

TAX AUDIT REPORT

(Important issues and recent amendments)

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Scope

- Preliminary understanding of Tax Audit
- Provisions regarding exemption from Tax Audit
- Amendments in last 3 years
- Discussion on important issues

Scope does not include

- System Created issues not elaborated
- No detailed discussion on intricacy of S. 28 to 41



Preliminary understanding of Tax Audit

S. 44AB

- It applies to assesseees having business and/or profession
- Certain businesses / profession are exempt or not liable for tax audit
- The due date for filing report under 44AB is 30th September and in case the TP is also applicable to the assessee date is 31st October (One month prior to the due date of filing the ROI)
- Prime Rule -Business
 - Turnover above Rs. 1 Crore
 - Profit @ 8%/6% - Rs. 2 Crore
 - 95% Banking transactions -Rs 10 Crore

Revision in Form 3CD

- Rule 6G provides for revision on account of payment u/s 43B regarding Statutory payments and allowance under S. 40 regarding TDS Violation, if the payments have been made subsequent to the signing of Form 3CD.
- Further ICAI guidance note provides for revision whenever there is necessity.
- There should be a clear mention 'REVISED REPORT'
- Questions may have to be answered why correction?

The main forms are detailed hereunder:

Form No	Applicable to	Remark
3CA	Whose accounts are audited under any other law	It is primary a covering letter – Remarks can be added which are relevant for Form 3CD
3CB	Other assessees liable for Tax audit	It is an Audit Report in substance and auditor has also has to report true and fairness of the accounts. This will also apply to companies following different PY /amalgamation case. This will also apply where a company has different financial year.
3CD	Particulars of various issues for determination of business income	<p>It also contains certain information which are not directly relevant for business income such as Income chargeable u/s 56, S. 269SS, S. 269ST etc.</p> <p>It is a certificate rather than report.</p> <p>As per ICAI, the filing of the details is the responsibility of the assessee and the assessee also has to sign the Data although prescribed form does not require such signature</p>

ICAI and Tax Audit

- Maximum Tax Audit per partner -60
- Latest Guidance Note Published as 8th edition 2022
- ICAI has also come out with a guideline for Financial Statement of Non-Corporate entities (whether none adherence of this guideline by assessee – need to put remark in observations?)

RELEVANT AUDIT STANDARDS

SA 200	Deciding on overall audit objectives and conduct of the audit
SA 210	Audit appointment documentation
SA 230	Audit documentation
SA 300	Audit planning
SA 310	Know Your Client
SA 500	Collection of audit evidence
SA 501	reliance on the work of internal auditor
SA 505	External confirmations
SA 520	Analytical procedures
SA 550	Collection of information relating to RPT
SA 580	Management Representation letter
SA 620	Reliance on expert opinion
SA 700	Qualifications and disclaimers in the audit reports

Understanding the legal aspect of Form 3CD

- It is generally a statement of facts – True and Correct
- However, some sections bring in the opinion –contradiction
- The opinion of Auditor is not sacrosanct
- The assessee may defer – issue of digitized processing? Additions in S. 143(1A) intimation (Correct?)
- As Auditor, one has to be conservative.
- Auditor may put assessee's different view by way of appropriate remark.
- The client may take up issue in computation and in ROI
- S. 143(1A) intimation is now an appealable order.
- Many follow attaching copy of full version of Tax Audit Report (Physically signed) with all the necessary comments while filing / filling online 3CD Report

What is first- Return or Tax Audit?

- Return of income requires Tax Audit Report as Annexure (Explanation clause (bb) to S. 139(9))
- We have also observed CPC declaring the Return to be defective if the Audit Report is not attached.
- Few clauses of Form 3CD requires reporting based on what assessee is opting while filing Return of Income specially where auditor accepts some of the interpretation, such as
 - options for concessional tax rates.
 - Similar would be a situation for newly inserted clause 8a and consequential answers to few other newly inserted clauses
- Therefore, though Tax Audit report precedes Return of Income, in effect it is simultaneous exercise.

Provisions regarding exemption from Tax Audit

Section	Brief Particular
S. 44AD	Business entities, based on turnover and/or profit
S. 44ADA	Professional entities based on receipt and surplus
S. 44AE	Plying, hiring on leasing goods carriages based on number of vehicles and deemed income

Provisions regarding exemption from Tax Audit Contd..

Section	Brief Particular
S. 44B	Non-Resident in Shipping Business - Deemed Profit @ 7.5%
S. 44BB	Non-Resident engaged in business of supply of plant or machinery on hire for exploration of Mineral Oil Profit @10%
S. 44BBA	Non-Resident Aircraft Operator – Business - Deemed Profit @5%
S. 44BBB	Foreign companies engaged in activities relating to turnkey power projects Profit of 10%

Remark: Resident shipping companies may opt for tonnage tax but not specifically exempt from tax audit.



Practical issues as regard whether liable to Tax Audit or not

Golden Rules

- When in doubt, better carry out Tax Audit
 - To avoid penalty @0.5% - Maximum Rs. 1,50,000/-
- When in doubt, file ROI before due date for non audit assessee
 - To avoid denial of carry forward of losses
 - To avoid denial of deduction as regard income
- Litigative issues- be conservative as auditors – may add appropriate remark as to the interpretation being considered by the assessee.

