

Tax Audit

2010-11

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Amendments By Finance Act, 2010

Tax Audit Threshold Limit : w.e.f 1-4-2011

Particular	Earlier	Amendment
Business	40 Lacs (INR)	60 Lacs
Profession	10 Lacs (INR)	15 Lacs



Amendments By Finance Act, 2010

Tax Audit Penalty Section 271B

Particular	Earlier	Amendment
Max Penalty Amt	INR 1 Lac	INR 1.5 Lac



Amendments By Finance (No.2) Act, 2009

- ◆ *Sec. 44AB-New clause (d) inserted:(w.e.f.1-4-2011)*

Every person-

Carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person w/s 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits & gains of his business and his income exceeds the maximum amount which is not chargeable to income- tax in any previous year.

get his accounts audited



Note:

an internal auditor of an assessee, whether working with the organisation or independently practising chartered accountant or a firm of chartered accountants, cannot be appointed as his tax auditor

(as per the guidelines of the council dated 12-12-2008.)



Tax Audit Report

Under section 44AB

- ◆ *Form 3CA/3CB*
- ◆ *Form 3CD*
- ◆ *Annexure – I*
- ◆ *Annexure – II*



Section 44 AB


Who has to get his accounts audited on compulsory basis -

Different taxpayers	When covered by the provisions of compulsory audit under section 44AB
A person carrying on business	If the total sales, turnover or gross receipt in business for the previous year(s) relevant to the assessment year exceed or exceeds Rs. 40 lakh. (60 lakhs by Finance Act 2010)
A person carrying on profession	If his gross receipts in profession for the previous year(s) relevant to the assessment year exceeds Rs. 10 lakh (15 lakhs Finance Act 2010)



<p>A person [covered under sec 44AE, 44BB or 44BBB] clause (c)</p>	<p>If such person claims that the profits and gains from the business are lower than the profits and gains computed under these sections (irrespective of his turnover).</p>
<p>A person [covered under sec 44AD] [By Finance (No.2) Act, 2009] clause (d)</p>	<p>If such person claims that the profits and gains from the business are lower than the profits and gains computed under this section and his income exceeds the maximum amount not chargeable to income tax in any previous year.</p>

Note: By Fin. (No.2) Act,2009 w.e.f 1-4-2011, assesseees covered by sec. 44AD & 44AF are not covered by clause (c)of sec. 44AB. However, 44AD is covered by insertion of clause (d). Thus, assesseees covered by sec. 44AF are reqd. to comply with the req. of sec 44AB even if they are claiming a lower income




Liability of Tax Audit

- ◆ There is no liability of tax audit if the assessee is not covered u/s 44AB.
- ◆ A charitable trust , cooperative society etc., though their income may be exempt, even if turnover exceed the threshold limit, they should get their account audited.
- ◆ If income of an assessee is *below the taxable limit*, he will also liable to get his account audited, if the turnover in business exceed the threshold limit.
- ◆ Section 44AB not applicable to assessee covered us 44B and 44BBA.
- ◆ Section 44AB is applicable to NRI also



Is tax audit applicable when income is exempt under section 10?

- ◆ *as per the ITAT's decision in Asstt. CIT v. India Magnum Fund [2002] 81 ITD 295 (Mum.),* if entire income of the assessee is exempt under section 10, he will not be liable to tax audit under section 44AB even though his turnover or gross receipts or sales may have exceeded Rs. 40 lakhs. However, ICAI has taken a contrary view in its Guidance Note on Tax Audit on the grounds that neither section 44AB nor any other provisions of the Act exempt an assessee from tax audit if his total income is exempt from tax. [Para 6.1 of ICAI's Guidance Note on Tax Audit].



Form No. 3CA/3CB- Rule 6G

Form 3CA

- ◆ In case of a person carrying business or profession and whose accounts are required to be audited under any other law

Form 3CB

- ◆ Person not referred in Form 3CA or liable to statutory audit under any other law but such audit is completed for a period other than previous year i.e. 31st March.



Gross Receipts

“Gross Receipts” is not define in the act

- It includes all the receipts in cash or kind
- Arising from carrying on of the business or profession.
- Which assesable as business/profession income under the act.
- ◆ U/s 145(1) “Sales”, “Turnover” or”Gross Receipts” computes either on cash or mercantile system.
- ◆ **“Sales Turnover”** The aggregate amount for which sales are effected or services rendered by an enterprise. The ‘gross turnover’ & ‘net turnover’ (or ‘gross sales’ and ‘net sales’) are sometimes used to distinguish the sales aggregate before and after deduction of returns and trade discounts.”

- ◆ In case of Share brokers
 - Transaction entered on his personal a/c also included in the sale value for purpose of Sec 44AB.
 - Sub-broker is not different from a share broker.

- ◆ **Turnover or Gross receipts:-** In case of shares, securities & derivatives
 - (a) Speculative Transaction:- Positive or negative difference amt arises on settlement of contracts is to be considered as Turnover.



contd...

(b) Difference of total favorables & unfavorables

- Premium received on sale of option
- Difference of any reverse trade entered

(c) Delivery based Transactions:- Total value of sales.



contd..

◆ Note:

*Where the assessee is proprietor of more than one concern, **aggregate of all the businesses** to be taken into consideration for the purposes of compliance with the provisions of sec. 44AB.*

Asst. CIT & Anr. V. Dr. K. Satish Shetty
[2009]310 ITR 366(Kar.)



FORM NO. 3CD

[See rule 6G(2)]

- ◆ Statement of particulars required to be furnished under section 44AB of the Income-tax Act, 1961



Amendment

- ◆ Central Law Board of Direct Tax
has amended tax audit form no.
3CD vide notification dated 10th
August, 2006 and 13th April 2009



PART A

Clause (1 to 6)

1. *Name of the assessee*
2. *Address*
3. *Permanent Account Number*
4. *Status*
5. *Previous year ended*
6. *Assessment year*



Issues on Clause(1 to 6)

- 1) If assessee is proprietor give his/her name along with all Proprietary Firm's name.
- 2) As per income tax record, if any change in address must be given.
- 3) If PAN has been applied and allotment is pending mentioned not yet allotted. The copy of application of applied PAN must be kept by the Auditor.
- 4) 'Status' means as per sec. 2 (31) of Income Tax Act & not 'residential status' [Sec 2(31) – "Person" includes an Individual, HUF, Firm etc.
- 5) As per sec. 3 of Income Tax Act, previous year should end on 31st March.
- 6) Assessment year according to the relevant Previous Year



PART B

Clause 7

7. (a) If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.
- (b) If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change.



Issues on Clause 7

- ◆ This applies only on Firm and association of persons.
- ◆ “Profit Sharing Ratio” would include Loss sharing ratio also as “Loss” is nothing but negative profit.
- ◆ All the changes occurring during the entire previous year must be stated.
- ◆ Change in remuneration this clause would not cover any change in relation to payment of remuneration or interest to partners or members without change in Profit/Loss Sharing ratio (C. No. 739).



Clause 8

8. (a) Nature of business or profession.
(if more than one business or profession is carried on during the previous year, nature of every business or profession)
- (b) If there is any change in the nature of business or profession, the particulars of such change.



