of investigation from Cyber cell to Economic offence wing

Mr. A has decided to take this investigation cum litigation to logical conclusion in order to compensate for his personal injuries

In meanwhile Mr. B has agreed for out of court settlement and pay compensation to Mr. A for following reasons as agreeable between parties

A) Compensation for personal injuries due to impairment of personal reputation before Investor, mental agony hardship and sufferings as querist spent years of efforts in developing and validating this idea and identifying partner

B) Compensation for unfair trade practices of stealing aforesaid Idea leading to permanent loss of business value

C) Compensation for relinquishment personal right to sue against criminal proceedings

Now Mr. A has following queries

A) Tax implication on receipt of aforesaid compensation?

B) Whether the amount shall be taxed to company or in individual hands of Mr A Personal / business

Reporting in Clause 16 (e) capital receipt and not to be Amounts not credited to the profit and loss account

(as not taxable capital receipt so give Remarks in Form 3CA/3CB and not add under capital receipt otherwise CPC will add to income)

Case study 13: 115BAA disallowance v/s sec 32

A Ltd, a newly incorporated Mfg. company in AY 2014-15 has booked losses and depreciation including additional depreciation and carried forward these losses AY 2021-22 which are as follows:

A.Y.	Profits	b/f business Losses	Unabsorbed depreciation	Additional Depreciation (included in depreciation)
2014-15	NIL	75,00,000/-	2,25,00,000/-	85,00,000/-
2015-16	NIL	85,00,000/-	2,75,00,000/-	85,00,000/-
2016-17	NIL	95,00,000/-	2,95,00,000/-	85,00,000/-
2017-18	3,90,00,000/-	-	-	-
2018-19	NIL	30,00,000/-	1,30,00,000/-	3,00,000/-
2019-20	1,40,00,000/-	-	20,00,000/-?????	3,00,000/-?????
2020-21	While opting the new scheme whether Co. will have to forgo additional unabsorbed depreciation.? Whether Co. will be right to say that while reporting under clause 32 the co. has already absorbed additional depreciation? so that the remainder ₹ 20,00,000/- is the normal unabsorbed depreciation?			

Case study 14: NEW TAX REGIME OR OLD REGIME:

ABC Ltd. have MAT credit entitlement to the extent of Rs 20 crores and brought forward business & depreciation loss is Rs 60 crores (As on 31st March 2019).

- As informed to us, ABC LTD. has made investment into cold chain warehouse facility for which deduction under Section 35AD is available to set off against profit from cold storage business or other specified business but if we are proposing to avail new tax regime the benefit of the same shall not be available.
- Please refer to working mentioned in the next page wherein tax working is worked out which will help management in evaluating whether to opt for new corporate tax rates or remain with the current tax regime
- Whether while opting new Scheme MAT credits will be allowed under new scheme?
- Whether loss under 35AD will be allowed to set off under new scheme?
- Whether carry forward losses will be allowed or Not?
- What will be the Net Difference after opting New scheme and Old scheme where?

Let's do one exercise to find out what will be beneficial to the co. having such huge carry forward losses and MAT credit and losses under 35 AD:

(for PPT yellow colour are highlighted are answers which should be animated)

As per old scheme:

Particulars	FY 20	FY21	FY22	FY23	FY24
NP as per Books	-20	100	120	150	200
MAT Rate	15%	15%	15%	15%	15%
Mat on Above-A	0	15	18	23	30
NP as per Tax books	-20	100	120	150	200
Less: Revenue expenditure capitalized	20	25	30	30	30
Less: Sec 35AD **		20			
Tax profit	-40	55	90	120	170
Carried forward loss available	-60	-100	-45	-	-

Net Income/loss after brought forward loss	-100	-45	45	120	170
Tax profit	-	-	45	120	170
Tax Rate	30	30	30	30	30
Normal Tax on Above-B	-	-	14	36	51
Tax liability (Higher of A or B)	0	15	18	36	51
Difference Between A & B	-	15	4	-14	-21
Mat Credit available/(availed)	-	15	4	-14	-21
Net Tax after taking MAT credit	-	15	18	23	30
Mat Credit Brought forward	22	22	37	41	27
Total MAT credit available/utilised	-	15	4	-14	-21
MAT Credit Forward	22	37	41	27	6
Mat Credit utilised					
Effective Tax Rate (Tax/Net profit)	-	15	15	15	15

(for PPT yellow colour are highlighted are answers which should be animated)

Effects If the Co. opts for new scheme

Particulars	FY 20	FY21	FY22	FY23	FY24
NP as per Books	-20	100	120	150	200
Mat on Above	NA	NA	NA	NA	NA
NP as per Tax books	-20	100	120	150	200
Less: Revenue expenditure capitalized	20	25	30	30	30
Less: Sec 35AD	-				
Tax profit	-40	75	90	120	170
Carried forward loss available for Set off	-60	-100	-25	-	-
Net Income/loss after brought forward loss	-100	-25	65	120	170

Net Tax profit	-	-	65	120	170
Tax Rate	22%	22%	22%	22%	22%
Tax on Above	-	-	14	26	37
Effective Tax Rate (Tax/Net profit)	-	-	12	18	19

(for PPT yellow colour are highlighted are answers which should be animated)

Net difference after above effects

Tax outflow in Old Regime	86
Tax outflow in New Regime	78
Net outcome	7

Miscellaneous Questions : clause wise

Clause 10

Business Nature – Inter Company Deposits we need to bring for the importance of business reference

- This type of nature of business should be reported properly as this is the crucial point at the time of the assessment and to be considered as Deemed dividend

Case Study:

A Co. lends money to its sister concern which is not its principal business and earns finance income due to their common connection but it's at arm's length rate.

While filling the TAR in this clause only the principal business was reported.

AO questioned why should I not consider deemed dividend as this not your business and you loaned the money to your group company.

If the Co. had reported this ICD as their business, then it would have been a concrete proof to argue.

Clause 9

Profit Sharing Ratios – importance of profit sharing reference

Case of Hospital

A firm's partners changed their ratio internally as some of them were paying higher taxes.

While filling the ITR and TAR of firm they didn't disclosed it properly.

While assessing the partner's income AO sought the ITR filled of Firm as the ratios declared by the firm were not the after changes, AO increased their income and accordingly taxed.

So here, if the firm would have disclosed proper ratios then this matter would not been more litigated.

- PSR from 25:25:24:26 to 25:25:48:2 changed
 - Should be reported properly in both ITR and TAR otherwise this creates troubles at the time of assessment

Case of reconstitution of firm

- PSR will be changed in case of retirement and death of a partner
 - This change is to be reported here and losses b/f to be reduced as per the ratio
 - And if the share is inherited and new partner comes in place of dead person then the loss can be c/f

Clause 16

Amounts not credited to the profit and loss account -

- Refund due but not received (should be recorded as the accrual system is followed)
- Pro forma credits, drawbacks, refund of customs or excise duties or service tax, sales tax or VAT, where the same are admitted as due by concerned authorities

Clause 29A Income chargeable u/s. 56(2)(ix)

Clause 29A:

Advance Money forfeited on the cancellation of agreement to sale the capital asset after 31-03-2014 is covered here.

Nature & Amount to be reported

Guidance Note:

Here the reporting of only business transaction should be done and not of personal assets (eg. FLAT)

Clause 2

- Branches and Registered place of business should be matched and reported
- Change in Address after FY end and before TAR should be reported