Comparative study of sec 44AD/ 44ADA/ 44AE

Particulars	Sec. 44AD	Sec. 44ADA	Sec. 44AE
Status	INDL, HUF, Firm (Not LLP)	INDL, Firm (Not LLP)	No Restriction
Residential status	Resident	Resident	No Restriction
Nature of activity	All business (Except 44ADA, 44AE, Ch. VI-A income cases)	Profession - S.44AA(1)	Plying, hiring leasing goods carriages

Comparative study of sec 44AD/ 44ADA/ 44AE

Particulars	Sec. 44AD	Sec. 44ADA	Sec. 44AE
Additional conditions	Not applicable for S. 44AA(1), brokerage, agency business*	INDL, Firm (Not LLP)	Not to own more than 10 vehicles at any time during PY
Turnover/ GR	Not to exceed Rs. 2 Crores	Not to exceed Rs.50 Lacs	No Restriction
	if Receipts in cash not to exceed 5% of Turnover /Gross Rpts		

* Many claim to have done filing of ITR claiming S. 44AD and S. 44ADA both and CPC has process those ITR

Comparative study of Sec 44AD/ 44ADA/ 44AE

Particulars	Sec. 44AD	Sec. 44ADA	Sec. 44AE
Min. Income	8/6% of Turnover/ Gross receipts	50% of Gross Receipts	HGC 1000 per ton pm/ Others - 7500 pm
If min. income offered	No 44AA /44AB	No 44AA /44AB	No 44AA /44AB, TO/ Income not counted for limits
If not offered, sec 44AB applicability	If income exceeds basic limit & Ss (4) applies	If income exceeds basic limit	Whether or not income exceeds basic limit

Comparative study of sec 44AD/ 44ADA/ 44AE

Particulars	Sec. 44AD	Sec. 44ADA	Sec. 44AE
Computation of WDV	As if depreciation allowed for each years		
Deduction u/s. 30 to 38	Deemed to be allowed		
Further claim of Interest & Remuneration to partners	Not allowed		Allowed

Meaning of Turnover and Gross Receipts.

- There are different opinions on what is 'turnover' or 'gross receipt'
- Institute canvasses the concept of the method of accounting followed by the assessee. (Para 5.10 of the Guidance Note-2014)
- Institute also requires to follow exclusive method of accounting.

Total Sales / Turnover / Gross Receipts

- **Items forming part of Turnover**
 - Advance received from customers and forfeited
 - Cash incentives for exports
 - Dividends on shares received by a dealer in shares
 - Hire charges and installments received in the course of hire purchase
 - Profit on sale of import license
 - Rental Income – Where the same is assessable as business Income
 - Sale proceeds of scrap, wastage etc., - if not treated as part of sale or turnover

Mixed activities- agriculture growing and processing business

- Tea growers – 40%
- Coffee grower – 25%
- Coffee grower – processing also includes grinding -40%
- Rubber plantation – 45%
- Other agro based processing- upto growing the product- it is agriculture and balance income is processing
 - Whether entire income is to be considered in turnover?
 - If one goes by Rule 7, 7A, 7B and 8, turnover shall include entire sale proceeds

Total Sales / Turnover / Gross Receipts

- **Speculative Transactions**
 - The aggregate of both positive and negative differences is to be considered as turnover.
- **Delivery based transactions**
 - The total value of sales is considered as turnover.

Total Sales / Turnover / Gross Receipts

- **Derivatives, Futures & Options**
 - The total of favorable and unfavorable differences shall be taken as turnover.
 - **Premium received on sale of options is also to be included in turnover. (excluded by ICAI GN 2022) if already included in profit**
 - In respect of any reverse trades entered, the difference thereon, form part of the turnover.
 - Difference in respect of reverse trade to be included
 - Year end open position case, differences to be ignored (differences will be added to turnover when transaction is actually squared up)
 - Delivery based settlement in derivative transaction, the differences between sale price and settlement price will be considered for turnover. In the hands of transferor, entire sale value will be considered in turnover.

Total Sales / Turnover / Gross Receipts

- **Gross Receipts for Business -**
- It will include all receipts whether in cash or in kind arising from carrying on of the business which will normally be assessable as business income under the Act.

Total Sales / Turnover / Gross Receipts

- Perquisites in the course of Business /Profession ?

Paragraph 5.12 of the guidance note clearly mentions to include the value of any benefit or perquisite whether convertible into money or not arising from business or profession.