Issues on Clause 8

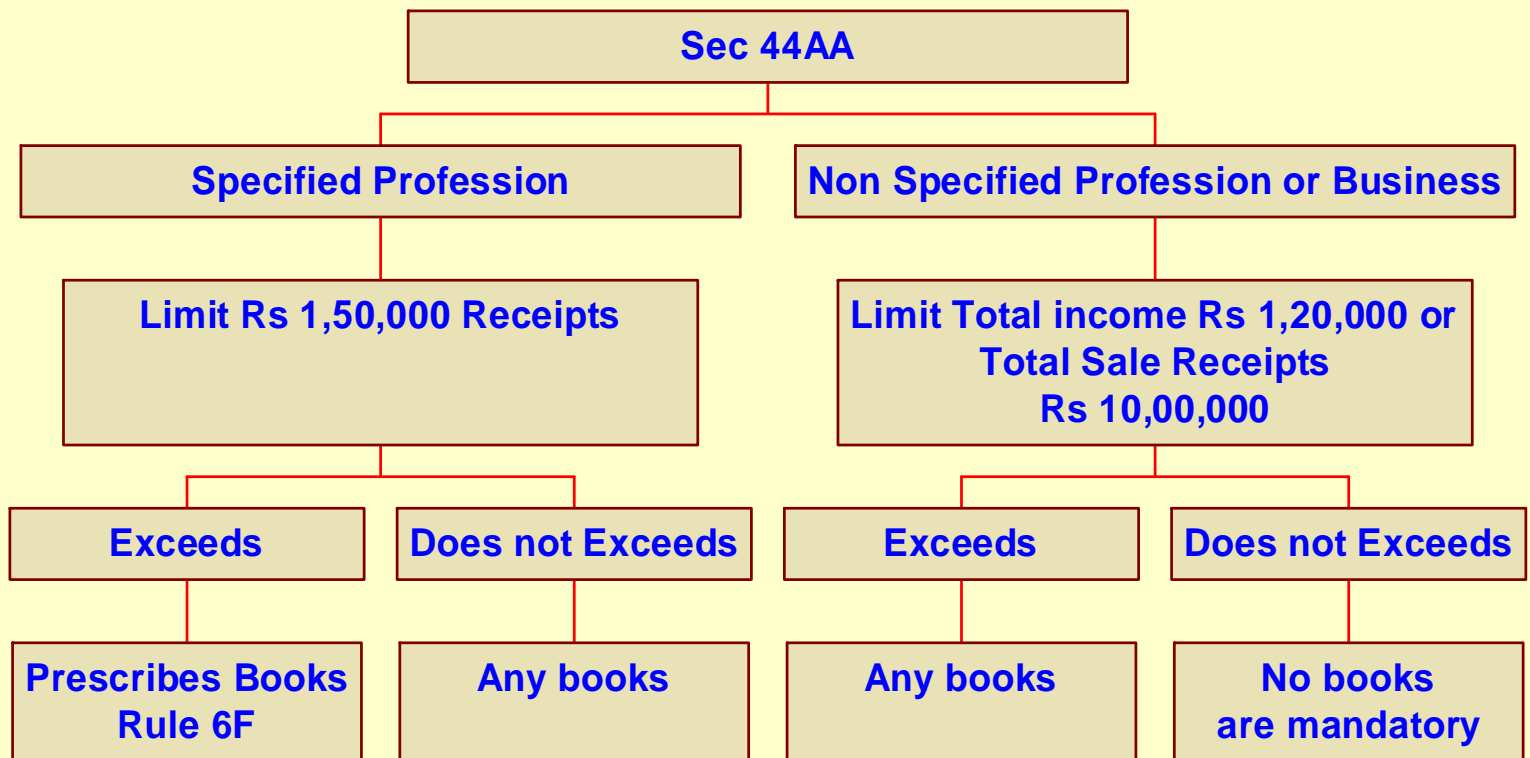
- ◆ Permanent discontinuance of a particular product line of business need to be reported not temporary suspension.
- ◆ “Nature of business or Profession” given must be same as Annexure -I.
- ◆ Effect on Carry or forward of losses :- from A.Y. 2000-01 losses will be carried forward, even if the business or profession is discontinued (Sec 72(1)(i))



Clause 9

- 9 (a) Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.
- (b) Books of account maintained. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system)
- (c) List of books of account examined.

Issues on Clause 9



Note: Any books means the books so as to enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.

◆ Prescribed Books:

- Cash book
- Journal (if the accounts are kept on mercantile bases)
- Ledger
- Serial numbered carbon copies of the bills and receipts issued
- Original purchase bill/payment vouchers.
- *If person carrying on medical profession in addition to above books a daily case register in form no. 3C. and stock register*

[RULE 6F (2) &(3)]

Prescribed books of account are to be kept at the place of profession or principal place of profession if carried at more than one place[s.rule(4)] and for a period of 6 years from the end of the relevant assessment year. [rule 6F(5)]

Specified Profession

- Legal, medical, engineering, accountancy, architectural profession, technical consultancy, interior decoration or other *notified profession*.

vide notification : No. SO 17(E), dated 12-1-1977., notified professions are the profession of authorised representative and the profession of a film artist.

◆ Sec 2(12A) Books or Books of account includes:-

- ✓ Ledgers
- ✓ Day- Books
- ✓ Cash books
- ✓ Account books
- ✓ Others

Whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro- magnetic data storage device.

- ◆ If case of books of accounts generated by the Computer system; the proper print out are mandatory.



Case Law

Ghai Construction vs. State of Maharashtra[2009] 184 Taxman 52(Bom.)

- ◆ Requirement of compulsory tax audit u/s 44AB is only in respect of business carried on by a person and not in respect of his income from other sources.



Case law

S.J Agarwal and Co. v. ITO[2008] 114 ITD 27(Pune) *(SMC)*

- ◆ *Merely because the assessee has not kept or maintained such books of account and other documents as are required under section 44AA, that would not by itself be sufficient to say that any other accounts whatsoever maintained by the assessee, shall not be required to be audited under section 44AB.*



contd...

- ◆ *for the purpose of section 44AB, it is not necessary that any books of account or any accounts maintained by the assessee should at first be such books of account as are required under section 44AA.*



Clause 10

10. Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section).

Sec 44 AD, 44AE, 44AF, 44BB, 44BBA, 44BBB

S.No.	Section	<i>Business Covered</i>
1.	44AD	<i>Civil construction business</i>
2.	44AE	<i>Transport business</i>
3.	44AF	<i>Retail trade</i>
4.	44B	<i>Shipping business of a non-resident</i>
5.	44BB	<i>Providing service or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils.</i>
6.	44BBA	<i>Operation of aircraft by non-resident.</i>
7.	44BBB	<i>Civil construction etc. in certain turnkey power project by non-residents.</i>
8.	Any other relevant section	<i>This refers to the sections not listed above under which income may be assessable on presumption basis like section 44D and sec 115A(1)(b) and will include any other section that may be enacted in future for presumptive taxation.</i>



Issues on Clause 10

- ◆ The value of material supplied by the client is not included in Gross receipt and value of work in progress would not constitute turnover.
- ◆ In case of composite business, if the books of accounts are commonly maintained, apportionment of the common expenses is on reasonable estimate.
- ◆ Turnover basis is mostly accepted by I.Tax Dept.
- ◆ If profit is credited directly to Profit & Loss a/c, appropriate qualification will be needed but if credited to capital a/c of partners/members no need to report here.



Clause 11

- a) Method of accounting employed in the previous year.
- b) Whether there has been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.
- c) If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.
- d) Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect thereof on the profit or loss.

Issue on Clause 11

- ◆ *U/s 145 - The income chargeable under the head “Profit & Gains of business or profession” or “Income from other source” must be computed in accordance with either cash or mercantile system of accounting *regularly employed* by the assessee (Para 22.7).
- ◆ *The hybrid system of accounting (i.e. mixture of cash and mercantile) is not permitted .

U/s 145(2)- Accounting Standard to be followed by all assessee following mercantile system of accounting .

The Central Government has notified two Accounting Standards [CBDT C.No. 9949 dated July25,1996]

(A) *Accounting Standard – I*

Relating to “ Disclosure of Accounting Policies”.

B) *Accounting Standard – II*

Relating to Disclosure of “Prior Period and Extraordinary Items and changes in Accounting Policies”.



contd...

- Change in accounting policy does not amount to change in method of accounting and thus need not be reported.
- Change in method of valuation of stock is not a matter of change in method of accounting but only a change in accounting policy.

In [2008] 22 SOT 13(Pune), held that accounting standards to be followed even if these provides for an accounting treatment contrary to accounting system regularly followed by assessee and to that extent AS are to have precedence.

where books maintained i.r.o all items of income on accrual basis, interest income on seed money loan is accounted on cash basis-permitted vide N.No. GSR 770(E) dated 10-9-1990.



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ICAI'S VIEWS ON CLAUSE 11(b)

Para 22.2 of ICAI's Guidance Note on Tax Audit notes that the assessee has only two choices - either cash or mercantile system. This implies that **(in the case of non-corporate assessees)** :

- ◆ The only permissible changes are from mercantile to cash and *vice versa*.
- ◆ The assessee cannot change from cash/mercantile to hybrid system of accounting.
- ◆ **A company** cannot change from mercantile to cash or hybrid.



Clause 12

12. (a) Method of valuation of closing stock employed in the previous year.
- (b) Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss.



Issues on Clause 12 (a & b)

Clause 12(a) of revised 3CD form

Refer the word “Closing stock”

Clause (b) refer sec 145A in which the term “inventory” is used and according to AS-2 “inventory” includes finished goods, raw material, work-in-progress, maintenance supplies, consumables and loose tools.