Total Sales / Turnover / Gross Receipts

- **Items not to be included in Gross Receipts**
 - Advance forfeited in respect of fixed assets
 - Out of pocket expenses collected separately from clients
 - Rental Income which is not assessable as business income
 - Sale proceeds of Fixed Assets Sale proceeds of Investments
 - Share of profit of a partner in a Partnership firm u/s 10(2A)
 - Write back of amounts no longer payable to creditors and provisions no longer required

Amendment from A.Y. 2021-22-Limit increased to Rs 10 Crores with conditions

- The person having aggregate of all amounts received including amount received for sales, turnover or gross receipts in cash of less than 5% of total receipts and – The person having aggregate of all payments made including amount incurred for expenditure in cash, of less than 5% of total payments.
- The person who meets above conditions the tax audit limit is Rs. 10 Crores, and he need not get audit done under S. 44AB even if his profit is less than 6% or 8% as may be applicable. (However, they will be required to maintain books of accounts as per S 44AA read with Rule 6F)

WHAT IS PGBP?

- The term "business" refers to the organized efforts and activities of individuals to produce and sell goods and services for profit.
- A **profession** is an occupation founded upon specialized educational training, the purpose of which is to supply disinterested objective counsel and service to others, for a direct and definite compensation, wholly apart from expectation of other business gain
- Vocation vs. profession??
 - S. 2(36)- Profession include Vocation -- **It does not apply to S. 44ADA**

Does S. 2(36) Apply When It Comes to S. 44ADA and 44AB?

Both these sections specify an assessee....engaged in a profession referred to in S. 44AA including for exclusion from the applicability of S. 44AD

However, the code list prescribed for ROI extends the meaning. – it is necessary to be sync with ROI code

Definition of Profession – IT Act

- S. 44AA: reference to
 - legal,
 - medical,
 - engineering,
 - **architectural consultancy**
 - **Profession of accountancy**
 - **Technical consultancy**
 - **Interior decoration**
 - **Film Artists**

Definition of profession – IT Act Contd..

- Actor, cameraman, Director, music director, art director, dance director, editor, singer, lyricist, story writer, screen writer, dialogue writer, dress designer
- Profession of Company Secretary
- Profession of information technology

Definition of profession – IT Act Contd..

Profession and Business codes- Income Tax

The heads given in the code list

- Profession Codes – Professions opting for Section 44ADA
- Business Codes – Business opting for Section 44AD
- Business code opting for S. 44AE
- Business code not opting for S. 44AD/44ADA/44AE

Business Codes opting for S. 44AD - Subheadings

- Agricultural, Animal, Husbandry & Forestry
- Fish Farming
- Mining and Quarrying
- Manufacturing
- Electricity, Gas and Water
- Construction
- Real Estate and Renting Services
- Renting of Machinery
- Wholesale and Retail Trade
- Hotels, Restaurants and Hospitality Services

Business Codes opting for S. 44AD - Subheadings Contd..

- Transport & Logistics Services**
- Post and Telecommunication Services**
- Financial Intermediation Services**
- Computer and Related Services**
- Research and Development**
- Professions**
- Education Services**
- Health Care and Services.**
- Social and Community Work**
- Culture and Sport**
- Other Services**
- Extra Territorial Organisations and Bodies**

Definition of profession – IT Act Contd..

- **Business Codes – Business opting for Section 44AD**

Some confusive Titles in code list

- **Professions opting for S. 44ADA**
 - Data processing -14003
 - Data base activities -14004
 - Other IT enabled services -14005
 - BPO -14006
 - Maintenance of Repair, of Office, Accounting and Computing Machinery -14008
 - Accounting, book- keeping and auditing profession - 16003

Some confusive Titles in code list Contd..

- **Professions opting for S. 44ADA**
 - General Hospitals – 18001
 - Super Speciality Hospital -18002
 - Nursing Homes - 18003
 - Diagnostic centres -18004
 - Pathological Lab -18005
 - Medical Education -18017
 - Individual Artists excluding authors – 20010
 - Other cultural activities- 20012

Some confusive Titles in code list Contd..

- **Business code opting for S. 44AD**
 - Cybercafe 14007
 - Computer Training and educational institute 14009
 - Other computer related services 14010
 - Natural Sciences and Engineering 15001
 - Social sciences and humanities 15002
 - Other Research and Development activities 15003

S 44AB(b) Profession

- Every person

Carrying on profession shall, if his gross receipt in profession exceed 50 lakh rupees (75 Lakhs from AY 2024-25) in any previous year (liable to audit)

- Does it envisage there can be some income otherwise than gross receipt from profession? **YES**
- Can other income be `business income`? **There does not seem to be any bar**
- **Less than Rs. 50 lakhs- exempt from audit?**

Turnover and GST

- Institute canvasses – if separate charge – not to be included in turnover
- Effect of *Chowringhee Sales Bureau (P)*- 87 ITR 0542: the case was more relating to income chargeable u/s 28- probably should not apply to S. 44Ab
- S. 145A- inclusive method- it is only for computation of taxable income.

Turnover or Gross Receipts.

- If assessee carrying on more than one eligible business then the same needs to clubbed and the total of all gross turnover or receipts should not exceed the relevant threshold
- However, Professional income ??

Circular 452 or 1986 – Commission agents

- CBDT separates out **Kacha Adatia and Pakka Adatia**
- Kachha Adatia- only commission income is to be included in turn over
- Pakka Adatia- it is principal to principal and total value of sales to be included in sales

S. 44AE- Transport vehicle owner

- Assessee should not own more than 10 goods carriages
- Minimum Income –
 - Heavy goods vehicle: Rs. 1,000/- per ton per month
 - Other Vehicle: Rs. 7,500/- per month
- If above conditions are fulfilled – no Audit u/s 44AB.-
- Also turnover of goods carrier to be excluded from total turnover for counting other threshold

What is heavy goods vehicle

- “heavy goods vehicle” means any goods carriage the gross vehicle weight of which, or a tractor or a road-roller, the unladen weight of either of which, exceeds 12,000 kilograms (Section 2 (16) of **M.V. Act**).
- Easier Answer: RC Book copy

3-Wheeler Goods Carrier - Part of Count of 10

- “motor vehicle” or “vehicle” means any mechanically propelled vehicle adapted for use upon roads whether the power of propulsion is transmitted thereto from an external or internal source and includes a chassis to which a body has not been attached and a trailer; but **does not include** a vehicle running upon fixed rails or a vehicle of a special type adapted for use only in a factory or in any other enclosed premises or **a vehicle having less than four wheels fitted with engine capacity of not exceeding twenty-five cubic centimeters.**

S 44AB(e) Business covered u/s 44AD(4)

- a) If provision of 44AD (4) is applicable and
- b) the income exceeds the maximum amount not chargeable to tax in the previous year

S. 44AD- Section not applicable

- A person **carrying on** profession
- A person **earning** income in the nature of commission or brokerage
- A person **carrying on Agency Business**
 - Where section does not apply at all, one has to look at other sections only

Eligible Assessee

- Type of assessee
 - Individual
 - HUF
 - Partnership Firm – other than LLP
- Qualitative restriction:
 - No deduction or exemption u/s. 10A, 10AA, 10B, 10BA & Chapter VIA Part C

S. 44AD(4)

- (4) Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section and he declares profit for any of the five assessment years relevant to the previous year succeeding such previous year **not in accordance with the provisions of sub-section (1)**, he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of sub-section (1).

S. 44AD(5)

(5) Notwithstanding anything contained in the foregoing provisions of this section, an eligible assessee to whom the provisions of sub-section (4) are applicable and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under sub-section (2) of section 44AA and get them audited and furnish a report of such audit as required under section 44AB

Issues in 44AD

- A Doctor has the following income other than his medical practice income --Trading in masks, steam inhaler and sanitizers Rs 1.50 crore.
 - Can he claim 44 ADA for his performance income of Rs 49 lakhs and 44 AD for his trading business? **NO***,
 - **Can 44 ADA be claimed?***
- A person is doing trading in steel products- turn over Rs. 1.2 Crore, he has shown profit of Rs 17 lakhs in this year and he also has commission income from LIC agency which he is operating
 - Can he claim 44 AD for the chemical business: **NO?***

* Many claim to have done filing of ITR claiming S. 44AD and S. 44ADA both and CPC has process those ITR

Issues in 44AD

- In the example above, instead of commission income would it make a difference if he is in transport business and covered under section 44 AE?
 - Yes he can claim both
- Can those not covered by term profession as listed in earlier slides claim benefit of S 44 AD?
 - Yes

Issues in 44AD(4)?

- Assessee was a partnership firm which got converted into LLP
 - A Y 2019 20 claimed 44 AD in return of income
 - A Y 2020 21 claimed 44 AD in return of income
 - A Y 2021 22 it gets converted in to a LLP and therefore does not claim benefit u/s 44AD

is it required to audit under section 44 AB(e) would 44 AD(4) and (5)apply

-No (otherwise also he will not be eligible for S. 44 AD once got converted to LLP)

Issues in 44AD(4)?

- In the same example if the facts are as under would audit apply for A Y 2020 21
 - A Y 2019 20 claimed 44 AD in return of income
 - A Y 2020 21 the turnover is above Rs 2 crore
 - He was not fulfilling the conditions of banking channel receipt and payment of 95%
 - His profit was more than 6%/8%

Issue: A. Y. 2021-22, whether his non filing u/s 44ADA attributable to the provisions of S.44AB(a) or he is hit by the provisions of S. (4) of S. 44AD –

No and therefore, not hit by S. 44AD(4)

Issues in 44AD(4)?

- A partnership firm has following information and wants to know whether audit is to be conducted under section 44 AD(4) r w S. 44 AB
 - A Y 2019-20 claimed 44 AD in return of income
 - A Y 2020-21 claimed 44 AD in return of income
 - A Y 2021-22 he has income from profession and hence is not eligible for benefit of S 44 AD, will it be able to claim 44 AD if no professional income in A Y 2022-23

Yes

Audit and partner's remuneration / interest

Partner's remuneration is more than tax audit limits - liable for tax audit:

- Hitesh D. Gajaria- ITA No. 993/Mum/2007-ITAT
- Suhail Amin Nathani- ITA No. 4240/Mum/2008-ITAT
- Sagar Dutta vs DCIT- ITA No. 692/Kol/2012-ITAT
- Usha Narayan vs DCIT -ITA No.703/Kol/1