Issues on Clause – 12

- ◆ The Liability for excise duty arise when the manufacture of goods is complete, it is necessary to create a provision for unpaid liability of Excise duty on stock lying in the factory or bonded warehouse.

[Guidance Notes on Accounting treatment for Excise duty (in June 2000)]

- ◆ In valuation of closing stock no adjustment of Sales tax, as liability of sales tax arises at the time of sale. However, in case VAT is included in the purchase value, the same be adjusted in closing stock to neutralize the effect i.e the inventory of inputs is to be valued at net of the input tax which is refundable. If the inputs are obtained from the dealers who are exempt from the VAT, the actual cost of purchase should be considered as a part of cost of inventory.



Cont.

- ◆ When closing stock is valued at Market Price (Being lower than cost) there is no need to add Excise duty.
- ◆ If an assessee made Advance Payment of Excise duty without liability, no deduction shall be given on account of Sec43B.

Case Law:

1. *Gopikrishna Gramites Vs DCIT 251 ITR 337 (A.P)*
2. *Hindustan Liver Ltd Vs K.K Pandey JCIT, 251 ITR 209(Bomb)*



Clause – 12A

12A Give the following particulars of the capital asset converted into stock-in-trade

- a) Description of capital asset
- b) Date of acquisition
- c) Cost of acquisition
- d) Amount at which the asset is converted into stock-in- trade

Issues on Clause – 12A

- ◆ This new clause is inserted to keep a track record of transactions related to conversion of capital asset into stock-in-trade.
- ◆ Such conversion is treated as transfer u/s 2(47)
- ◆ U/s 45(2) notional capital gain arise from such transfer and chargeable to tax in the year in which such stock-in-trade is sold.
- ◆ No requirement of details of taxability of capital gain or business income from such deemed transfer.
- ◆ Follow AS-2 for valuation of stock-in-trade
- ◆ Follow AS-10 for valuation of fixed assets.
- ◆ Follow AS-22 for provision of I.Tax as temporary timing difference.
- ◆ Sec 47 & 47A also to be kept in mind.

◆ *Cost of capital asset in case of:*

- **Purchase** – From invoice, Books etc
- **Self – constructed** – directly related cost
- **Acquired in exchange** – FMV or Net Book value of asset given up
- **Acquired by way of inheritance** – In this case if no evidence exist – Auditor should rely upon the report of the experts such as valuers.



contd...

- ◆ Para 9.1 of the Accounting Standard (AS) 10, issued by the ICAI, provides that the cost of the fixed assets should include the non-refundable taxes or levies. *Since the VAT tax is in the nature of a refundable tax, it cannot be included in the cost of the capital goods.*



contd...

- ◆ Information under item no. 12A should be necessary not only in the year of conversion but also in the year of sale of relevant stock in trade. Since sec. 45(2) provides only for the computation of capital gain in the year of conversion but the due date of payment of tax is in the year of sale of such converted stock-in-trade.

Clause 13

13. Amounts not credited to the profit and loss account, being,—
- a) the items falling within the scope of section 28;
 - b) the Performa credits, drawbacks, refund of duty of customs or excise or *service tax*, or refund of sales tax *or value added tax*, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
 - c) escalation claims accepted during the previous year;
 - d) any other item of income;
 - e) capital receipt, if any.



Issues on Clause - 13

- ◆ Sub clause(a) –Chargeability of Income under PGBP (Sec 28)
- ◆ Sub clause(b) –
 - Any capital receipt adjusted in actual cost for calculation of depreciation allowable reported here & under clause 14 d (ii) also.
 - “Capital receipts” for this clause not cover share capital or item of gift etc.



Issues on Clause - 13

Sub clause (c)

- ◆ Only the escalation claims accepted during the year are required to be reported.
- ◆ Mere claims under negotiations cannot constitute accepted claims.

CIT v. Hindustan Housing and Land Development Trust ltd. [1986] 161 ITR 524(SC)

- ◆ Sub clause(d) –Any other item of income not credited to P&L a/c [Income u/s 2(24)].
- ◆ Under clause (x) Sec 2(24), any amt received by the assessee from his employee like contribution to any provident fund as income.
- ◆ Report all the items of income ascertain from the books of a/cs available to the tax auditor but state such income excludable u/s 10 (if any).
- ◆ The Tax auditor shall be governed by **AS-9** relating to revenue recognition.



Clause 14(a to f)

14. Particulars of depreciation allowable as per the Income-tax Act, 1961 in respect of each asset or block of assets, as the case may be, in the following form :—
- (a) Description of asset/block of assets.
 - (b) Rate of depreciation.
 - (c) Actual cost or written down value, as the case may be.
 - (d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—



contd...

- (i) Modified Value Added Tax credit (though MODVAT is now CENVAT, but in 3CD, no corresponding change) claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,
 - (ii) change in rate of exchange of currency, and
 - (iii) subsidy or grant or reimbursement, by whatever name called.
-
- (e) Depreciation allowable.
 - (f) Written down value at the end of the year.

Issues on Clause -14

- ◆ It is compulsory for all assessee to claim depreciation or additional depreciation in calculating taxable income otherwise no deduction will be allowed & WDV will be treated as reduced – Explanation 5 to Sec 32 (w.e.f A.Y. 2002-03).
- ◆ ‘Allowable’ implies permissible deduction under provision of Act and Rules.
- ◆ “Used” means actual use and is not kept ready for use.
- ◆ Assets used partly for Business purpose, deduction u/s 32(1) restricted to proportionate part.
- ◆ In clause 14 d(ii) adjustment is contemplated u/s 43A & AS-11 . U/s 43A deduction on cash basis but AS-11 (revised) deduction on accrual basis.

No amendment is made in this respect in Schedule VI & in form 3CD.

Cont.

◆ Depreciation is not allowed on an amount equivalent to CENVAT credit claimed and allowed.

◆ Depreciation is allowed on “Actual Cost”- term defined u/s 43(1) of I.T. Act.

◆ An assessee can claim depreciation on actual cost even if he follows Cash method of accounting.

◆ Subsidy received over & above of WDV of block of asset in the absence of specific provisions not taxable.

◆ The interest relatable to any period after such asset is first put to use is not a part of actual cost.

Cont.

- ◆ Sub clause (iia) to Sec 32(1) inserted by Finance Act,2002 w.e.f A.Y. 2003-04 to provide additional depreciation on fulfillment of prescribed conditions.
- ◆ W.e.f 2006-07 additional depreciation allowed to all the assessee engaged in the business of manufacturing or production of any article or thing in respect of New machinery or Plant installed on or after 31st day of March,2005.
- ◆ Depreciation debited to P&L a/c as per requirement of Schedule VI not reported under clause – 14.
- ◆ In case of dispute between assessee, department & Auditor regarding classification of assets, rate of depreciation etc in earlier year a suitable disclosure is required.



Clause 15 & 16

15. Amounts admissible under sections 33AB, 33ABA, 33AC, 35, 35ABB, 35AC, 35CCA, 35CCB, 35D, 35DD, 35DDA, 35E :—

- (a) debited to the profit and loss account (showing the amount debited and deduction allowable under each section separately);
- (b) not debited to the profit and loss account.

16.(a) Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1)(ii)].

(b) Any sum received from employees towards contributions to any provident fund or superannuation fund or any other fund mentioned in section 2(24)(x); and due date for payment and the actual date of payment to the concerned authorities under section 36(1)(va).

Relevant section of clause 15

S.No	Section	Details
1	33AB	Tea Development
2	33ABA	Site Restoration Fund
3	33AC	Reserve for Shipping** (However the section is not available from A.Y 2005-06)
4	35	Expenditure on Scientific Research
5	35ABB	Expenditure on license to operate telecommunication services
6	35AC	Eligible Projects/Schemes
7	35CCA	Rural development programme
8	35CCB	Conservation of Natural resources***
9	35D	Amortization of Preliminary Expenses
10	35DD	Amortisation of Expenditure in case of amalgamation or demerger
11	35DDA	Amortisation of expenditure incurred under voluntary Retirement Scheme
12	35E	Expenditure on prospecting certain minerals



Issues on Clause -15

- ◆ Requirement of disclosure of amount only
- ◆ Opinion of Auditor of allowability or otherwise not required.
- ◆ **From A.Y. commencing on or after 1st day of April,2005 – No deduction allowed u/s 33AC
- ◆ ***Deleted from A.Y 2003-04
- ◆ State the amount of each deduction separately if deduction under one or more section is eligible.
- ◆ Under clause (b) – Report any capital expense incurred and allowed as deduction for Computation of Profit & Gain.