S. 44AD and S. 44ADA- Further provisions Contd..

One has to take care of choosing the appropriate Form of Return (ITR-3) if he is eligible so that he is not hit by the above provision. If one files ITR 4, though not applicable, CPC may presume that the assessee has opted for S. 44AD and will have issues in subsequent year/s. (ITR 3 requires accounts details and ITR 4 does not require)

S. 44AD and S. 44ADA- Further provisions Contd..

- Deduction under Chapter VI A allowable
- Deduction u/s 80C to 80 U are allowed
- Books of Account need not be maintained
- No Books – No Audit – **look at the compliance under other law**
- Basic Records to be maintained – Turnover – Receipt by cash or other mode (e. g. Patient Register in case of Doctor)
- Block of assets will be deemed to have been depreciated
- Advance Tax in respect of Business Income to be paid in one instalment on 15th March.- For Other Income, normal rules of Advance Tax Applicable



3CD- CLAUSE BY CLAUSE

Amendments since 2018

Clause	Amendment	Remark
3	PAN or Aadhar Card	
4	GST and GST No. added	
8A	Information of Option S. 115BA, S. 115BAA, S. 115BAB, S. 115BAC and S. 115BAD S. 115BAE from AY 2024-25 New Mfg. Coop. 15%	S. 115BA 25%, S115BAA 22%, S. 115BAB 15%, S. 115BAC New regime Tax S. 115BAD 25% for cooperative
17	S. 43CA and S. 50C	S. 50C relating to Capital Gain
18	Adjustment as regard disallowance of depreciation – Details on account of opting S. 115BAC and S. 115BAD	Details were relevant only for A.Y. 2021-22 opting for new regime tax
19	Amount admissible u/s 32AD	15% extra depreciation for backward area

Amendments since 2018 Contd..

Clause	Amendment	Remark
29A	S. 56(2)(ix) information added	Advance against capital asset transfer Amount forfeited
29B	S. 56(2)(x) information added	Gift received details added
30C	GAAR reporting implemented	Finally, GAAR Reporting implemented from 2022-23
31	In all sub clauses optionally Aadhar card details added	
31	Sub clause (c) correction made 'repaid' instead of taken or accepted	
31	Sub clause (e) repayment of loan deposit or specified advance	Corrected
32	Details of losses and allowances not allowable on opting for concessional rate of tax added	

Amendments since 2018 Contd..

Clause	Amendment	Remark
42	Specified transaction reporting added Form 61, Form 61A and Form 61B added)	Form 61 details of Form 60 Filed by other persons Form 61A specified financial transactions Form 61B reportable account details
43	CBCR Report	Applicable to MNCs
44	GST Data	Finally, Reporting implemented from 2022-23

Clause 1: Name of the Assessee

- This clause requires name of the assessee to be stated. It is possible that the Form 3CD has particulars of the proprietary concern but the clause requires name of the assessee and not name of the concern
- In respect of a branch, name of such branch should be mentioned along with the name of the assessee
- As compared to immediately preceding previous year change in name could be due to -
 - assessee voluntarily changing the name;
 - in case of an individual who is a female – consequent upon marriage;

Clause 1: Name of the Assessee

Contd...

- Conversion of the entity from partnership to LLP
- The Tax Auditor should examine whether the new name has been intimated to the Department
- He should check if the new name updated in PAN data base
- In case where the company changes the name voluntarily check the certificate of incorporation for the new name
- In case of change in name of the assessee it would be advisable to state even the earlier name
- If the change in name is after end of previous year but before date of signing the report, the new name should be stated along with old name

Clause 2 : Address

- The address mentioned under this clause should be same as communicated to ITD – PAN data unless there is a change in the address which has not been communicated to the Department. In that case, the auditor must ascertain the reason of not intimating the change in the address to the Department
- In case of a company, address of its registered office must be stated
- In case of a branch, the address of the branch should also be stated

Clause 2 : Address

- In case of a new assessee the address will have relevance to decide the jurisdiction of the AO
- In case of a proprietary concern if the address of the proprietary concern is different from the address of the assessee (proprietor), obtain the address of the proprietor and ensure that it is also stated in Form 3CD
- In case of new assessee, the address should be that of the principal place of business
- These aspects are significant as tax department issues notices on the basis of PAN data base

Clause 3 : Permanent Account Number (PAN) OR Aadhar Card No., if available

- In case, during the previous year, there has been business reorganization, as a result of which new PAN has been applied for and allotted, ensure that the new PAN is stated
Eg. partnership firm being converted into LLP
- PAN could change as compared to immediately preceding previous year in cases where, in case of an individual, the individual assessee has expired during the previous year but the business continues to be carried on by the Legal Heirs or by Executors, as the case may be.
- The PAN to be mentioned should be checked from the PAN card

Clause 4: Indirect Taxes Payable

- This clause will be attracted if the assessee is liable to pay indirect tax. Indirect tax is a tax which is levied on a person but the economic burden of which is borne by another person
- While the clause makes a mention of only five taxes viz. excise duty, service tax, sales tax, goods and services tax, customs duty, it is worthwhile to note that the clause uses the word 'like' after the words 'indirect tax' and also uses 'etc' after customs duty thereby indicating that the taxes mentioned in the clause are only illustrative and that the scope of reporting under this clause is not restricted only to the five taxes mentioned therein but would also cover even other indirect taxes

Clause 4: Indirect Taxes Payable Contd..

- The indirect tax, of which a reference is to be made in this clause, should be such that a registration number or identification number has been allotted to the assessee
- S. 43B makes a mention of the words “tax, duty, cess or fee”. There is a difference between tax, duty and cess – while the clause requires mention of indirect tax it also states as an example excise duty. However, SC has held that the name is not indicative. A particular levy may be called as a ‘Fee’ but may be a tax.
- Examples of other indirect taxes could be entertainment tax levied on theatres and cinema halls, local body cess/tax, if not merged in GST or for pending proceedings of old years.

Clause 5 : Status

- This refers to the different classes of assessee included in the definition of “Person” in section 2(31) of the Act, namely, individual, Hindu undivided family, company, firm an association of persons or a body of individuals whether incorporated or not, a local authority or artificial juridical person.
- The status mentioned by the assessee should be verified
- If there is any dispute about the status of the assessee, the factual position should be brought out very clearly
- In case during the year there was a change in status on account of conversion then the status as mentioned in the current year’s form needs to be checked

Clause 6 : Previous Year From ____ To ____

- The requirement is to state both the first date of the previous year as well as the last date
- In the case of a business or profession newly set up during the financial year the previous year shall be the period beginning from the date of setting up of the business or profession
- Therefore, in a case where a new business or profession is set up during the previous year, the auditor will have to ascertain from facts the date of setting up of the business or profession and mention that date as the first date of the previous year
- Merger / demerger – previous year dates may be different.
- Previous Year in the case of person leaving in India (S. 174)

Clause 6 : Previous Year From ____ To ____

- The requirement is to state both the first date of the previous year as well as the last date
- In the case of a business or profession newly set up during the financial year the previous year shall be the period beginning from the date of setting up of the business or profession
- Therefore, in a case where a new business or profession is set up during the previous year, the auditor will have to ascertain from facts the date of setting up of the business or profession and mention that date as the first date of the previous year
- Merger / demerger – previous year dates may be different.
- Previous Year in the case of person leaving in India (S. 170A)
- Similar other situation -- S. 175 onwards

Clause 7 : Assessment Year

- The assessment year relevant to the previous year for which the accounts are being audited should be mentioned.

Clause 8 : Relevant clause of section 44AB under which the audit has been conducted

- The five clauses (plus 1) of section 44AB under which tax audit can be carried out are:
 - a. Under clause (a) if the person is carrying on business whose total sales, turnover or gross receipts, as the case may be, exceed Rs. One crore

There is separate multiple choice on drop down box for Proviso to clause (a) , namely 10 CR with 95% banking channel
 - b. Under clause (b) if the person b. is carrying on profession whose gross receipts in profession exceed Rs. Fifty lakhs

Clause 8 : Relevant clause of section 44AB under which the audit has been conducted

- c. Under clause (c) if the person satisfies all the following conditions cumulatively –
- i. The person is carrying on the business
 - ii. The provisions of sections 44AE or s. 44BB or S. 44BBB are applicable to the person
 - iii. He claims that his income is lower than the amount deemed by sections 44AE or 44BB or 44BBB to be his profits and gains

Clause 8

Contd...

- d. Under clause (d) if the person satisfies all the following conditions cumulatively –
 - i. The person is carrying on a Profession
 - ii. The provisions of section 44ADA are applicable to the person
 - iii. He claims that his income is lower than the amount deemed by section 44ADA to be his professional income
 - iv. His income exceeds the maximum amount which is not chargeable to income-tax

Clause 8

Contd...

- e. Under clause (e) if the person satisfies all the following conditions cumulatively –
 - i. The person is carrying on the business
 - ii. The provisions of section 44AD are applicable to the person
 - iii. He claims that his income is lower than the amount deemed by section 44AD including 44AD (4) cases to be his profits and gains
 - iv. His income exceeds the maximum amount which is not chargeable to income-tax

Clause 8

Contd...

- The case of an assessee may fall under more than one clauses eg. an assessee carrying on both a business as well as a profession
- We are also required to mention subclause while getting UDIN

Clause 8a -Opting for 115BA etc- reporting

- *Q 8a: Whether the assessee has opted for taxation under Section 115BA/115BAA/ 115BAB*
- Subsection(5) of relevant section allows filing of option in Form 10-IC,10-ID.10-ID anytime before due date u/s 139(1)
- We need to insist that the relevant Form is filed before signing Form 3CD

Clause 9(a) : Details of constitution of firm or association of persons

- This clause applies only to firms (including LLPs) and association of persons
- If a partner is a partner in representative capacity then name of the beneficial partner should also be indicated
- Profit sharing ratio will also include loss sharing ratio
- If loss sharing ratio is different from the profit sharing ratio – both should be mentioned eg in a case where minor is admitted to the benefits of the partnership

Clause 9(a) : Details constitution of firm or association of persons

- Payment of remuneration or interest need not be mentioned in this clause
- Verify the names and profit sharing ratios from the partnership deed/instrument evidencing the agreement, documents filed with The Registrar, if any / minutes maintained, if any