Issues on Clause – 16

- ◆ Sec 36(1)(ii) – Bonus or commission to employees allowed on commission basis.
- ◆ Only amounts which are not in nature of reward for services will be covered by this item.
- ◆ Only disclosure of amt is required but the Auditor's opinion about its allowability or otherwise is not required.

Case Law:

Loyal Motor Service Company Ltd Vs CIT (1946) 14 ITR 647, (Bombay)

The Company paid bonus at the rate of two months salary to its employees cum shareholders. The tax auditor disallowed such bonus on the ground that it would be distributed as profit or dividend among the employees.



Clause 17 (a to d)

17. Amounts debited to the profit and loss account, being :—

- (a) expenditure of capital nature;
- (b) expenditure of personal nature;
- (c) expenditure on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a political party;
- (d) expenditure incurred at clubs,—
 - (i) as entrance fees and subscriptions;
 - (ii) as cost for club services and facilities used;



Clause 17 (e to f)

- (e)
 - (i) expenditure by way of penalty or fine for violation of any law for the time being in force;
 - (ii) any other penalty or fine;
 - (iii) expenditure incurred for any purpose which is an offence or which is prohibited by law;
- (f) amounts inadmissible under section 40(a);
- (g) interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;



Clause 17 (h to m)

- (h) (A) whether a certificate has been obtained from the assessee regarding payments relating to any expenditure covered under section 40A(3) that the payments were made by account payee cheques drawn on a bank or account payee bank draft, as the case may be, [Yes/No]
- (B) amount inadmissible under section 40A(3), read with rule 6DD [with break-up of inadmissible amounts]
- (i) provision for payment of gratuity not allowable under section 40A(7);
- (j) any sum paid by the assessee as an employer not allowable under section 40A(9);



contd...

- (k) particulars of any liability of a contingent nature.
- (l) amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income
- (m) amount inadmissible under the proviso to section 36(1)(iii)

Issue on Clause – 17 (a to d)

- ◆ Finance Act, 2003 – Explanation to Sec 30 & 31.
Cost of repairs & current repairs to building – not a capital expenditure.
Current repairs to machinery – Plant & Furniture – not a capital expenditure.
- ◆ Auditor qualified the report if capital expense W/o with revenue in P&L a/c.
- ◆ Separately indicate capital expenses allowed as deduction in computation to total income under the Act.



contd..

- ◆ In clause (b) “Personal” is confined & related with assessee only.

Company cannot have personal expenses because it is an artificial entity, which does not have personal needs and thus use of vehicles for directors cannot be treated as personal use by the company.. *Sayaji Iron and Engg. Co. v. CIT[2002] 253 ITR 749(Guj.)*

- ◆ Clause (c) Report expenses disallowable u/s 37(2B).
Donation paid directly to political party, expense on advertisement in newspaper not to be reported.



Issues on Clause – 17 (e)

- ◆ Clause (e)(i) – expenditure by way of penalty or fine for violation of any law is not admissible as expenditure.

Infraction of law even if not deliberate may discredit the claim for deduction.



contd...

- ◆ Clause (e)(ii) – In case of illegal business, fine or penalty imposed thereon is not deductible (Explanation to Sec37(1)).

It was held that where the assessee is required to pay amount comprising both the element of compensation & penalty . Only the amount of compensation deductible as Business expense


Malura Vanaspati & Chemical Co Vs CIT (1997) 225 ITR 383 (SC)



Issues on Clause – 17 (f)

- ◆ Amendment to sub clause(ia) by Finance Act, 2010 provides for disallowance if tds deducted during the previous year is not deposited by the due date of ITR filing in respect of payments being interest, commission, brokerage, rent, royalty for Professional/Technical fees service, payment to Contractor or Sub contractor
- ◆ Sub clause(ib) providing for disallowance on account of STT –omitted w.e.f 1-4-2009 since allowed u.s 36(1)(xv).
- ◆ Sub clause (ic) inserted by Finance Act, 2005 provides for disallowance of FBT
- ◆ New Sub clause (v) of Sec 40(a) tax referred in Sec 10(10ccc) paid by the employer on non- monetary perquisites provided to employees shall not deducted.

Note: Earlier, only the last month tds could be deposited by the due date of ITR filing, now benefit extended i.r.o tax deducted during the entire previous year.



Clause 17(h) - Sec 40A(3)

[Notification No 208/2007, dt 27.06.2007]

- ◆ Sec40A(3) amended by CBDT
- ◆ Applicable from A.Y. 2009-10.

Rule 6DD- no disallowance of sum exceeding Rs 20,000 made to a person in a day otherwise than by a/c payee cheque or draft for payment for following:

- ◆ Payment made to
 - RBI
 - SBI
 - Cooperative/land mortgage Bank
 - Primary agricultural credit society
 - LIC
- ◆ Payment to Govt. for legal tender

- ◆ **Payment made by**
 - LC
 - Mail or Telegraphic t/f
 - Book adjustment in bank or inter bank.
 - BE
 - ECS
 - Credit card
 - Debit card

- ◆ **Payment made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee.**



contd...

- ◆ **Payment for purchase of**
 - Agriculture or forest produce
 - Production of animal husbandry.
 - Fish or fish products
 - Products of horticulture or apiculture

- ◆ Payment for purchase product produced without aid of power in cottage industry.
- ◆ Payment made in village or town & date of payment is not served by bank.
- ◆ Payment not exceeding Rs 50,000 by an assessee to his employee or his heirs as gratuity, retrenchment compensation etc.
- ◆ Payment of Salary to employee(Sec 192).
- ◆ Payment made on date when banks were closed.
- ◆ Payment made by person to his agent who requires to make cash payment for goods.
- ◆ Payment by authorized dealer for purchase of foreign currency



contd..

Note:

There may be practical difficulties in verifying the payments made through crossed/account payee cheque or bank drafts. If no proper evidence for the verification of the payment by the crossed/account payee cheque or draft is available, such a fact could be brought out by appropriate comments in the following manner applicable to the relevant assessment year.



Clause(i to m)

- ◆ Sec 40A(7) – *Payment made by the employer for gratuity etc*
- ◆ Sec 40A(9) - *Payment made by the employer towards the setting up or formation of, or as Contribution to, any Fund, Trust, Company, AOP, BOI, etc.*
- ◆ Clause (k)- regarding particulars of any liability of a contingent nature, AS-4 relating to “contingencies and events occurring after the Balance-sheet date” need to be followed



contd...

- ◆ . Sec 14A – Expenditure incurred in relation to Income not included in total income.
- ◆ Sec 36(1)(iii) – The amt of the interest paid in respect of capital borrowed for the purpose of acquisition of an asset for extension of existing business or profession upto the date of asset was first put to use – not allowable.



contd...

- ◆ The broad principles enunciated in the guidelines of the council of ICAI may be kept in mind while verifying the amount of inadmissible expenditure. After verifying the amount of inadmissible expenditure, if the tax auditor:
 - ◆ (a) is in agreement with the assessee, he should report the amount with suitable disclosures of material assumptions, if any.
 - ◆ (b) is not in agreement with the assessee with regard to the amount of expenditure determined, he may give:
 - ◆ **A qualified opinion:**
 - ◆ **An adverse opinion:**
 - ◆ **The disclaimer of opinion:**



Clause 17A

- ◆ Amount of interest **inadmissible** under section 23 of Micro Small and Medium Enterprises Development Act, 2006.

Insertion by the IT(Tenth Amdt.) Rules,2009, w.e.f 13-04-2009.

This will have to be reported upon in all tax audit reports signed on or after 13-4-2009 irrespective of the assessment year to which the report pertains



Issues on clause 17A

- ◆ **Sec. 16** of Micro small & Medium Enterprises Development Act, 2006,
Where any buyer fails to make payment of the amount to the supplier, as required under section 15, the buyer shall, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed day or, as the case may be, from the date immediately following the date agreed upon, **at three times of the bank rate notified by the Reserve Bank.**



contd...