Clause 9(b): Details of change in the constitution of firm or AOP

- In case there is a change in partner / member or profit sharing ratio several times during the previous year, each of such changes should be stated
- When partner in representative capacity retires & is admitted as partner in individual capacity, will it amount to change in partnership?
- Change in remuneration paid to partners without change in profit sharing ratio would not require disclosure in tax audit report indeterminate
- In case share of member of an AOP is indeterminate, the same should be stated
- **NEED TO WORRY ABOUT S. 9B AND S. 45(4)**

Clause 10(a) : Nature of Business

- Verification of nature of business is a matter of fact
- Principal line of business or nature of service or activity can be mentioned in this clause
- In case of doubt, preference should be to include rather than exclude. In either case, consequences /implications should be examined
- Disclosure can be under broad heads viz. manufacturing, trading, services, etc. For this purpose reference can be made to the sectors and sub-sectors mentioned in Annexure to old Form 3CD

Clause 10(a) : Nature of Business

- If assessee manufactures certain products and also sells certain components which are used in manufacture of product, would he be categorized as trader or manufacturer?
- If nature of business covers vast number of activities, it is sufficient for tax auditor to obtain management representation
- While stating the nature of business – consistent with what is stated in ITR

Clause 10(b): Change in the nature of Business or Profession

- Change would cover both a new activity commenced and also an existing activity discontinued
- Any material change in the nature of business should be clearly brought out
- In case there has been reorganization of the assessee's business the auditor should check if there is a change in the nature of business e.g. in cases of amalgamation, demerger, etc.
- Whether temporary suspension amounts to a change in business – Generally No

Clause 11: Details of books prescribed u/s 44AA

- To give list of books prescribed, maintained and address at which maintained.

Location of the books may have implications

- Books for certain professions prescribed in Rule 6F
- Books constitute books of original entry and may be prescribed under some other statute
- Sec 2(12A) of the Act defines “books or books of account”— can be in written form or print-outs or other form of electro magnetic data

Clause 11: Details of books prescribed u/s 44AA

- Though for business, books not prescribed in sec44AA(2), such books are required to be maintained so as to enable the AO to compute the income as per the IT Act
- Give the list of locations and books maintained at such location
- If maintained in a computer system—to mention the fact
- List of books of account and nature of relevant documents examined

Clause 12: Profits on Presumptive basis

- In case profits and gains of the business are assessable on presumptive basis under any provision of the Act, reporting has to be of an amount included in Profit & Loss account
- It is not necessary to indicate whether such amount corresponds to the amount assessable under the relevant section relating to presumptive taxation
- The tax auditor may clarify by way of a note that the amount mentioned under this clause is not necessarily the actual amount of profits and gains chargeable to tax under the relevant section.

Clause 12

Contd...

- Where the assessee carries on more than one businesses the following 3 situations could arise –
 - The assessee maintains separate set of books of accounts – in such a situation there will be no issue whatsoever
 - The assessee maintains same set of books of accounts for more than one businesses – profits of some of which are taxable on presumptive basis and the profits of the others are not covered by presumptive taxation – in such a situation the auditor will have to ask the assessee to provide him and justify the basis on which expenses have been apportioned to various business. The auditor will have to arrive at a fair and reasonable estimate of such expenditure on the basis of evidence in his possession. The basis of apportionment of common expenditure should also be checked. If the auditor is not satisfied with the correctness of such apportionment, he should indicate such fact under this clause by way of a suitable note

Clause 12

Contd...

- The assessee maintains books of accounts for his regular business but does not maintain any books for business covered by presumptive tax provisions. In such cases, the auditor will be unable to satisfy himself about the correctness of the net income from the presumptive business credited to the profit and loss account. He should, state the amount of income appearing in the profit and loss account with a suitable note expressing his inability to verify the said figure. He may have to consider qualifying his report in Form 3CB

Clause 12

Contd..

- Various businesses / Professions covered by presumptive tax provisions

Section	Description
44AD	Eligible business carried on by resident individual, Hindu undivided family or firm (other than LLP)
44ADA	Professions referred to in Section 44AA(1) i.e. legal, medical, engineering, architect, accounting, technical consultancy, interior decoration and other notified profession
44AE	Business of plying, hiring or leasing goods carriages where assessee owns not more than ten goods carriages at any time during the previous year
44B	Profits and gains of non-resident engaged in operation of ships
44BB	Profits and gains of business of exploration, etc. of mineral oils in case of non-residents

Clause 12

Contd..

- Various businesses / Professions covered by presumptive tax provisions

Section	2
44BBA	Profits and gains of business of operation of aircrafts in case of non-residents
44BBB	Profits and gains of foreign companies engaged in business of civil construction, etc. in certain turnkey power projects ³
Chapter- XII-G	Shipping Business
First Schedule	Insurance Business

Clause 13 : Method of accounting

- Method of accounting followed:
 - Accrual vs. Cash method (mixed or hybrid method not allowed)
 - Method to be consistently followed
 - Cash basis not possible for companies (Section 129 of Cos Act 2013) However, one ITAT has allowed cash basis for Income Tax purposes
 - Computation of income under the heads “ Profits and gains of Business or profession “ and ‘Income from other sources “ must be in accordance with Income computation and disclosure standards (ICDS), if applicable.