- ◆ **Section 15 of the MSME Act**, *requires the buyer to make payment on or before the date agreed upon in writing, or where there is no agreement in this behalf, before the appointed day. It also provides that the period agreed upon in writing shall not exceed **forty five days** from the day of acceptance or the day of deemed acceptance.*



contd...

◆ **Sec 23** provides that:

Notwithstanding anything contained in the Income-tax Act, 1961, the amount of Interest payable or paid by any buyer, under or In accordance with the provisions of this Act, shall not, for the purposes of computation of income under the Income-tax Act, 1961, be allowed as deduction.

Note: The inadmissible interest has to be determined on the basis of the provisions of the MSME Act.



contd...

- ◆ The tax auditor needs to report the amount of interest inadmissible under section 23 of the MSMED Act, 2006 *irrespective of whether the amount of such interest has been debited to profit and loss account or not.* In case the auditee has adopted mercantile system of accounting, the non-provision may affect true and fair view and the auditor should give suitable qualification.
- ◆ The tax auditor should verify that TDS under section 194A is deducted from interest credited/paid to MSEs and deposited with Central Government.[Clause 27 of Form No.3CD]



contd...

- ◆ Where the tax auditor is issuing his report in Form No.3CB, he should verify that the financial statements audited by him contain the information as prescribed under section 22 of the MSME Act.
- ◆ If no disclosure is made by the auditee in the financial statements he should give an appropriate qualification in Form No.3CB, **in addition to the reporting requirement in clause 17A of Form No. 3CD.**



Clause 18, 19 & 20

18. Particulars of payments made to persons specified under section 40A(2)(b).

19. Amounts deemed to be profits and gains under section 33AB or 33ABA or 33AC.

20. Any amount of profit chargeable to tax under section 41 and computation thereof.



Issue on Clause – 18

- ◆ Any Payment made by AOP to its member for supply of goods should be reported.
- ◆ **“Specific Person”** means relative, partners, members, directors or person having substantial interest.
- ◆ A person will be deemed to have a **substantial interest** in a business or profession if, (in case of a company) the person is beneficially owning the shares (other than the preference shares), carrying not less than 20% of the voting power and in any other case, person is entitled to not less than 20% of the profits of business or profession.



contd...

- ◆ If information is not available about specified persons with the client, suitable disclaimer may be given.
- ◆ Sec 40A(2) – Payment to Specific Persons & AO is of the opinion that such payments is excessive or unreasonable. Then disallow the excessive or unreasonable amount.
- ◆ Amounts to be reported whether or not debited to profit and loss account



contd...

- ◆ The item does not require report of the auditor as to his own inference, whether the payment is excessive or unreasonable. He is required to specify the amounts paid to such related persons.
- ◆ Tax auditor should obtain from assessee list of specified persons and expenditure/payment made to them and then scrutinize the items with reference to sec. 40A(2).



contd..

- ◆ **In case of a large company**, it may not be possible to verify the list of all persons covered by this section. Therefore, the information supplied by the assessee can be relied upon. **Circular No. 143, dated 20-8-1974**, issued by the Board, clarifies that tax auditor can rely upon the list of persons covered under section 13(3) as given by the managing trustee of a Public Trust.

The same analogy may be extended to this case. *Where the tax auditor relies upon the information in this regard furnished to him by the assessee it would be advisable to make an appropriate disclosure.*



Case Laws on Clause 18

- ◆ *Dy Cit v Joshi Formulabs (p) Ltd (2000) 67 TTJ 396 (Rajkot)*

A fully vouched and genuine expenditure cannot be disallowed u/s 40A(2)(b) even if made to sister concern.

- ◆ *Khan Carpets v CIT (2003) ITR 325 (All)*

Only when there was disproportionate increase in salary without showing exceptional circumstances for it, that the increase in salary could be disallowed.



Issues on Clause – 19

- ◆ **Sec 33AB** - Tea Development Account.
- ◆ **Sec 33ABA** - Site Restoration Fund
- ◆ **Sec 33AC** – Reserve for Shipping Business.
[No deduction is allowed under this section w.e.f. A.Y 2005-06]
- ◆ Amount withdrawn from such deposit account for other than the specified purposes is to be deemed income chargeable to tax.



Sec 41 Covers

- ◆ Sec 41(1) - Recovery against any deduction.
 - (a) Recovery by the same Assessee.
 - (b) Recovery by the successor in Business or Profession.
- ◆ Sec 41(2) - Balancing charge in the case of Power units.
- ◆ Sec 41(3) - Sale of Capital Asset used for Scientific research
- ◆ Sec 41(4) - Recovery of Bad debts allowed as deduction
- ◆ Sec 41(4A) - Amount withdrawn from Special Reserve created & maintained u/s 36(1)(viii).
- ◆ Sec 41(5) – Adjustment of loss (discontinued business)



Issues on Clause -20

- ◆ Loss of the Previous year in which Business ceased to exists can be set off from the above deemed Profit u/s 41.
- ◆ State Profit chargeable to Tax under this Clause, irrespective the relevant amount credited to P&L a/c or not.
- ◆ Any amount already credited in P&L a/c is to be reported in this clause.
- ◆ Computation of chargeable Profit be also reported in this clause.

Clause 21

21. (i) In respect of any sum referred to in clause (a), (b), (c), (d), (e) or (f) of section 43B, the liability for which :-

(A) pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was

(a) paid during the previous year;

(b) not paid during the previous year



contd...

(B) was incurred in the previous year and was

(a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1);

(b) not paid on or before the aforesaid date



Issues on Clause 21

- ◆ Taxes and other dues u/s 43B
- ◆ The deduction of amount paid in the year of Audit & unpaid (outstanding) amount in the year of actual payment.
- ◆ **Explanation 3C & 3D to Sec 43B** - Any unpaid interest or interest unpaid converted into Loan or Borrowing or Advance allowed as deduction only when actually paid (C.No 7/2006 dated 17th July).
- ◆ No deduction in case of waiver of interest as it is not representing actual payment.
- ◆ Payment of PF in relation to employers contribution under this clause.



contd...

- ◆ In case of payment made by cheque date of clearance of cheque is considered date of payment.
- ◆ Payment made beyond the due date but within the financial year will be allowed.
 - * state whether sales tax, custom duty, excise duty or any other indirect tax, levy, cess, impost etc. is passed through the P&L account- meaning thereby that the question of disallowance would arise only if it passes through P&L a/c.



contd..

- ◆ The provision made in the accounts for excise duty payable on the closing stock of finished goods should also be disclosed against clause 21(i). The tax auditor should verify that the said goods have been cleared and the excise duty has been paid or adjusted against the Cenvat credit on or before the due date for filing return of income. **[Para 42.8 of the ICAI's Guidance Note on Tax Audit]**
- ◆ If assessee is following cash system of accounting, then tax auditor should write **“Not applicable since cash system followed by the assessee”** against clause 21. If the assessee is following mercantile system of accounting, then only this clause 21 is relevant



Case law

- ◆ [2010] 228 CTR 72 (CAL.) Peerless General Finance & Investment Co. Ltd.v. CIT-
Information contained in tax audit report does not enable Assessing Officer to make any *prima facie* adjustments under section 143(1)(a) with reference to provisions of section 43B.



Case Law on Clause-21

Tax/Duty allowed as Deduction

- ◆ *CIT Vs S.P. Foundry 185 ITR 555 (All)*

In certain cases Sales Tax collected are credited to separate A/c and does not form part of trading receipt whether Sec 43B is attracted. The amount is not charged in P&L A/c

Judgment – The particular should be reported whether have been debited to P&L A/c or not



Case law

- ◆ [2010] 186 TAXMAN 407 (SC)- CIT vs. Maruti Udyog Ltd.(ruling of DHC in 92 ITD 119 reversed)- Whether question as to whether unutilized Modvat credit of earlier years adjusted in assessment year-in-question should be treated as actual payment of excise duty under section 43B is a question of law - Held, yes



Case law

- ◆ *[2010] 186 TAXMAN 72 (KAR.)-Vinir Engineering (P.) Ltd v. DCIT-*

Whether rescheduling of interest payable to financial institution by means of fresh loan can be treated as interest payment deductible under section 43B - Held, yes



Case law

- ◆ *In CIT v. Udaipur Distiller Co. Ltd. [2009] 180 Taxman 539 (SC), CIT v. McDowell & Co. Ltd. [2009]180 Taxman 528, 526, 524, 521, 514 (SC)*, it was held that bottling fees payable for acquiring a right of bottling of IMFL, which is determined under Excise Act and Rules, is neither fee nor tax, but is consideration for grant of approval by Government in respect of exclusive right to deal in bottling of liquor in all its manifestations. Therefore, bottling fee payable under Excise Law for acquiring a right of bottling of IMFL does not fall within purview of section 43B.

Clause-22 & 23

- 22.** (a) Amount of Modified Value Added Tax credits availed of or utilized during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.
- (b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.
- 23 .** Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D].



Issues on Clause - 22

- ◆ Clause (b) is applicable on the assessee following Mercantile System of Accounting.
- ◆ U/s 145 - Material Charges (expense) or credit (income) which arise in the current year as a result of error or omission in the account of earlier years will be considered as prior period items.

AS-5 issued by ICAI need to be considered for the purposes of this clause.



Case laws on Clause –22

- ◆ *CIT vs Durga Jewelers 172 ITR 134 (M.P)*

Assessee sustained loss due to theft in one year, but became finally irrecoverable in subsequent year. Held it was allowable in the year in which loss became irrecoverable.

- ◆ *Kalinga Tubes Ltd Vs CIT 169 TTR 374 (Orissa)*

Disputed wages for the year ended 31st March 2001 but settled and accounted during the year ended 31st March 2002. Whether such expenditure is of prior period debited to the profit & loss account

Judgment-It is not an error or omission such exp cannot be considered as prior period expenditure,



Sec 69 D

Amt borrowed or repaid on hundi

- ◆ Where any amt is borrowed on a hundi from, or any amt due thereon is repaid to, any person otherwise than through an account payee cheque drawn on a bank, the amt so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amt aforesaid for the P.Y. in which the amt was borrowed or repaid, as the case may be.




contd..

- ◆ *Explanation:* Provided that, if in any case amt borrowed on a hundi has been deemed under the provision of this sec to be the income of any person, such person shall not be liable to be assessed again in respect of such amt under the provisions of this sec on repayment of such amt.
- ◆ *For the purposes of this sec, the amt repaid shall include the amt of interest paid on the amt borrowed.*

Clause 24

24. (a)*Particulars of **each loan or deposit** in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year :-
- (i) name, address and permanent account number(if available with the assessee) of the lender or depositor;
 - (ii) amount of loan or deposit taken or accepted;
 - (iii) whether the loan or deposit was squared up during the previous year;
 - (iv) maximum amount outstanding in the account at any time during the previous year;



(v) whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft.

**(These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act.)*

(b) Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year :—

(i) name, address and permanent account number (if available with the assessee) of the payee;

- (ii) amount of the repayment;
- (iii) maximum amount outstanding in the account at any time during the previous year
- (iv) whether the repayment was made otherwise than by account payee cheque or account payee bank draft

(c) Whether a certificate has been obtained from the assessee regarding taking or accepting loan or deposit, or repayment of the same through an account payee cheque or an account payee bank draft. [Yes/No]



Cont.

- * *Particulars (i) to (iv) at (b) and certificate at (c) need not be given in case of repayment of any loan or deposit taken or accepted from Gov., gov. company, banking company or a corporation established by a Central, state or Provincial Act.*



Issues on Clause -24

- ◆ Payment made Electronically through Internet, Mail transfer, Telegraphic transfer needs to be reported under this clause even though they are treated at par as A/c Payee cheque.
- ◆ Transaction of current a/c also cover in 'Deposits'.
- ◆ In case of mixed a/c, transactions only related to Loans/Deposits are reported.



contd...

- ◆ Advance received against Sale & Agreement of sale is not a Loan or Deposit.
- ◆ Opening balance of Loan a/c is to be considered for calculation of maximum amount outstanding.
- ◆ Security Deposit against contract etc cover under Deposits.



Case Laws on Clause – 24

- ◆ *Sunflower Builders (P) Ltd v DCIT 61 ITD 227(Pune)*
Penalty under Sec 271D- Acknowledgment of debt by passing a journal entry in the books of account would not come within the ambit of the words ‘loans’ or ‘deposits’- Sec 269SS applies only where money passes from one person to another by way of ‘loan’ or ‘deposit’ – Hence levy of penalty cannot be sustained.
- ◆ *CIT Vs Noida Toll Bridge Co. Ltd 262 ITR 260 (Del)*
Where the transaction is by an A/c Payee Cheque and no payment was made in Cash . Provisions of Sec 269SS shall not be attracted.



Case Laws on Clause – 24

- ◆ If the cheque or bank draft through which loan is received is ‘crossed’ but words ‘account payee’ is not written in the crossing but the transaction is otherwise genuine and the bank confirms that these amounts have been deposited in assessee’s account and are as per the banking norms and there was no flaw in the transaction, penalty under section 271D is not imposable for such a trivial violation. *In CIT v. Makhija Construction Co. [2002]123 Taxman 1003(MP)*

Clause 25 & 26

25. (a) Details of brought forward loss or depreciation allowance, **in the following manner**, to the extent available:

S. No	Assessment Year	Nature of loss/allowance (in rupees)	Amount as returned (in rupees)	Amount as assessed (give reference to relevant order)	Remarks



contd...

(b) whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79 .

26 Section-wise details of deductions, if any, admissible under Chapter VIA.



Issues on Clause – 25(a)

- ◆ Disclose any assessment, rectification, revision or appeal proceedings pending at the time of tax Audit.
- ◆ A format is prescribed, it can be extended with Alteration to be similar to provided in ITR form.
- ◆ Losses from House Property, Profits & gains of Business & Profession & Capital Gains are Carry forward u/s 70 to 80
- ◆ Unabsorbed Depreciation is carry forward under sec 32.
- ◆ If return is filed Late unabsorbed depreciation can be carried forward but losses under different head cannot allowed to carry forward.



Issues on Clause – 26

Categories of deduction under Chapter VIA

- ◆ Deductions in respect of certain Payments – 80D to 80GGA, 80GGB & 80GGC
- ◆ Deductions in respect of certain Income – 80HH to 80RRA
- ◆ Other deductions in respect of certain Assessee – 80U.
- ◆ The particulars of deduction admissible under Chapter VIA is given only for the items appear in books of a/cs subject to audit u/s 44AB.



contd...

- ◆ The amount calculated by the Auditor & the amount claimed by the assessee may be different (on basis of judicial pronouncement), state this fact in the Report.
- ◆ Separate Audit Report/ Certificate is required under Sec 80IA, 80IB, 80JJA etc of Chapter VI.
- ◆ The Income/expenditure covered under different Sections 80G, 80GGB/80GGC, 80JJA, 80P etc of Chapter VIA, recorded in the books should be reported under this clause.



contd...

- ◆ From AY 2011-12, of max. Rs. 20,000/- is available in respect of Long term Infrastructure Bonds (It is an additional deduction over and above existing limit of Rs. 1 lakh u/sec. 80 CCE)
- ◆ Further from AY 2011-12, deduction u/s 80D in case of senior citizen increased from 15,000/- to Rs. 20,000/-



Clause 27

27 (a) Whether the assessee has complied with the provisions of Chapter XVII-B regarding deduction of tax at source and regarding the payment thereof to the credit of the Central Government.
[Yes/No]



contd...

- (b) If the provisions of Chapter XVII-B have not been complied with, please give the following details*, namely
- (i) Tax Deductible and not deducted at all
 - (ii) Shortfall on account of lesser deduction than required to be deducted
 - (iii) Tax deducted late
 - (iv) Tax deducted but not paid to the credit of the Central Government

Please give the details of cases covered in (i) to (iv) above



Issues on Clause 27

- ◆ Previously under this clause the Auditors only report late payments of TDS.
- ◆ But in new form this clause have wider scope.
- ◆ The Auditors has to carry out complete audit of TDS transactions and verify the necessary returns.
- ◆ On non compliance, the auditor should give information of, sub clause (i) to (iv) of clause (b) in a prescribed format.



Issues on clause 27(a)

- ◆ As per clause(a),The tax auditor is not required to verify compliance with provisions regarding filing of TDS returns and issue of TDS certificates.
- ◆ Since the reference is to “Central Government” and to Chapter XVII-B, it is clear that TDS under Income-tax Act is only covered. TDS under other laws (e.g. TDS on works contracts under State VAT laws) are not covered. The tax auditor is also not responsible for reporting timely deposit with the State Government of Profession Tax deducted from salaries of employees - ICAI’s Issues on Tax Audit.



Issues on clause 27(b)

- ◆ If the non-deduction/short deduction is in accordance with a certificate of no deduction furnished by payee under section 195/197, there is no need to report such cases of non-deduction/short deduction as these are not non-compliances with Chapter XVII-B.
- ◆ If tax auditor does not agree with the auditee's views on deductibility/non-deductibility of tax in particular cases, it would be advisable to state both views (his views as well as the auditee's views)



contd..

- ◆ The tax auditor should verify cases where TDS has been deducted but not paid before the last date of the previous year under audit. Only such cases need reporting against clause 27(b)(iv). For example, in respect of previous year 2007-08, details of tax deducted at source and due for payment upto 31-3-2008 but not paid to Government before 31-3-2008 are to be reported. Tax deducted at source on 31-3-2007 and due to be deposited on 7-4-2007/31-5-2007 but not deposited upto 31-3-2008 should also be reported.

Case Laws on Clause - 27

Salary

- ◆ *Grindlays bank Ltd Vs CIT(1991) 56 Taxman 213 (Cal)/(1992) 193 ITR 457 (Cal)*

Further pay which was paid in foreign currency abroad was held to be salary for services rendered in India and TDS has to be deducted.

Penalty Payable

- ◆ *Wodward Governor India(P) Ltd vs CIT & others (2002) 253 ITR 745 (Delhi)*

Levy of penalty u/s 271c is not automatic. Absence of reasonable cause, existence of which has to be established by the assessee.



Clause - 28

28 (a) In the case of a trading concern, give quantitative details of principal items of goods traded:

- (I) opening stock;
- (ii) purchases during the previous year;
- (iv) sales during the previous year;
- (v) Closing Stock;
- (vi) Shortage/excess, if any.

Cont.

(b) In the case of a manufacturing concern, give quantitative details of the **principal items** of raw material, finished products and by-products:

(A) Raw materials:

- (I) Opening stock;
- (ii) purchases during the previous year;
- (iii) Consumption during the previous year;
- (iv) Sales during the previous year.
- (v) Yield of finished products
- (vi) Percentage of yield;
- (vii) Shortage/excess, if any.

(B) Finished products/By-products :

- (i) opening stock;
- (ii) purchases during the previous year;
- (iii) quantity manufactured during the previous year;
- (iv) sales during the previous year;
- (v) closing stock;
- (vi) shortage/excess, if any.

**Information may be given to the extent available.*

Issues on Clause – 28

- ◆ “Principal Items” :- Items constitute more than **10% of the aggregate value** of purchase, consumption or turnover.
- ◆ Report **only Principal Items** under this clause
- ◆ Clause (a) – Applicable on Trading concern.
- ◆ Clause (b) – Applicable on Manufacturing concern.
- ◆ The Information about (vi),(vii) & (viii) of sub clause A of (b), to the extent of availability of information in the record.



Cont.

- ◆ The information about ‘yield’, ‘percentage of yield’, and ‘shortages/excess’ is to be given only to the extent such information is available in the records of the business.
- ◆ The tax auditor should obtain certificates from the assessee in respect of the principal items of goods traded, the balance of the opening stock, purchases, sales and closing stock and the extent of shortage/excess/damage and the reasons thereof.



Cont.

- ◆ If the assessee is engaged in the manufacture of goods where the input of raw materials and the output of finished goods are recorded in different units of measurement, unless an alternative method is available to convert the end product into the same unit of measure as the inputs, the yield and shortage cannot be ascertained. If the end product is a standard item and can be converted back and related to the input of the raw material in the same unit of measurement, it should be done to ascertain the shortage, yield etc. If it is not possible, the tax auditor should state the fact under this clause.



contd..

- ◆ In respect of assesseees other than companies and those whose accounts have not been audited under any other law, the tax auditor should obtain the following certified documents for the principal items of raw materials, finished goods and by-products:
 - (a) Certificate from the assessee certifying the balance of the opening stock, purchases, sales and closing stock.
 - (b) Certificate to the extent of shortage/excess/damage and the reasons thereof.

contd..

- ◆ As required by SA-501 “Audit Evidence - Additional Considerations for specific items”, the tax auditor (if he is issuing Form No. 3CB also) should attend the physical stock-taking conducted by the management if the inventories are material unless such attendance is impracticable due to matters such as nature and location of the inventory.
- ◆ The auditor should Obtain certificates from the management regarding quantitative details , Cross check the data furnished by the management with excise records, VAT returns, production records etc. and verify the data with details as per stock statements submitted to bank and ascertain the reasons for variation, if any.
- ◆ In case of companies, verify that these details tally with details given in annual accounts in the notes to accounts.

Clause 29

29. In the case of a domestic company, details of tax on distributed profits under section 115-O in the following form :—
- (a) total amount of distributed profits;
 - (b) total tax paid thereon;
 - (c) dates of payment with amounts.



Issues on Clause - 29

- ◆ Sec 115-O Tax on distributed profits of Domestic Companies. The special levy at the prescribed rate, on the amt of dividend declared, distributed or paid (interim or other wise) out of current Profits or accumulated Profits.
- ◆ This tax shall be payable even if no Income tax is payable by such Company on its total Income.
- ◆ “ Dividend ” means dividend under clause (22) of Sec 2 exclusive of sub clause (e) advance or loan out of accumulated profit or shareholders etc.

- ◆ The Date of Payment should be verified from the Challans and Books of A/cs etc.
- ◆ Tax u/s 115-O should be deposited within 15 days of date of declaration/ distribution or payment which ever is earlier.
- ◆ The tax rate on dividend distributed u/s 115-O is 15%.
- ◆ *The tax auditor need not go into the computation of distributed profits but to report the amount actually distributed.* (Para 53.2 of ICAI's Guidance Note on Tax Audit)



Cont.

- The date of declaration/distribution/payment of dividend is not required. However, it is advisable to give the same. **(Para 53.2 of ICAI's Guidance Note on Tax Audit)**
- whether the company has paid any deemed dividends mentioned in clauses (a) to (d) of section 2(22). If yes, then give details required in sub-clauses (a) to (c) of clause 29.



Clause 30 & 31

- 30 Whether any cost audit was carried out, if yes, enclose a copy of the report of such audit [section 139(9)].
31. Whether any audit was conducted under the Central Excise Act, 1944, if yes, enclose a copy of the report of such audit.



Issues on Clause - 30

- ◆ Enclose the copy of Cost Audit Report under Sec 233B of the companies Act 1956 (if conducted such Audit).
- ◆ The Auditor need not express any opinion if such Audit is ordered and not conducted.
- ◆ The Auditor state the fact if such Audit is not completed by the time of his Audit Report.
- ◆ Make note of any material observation made in such Report.
- ◆ Give information only for that Cost Audit Report which falls within the relevant Previous Year.



Issues on Clause - 31

- ◆ This clause does not require the tax auditor to verify or examine anything. All that it requires of the tax auditor is to specify (“yes” or “no”/“NA”) whether any audit was conducted under the Central Excise Act, 1944. And if so, the tax auditor has to merely obtain a copy of the audit report and attach the same with Form No. 3CD.
- ◆ Tax auditor is not required to study the Central Excise audit report in detail. However, he should take note of any material observation made in such Central Excise audit report which may have relevance to the tax audit conducted by him.



contd..

- ◆ If Central Excise audit has been ordered but not carried out, the tax auditor need not express any opinion in such a case.
- ◆ If Central Excise audit ordered is not complete by the time the tax auditor gives his report, he has to state the same in this report.
- ◆ Information needs to be given against this clause only if the Central Excise audit report pertains to the period covered by the tax audit report.
- ◆ If Excise Audit Report is not enclosed, the return cannot be considered as defective return under Sec 139(9).



Clause 32

32. Accounting ratios with calculations as follows :—

- (a) **Gross profit/Turnover;**
- (b) **Net profit/Turnover;**
- (c) **Stock-in-trade/Turnover;**
- (d) **Material consumed/Finished goods produced.**

Issues on Clause - 32

- ◆ Calculate ratios for manufacturing or trading concern in terms of value only.
- ◆ Calculate Ratios for the business as a whole and not product wise.
- ◆ If Closing stock is Nil, this sub clause (c) is not applicable.
- ◆ Stock - in -trade include only closing stock of finished goods not stock of raw material & work -in -progress.

contd...

- ◆ Overall G.P Ratio is enough if gross profit from each product is different.
- ◆ Depreciation on Plant & Machinery considered for valuation of Finished goods [AS-2 (revised)]
- ◆ Depreciation on P&M should be deduct to arrive at gross profit.
- ◆ Exclude extraordinary items for calculation of ratios unless give material effect [AS 5, AS(IT) II].

Cont.

- ◆ Take the value of Sales, Purchase & Inventories before the Statutory Adjustment (of Sec 145A).
- ◆ *In case of Share broker*
 - i) Dealing for Commission – Calculate Net Profit Ratio
 - ii) Doing Business – Calculate Gross Profit Ratio

Case Law

N.C. Budharaja & Co, (1993) 204 ITR 412(SC)

In this Case Hon'ble Supreme Court decided that construction of tunnels, bridges, dams etc is only a Service activity and it cannot amount to manufacturing activity.

Annexure -I

- ◆ Part A [1 to 6] – Same as given in main 3CD form.
- ◆ Part B – Nature of Business: Not to be contradicted with clause 8(a)
- ◆ Code is must for every business.
 - (i) In case of
 - Corporate assessee –Paid up Share capital
 - Non corporate assessee - Fixed capital or Net capital
 - (ii) Share application money [current account of partner or proprietor if any]
 - (iii) “Reserve” – General or for specific purpose other than provisions for depreciation or diminution in the value of asset or for known liability.
 - (iv) Security or guaranty are not reported here
 - (vii) Total of B/s may be differ
 - (x,xi) TDS is deducted from commission paid u/s 194H

(xii,xiii) – State gross amt of interest paid or received.

(xiv) – State amt of depreciation debited to P&L a/c

(xvi) – Corporate assessee: State amt of I.Tax in P&L a/c

Non Corporate assessee: Amt of Advance Tax paid (if any)

In last signature of auditor with name, address, M.No, Place & date



Note:

- ◆ *w.e.f 1-12-2004, Form 3CD will be treated as incomplete, if Annexure I is not filled up.*
- ◆ *Annexure-I to be signed by the person competent to sign Form 3CA/3CB*



Annexure II - FBT

Note: By Finance(No.2) Act, 2009, new sec. 115WM is inserted providing that Chapter XII-H relating to FBT is not applicable from A.Y 1-4-2010. Thus, this annexure-II is not applicable now but no corresponding change is made in Form 3CD and it provides as under:

- ◆ Annexure II is inserted w.e.f 10.08.2006
- ◆ Similar format is prescribed for assesseees not liable to 44AB.
- ◆ Entities liable to Sec 44AB but not to FBT should report that Annx- II of Form 3CD as “not applicable”
- ◆ Total of column 6 in Annx II may not tally with books as the word “purposes” in Sec 115WB(2) (refers proximate purpose & not distant purpose)
- ◆ Advisable to maintain grouping statements & working sheets of items included/excluded from statement & reasons.



Important Points

- ◆ 3CD must be filled up and signed by the **designated person** who has signed Form No. 3CA or 3CB. *[F.R.N.No. need to be mentioned as per the guidelines of ICAI alongwith the M.No.]*
- ◆ While signing the form, **following should be kept in view:**
 - judicial pronouncements may be relied upon in the matter of inclusion or exclusion of any items in the particulars to be furnished under any of the clauses of the statement.
 - In case of conflict of judicial opinion on any particular issue, view which has been followed may be referred to while giving the particulars under any specified clause.

Contd....

- General accounting principles/guidelines by ICAI/ICWAI should be followed.
- Relevant changes in law relating to items to be reported on.
- Since auditor is to report the particulars as true and correct, he should obtain from the assessee the statement of particulars duly authenticated by him.
- **Under Rule 12(2)** the report etc., should not be furnished along with the return of income.



Penalty for failure to get accounts Audited- Sec. 271B

- ◆ If the assessee fails to get his accounts audited u/s 44AB,
 - a flat penalty u/s 271B shall be attracted.
 - ½ of total Sales, turnover or gross receipts
 - Or
 - Sum of Rs. 150,000 (w.e.f.1-4-2011)
 - (Whichever is less)
- U/s 271B No penalty shall be imposed, if assessee proves that there was reasonable cause for such failure.



Reasonable Causes

◆ Reasonable Cause

- (a) Resignation of tax auditor and consequent delay;
- (b) Bona fide interpretation of the ‘turnover’ based on expert advice;
- (c) Death or physical inability of the partner in charge of the account
- (d) Labour problems such as strike, lock-out for a long period, etc;
- (e) Loss of accounts because of fire, theft, etc., beyond the control of the assessee;
- (f) Non-availability of accounts on account of seized;



contd...

(g) Natural calamities, commotion, etc.

The opportunity of being heard shall be given to the assessee.

Case Law

(i). *ITO v. Sachinam trust (2009) 223 CTR (Guj.)152/[2010] 320 ITR 445*- legal opinion in tax audit manual published by the Bombay Chartered Accountants' Society constituted reasonable cause for bonafide belief of the assessee that provisions of sec. 44AB are not applicable in its case.

(ii) *CIT v. Capital Electronics 261 ITR 4 (Cal).*

(iii). *Tools India Distributors v. ITO (2000) Taxman 216 (Mum).*



Circular 3/2009

- ◆ An assessee should obtain the report of audit from an accountant under section 44AB of the Act, on or before the due date of the furnishing of the return and should fill out the relevant columns of the return forms on the basis of such report. However, the report of audit should not be attached with the return or furnished separately any time before or after the due date.
- ◆ No penalty under section 271B shall be initiated or levied for not furnishing the tax audit report on or before the due date. However, if the audit report has not been obtained before the due date, provisions of section 271B shall continue to be attracted.



Case Law

[2010] 320 ITR 498(Mad) CIT v. apex Laboratories Pvt. Ltd.

Held that no penalty is imposable u/s 271B for non-compliance with the provisions of section 44AB on the ground that the returns were filed belatedly. Penalty is leviabale only if the assessee fails to get his accounts audited and obtain a report.



Case Law

[2008] 307 ITR 331 (PUNJ. & HAR.) CIT vs. Cheema Filling Station-

Where a finding of fact had been recorded by Tribunal that assessee had sent a certified copy of tax audit report to department well in time under postal certificate (UPC) and authenticity of UPC had not been doubted by department, penalty under section 271B could not be imposed on assessee



Case Law

- ◆ [2001] 119 TAXMAN 258 (PUNJ. & HAR.) CIT vs. Punjab State Leather Development Corpn. Ltd.-

Assessee, Government Corporation, filed its return along with tax audit report which was prepared on basis of unaudited profit and loss account and balance sheet as on 31-3-1990 - Statutory auditors appointed by company were in process of audit and completed audit in March, 1992 - Whether penalty could be levied under section 271B - Held, no



Penalty u/s 277 A

- ◆ *Falsification of books of accounts or documents etc.,*

The Finance (No.2) Act, 2004 has inserted section 277 A w.e.f 1-10-2004. According to this section, any person shall be punishable with rigorous imprisonment, which may extend form 3 months to 3 years and shall be liable to fine if the following conditions are satisfied;

- (1) He willfully and with intent to enable any other person (assessee) to evade any tax or interest or penalty chargeable and imposable under the Income Tax Act.



contd...

(2) He makes or causes to be made, any entry or statement in any books or other documents relevant for any proceeding under the Act which is false.

(3) He knows it to be false or dose not believe it to be true.

However, it shall not be necessary to prove that assessee has actually evaded any tax, penalty or interest chargeable or imposable under the Act.



E-filing of Return

- ◆ *Vide press release dated Saturday, April 28, 2007 Finance Minister had announced that E filing of return would be mandatory for firms liable to tax audit u/s 44AB for the assessment year 2007-08.*
- ◆ *Recently the Central Board of Direct Taxes has amended this provision by amending rule 12. This amendment has been made by Notification No. 49/2010, dated July 9, 2010*



contd..

- ◆ After the amendment of rule 12, individuals/HUFs (covered by section 44AB) will have to submit return for the assessment year 2010-11 (or any subsequent year) electronically with or without digital signature. This rule is applicable **with effect from July 9, 2010.**

However, if an individual/HUF (covered by section 44AB) has already submitted his return of income before July 9, 2010 in paper mode, he or it will not be required to again submit the same return electronically.



Thank You

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