Issues

- Is it possible to follow different methods of accounting for different sources under the same head?

Clause 13 (d) / (e) / (f) – ICDS Impact

- If any adjustment is required to be made in the Profit/ Loss for complying with ICDS then:
 - i. Increase/Decrease in the Profit/Loss relating to each ICDS to be disclosed along with net effect
 - ii. Disclosure as per ICDS

Clause 13

Contd...

- i. ICDS is a computation standard, therefore this disclosure will have to be made separately as mandated by ICDS.
- ii. If however, the accounts are maintained according to ICDS and disclosure to that effect is contained in the financial statements a reference to that disclosure should suffice.

Clause 13

Contd..

- Change in method of accounting
 - Allowed as per para 9 of AS 2(IT) in 2 cases
 - ✓ Adoption required by statute
 - ✓ Change would result in more appropriate presentation of FS
 - Materiality to be considered
 - Effect on profit/loss to be stated (*in columnar format*)
 - Changed policy to be followed consistently
 - Change in policy is not to be reported as ‘change of method of accounting’
 - impact thereof is however disclosed in FS

Issue - Borrowing cost (ICDS-IX)

Clause 13 of Form 3CD

- How much borrowing cost should be capitalized considering the provisions of ICDS IX and AS 16 in the following case?

Particulars	Amount
Total Borrowings	1000
Specific borrowing for qualifying asset	200
Total interest expense	100
Interest on specific borrowings	10
Qualifying asset (opening)	300
Qualifying asset (closing)	450
Expense on qualifying asset (450-300)	150
Average of total assets	1000
Capitalization rate for AS $[(100-10)/(1000-200)]$	11.25%

Issue- Borrowing cost (ICDS-IX)

Contd..

Particulars	Capitalization as per ICDS	Capitalization as per AS
Specific	10	10
General	33.75 [90*375/1000] Average of qualifying asset = (300+450)/2 =375	16.875 [11.25%*150]

Issue - Borrowing cost (ICDS-IX)

Contd..

⑩ Relevant extract of AS 16

- *“To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.”*

Issue - Borrowing cost (ICDS-IX)

Contd..

ICDS - amount of borrowing costs to be capitalized shall be computed in accordance with the following formula namely :— $A*B/C$

Where A = borrowing costs incurred during the previous year except on specific borrowings

B = (i) the average of costs of qualifying asset as appearing in the balance sheet of a person on the first day and the last day of the previous year;

(ii) in case the qualifying asset does not appear in the balance sheet of a person on the first day, half of the cost of qualifying asset; or

(iii) in case the qualifying asset does not appear in the balance sheet of a person on the last day of the previous year, the average of the costs of qualifying asset as appearing in the balance sheet of a person on the first day of the previous year and on the date of put to use or completion, as the case may be, excluding the extent to which the qualifying assets are directly funded out of specific borrowings;

Issue - Borrowing Cost (ICDS-IX)

Contd..

C = the average of the amount of total assets as appearing in the balance sheet of a person on the first day and the last day of the previous year, other than assets to the extent they are directly funded out of specific borrowings;

- **FAQ on ICDS**

The capitalization of general borrowings cost under ICDS IX shall be done on asset to asset basis

Issue - Borrowing cost (ICDS -IX)

Contd..

Particulars	ICDS IX	AS 16
Qualifying Asset	Land is included in definition of Qualifying Assets	Not included
Commencement of capitalization	Three conditions <ul style="list-style-type: none"> • Incurrence of capex • Incurrence of borrowing cost • Preparatory activities are in progress 	<ul style="list-style-type: none"> • Specific Borrowing – Date on which funds are borrowed • General Borrowing – Date on which funds are utilized • Capitalization starts early under ICDS
Income from temporary investment of borrowed funds	No netting off from cost of asset. Will be taxed as income	To be netted off from the borrowing costs and capitalized

S. 36 disallowance Vs/ ICDS Capitalization

Issue – Exchange of assets

Clause 13 of Form 3CD

- Company A receives a building in exchange of a machinery from company B. What will be the impact on block of assets considering ICDS V?

Form 3CD- Clause 13(d)

(d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)

Form 3CD-Clause 13(e)

ICDS No	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)	Net Effect (Rs)
I	Accounting Policies			
II	Valuation of Inventories			
III	Construction Contracts			
IV	Revenue Recognition			
V	Tangible Fixed Assets			

Form 3CD-Clause 13(e)

ICDS No	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)	Net Effect (Rs)
VI	Changes in Foreign Exchange Rates			
VII	Governments Grants			
VIII	Securities			
IX	Borrowing Costs			
X	Provisions, Contingent Liabilities and Contingent Assets			

ICDS

- There is no ICDS as regard the transaction of real estate development.
- CBDT was to come with it but not yet

Form 3CD-Clause 13(f)

ICDS No	Particulars	Disclosure
I	Accounting Policies	
II	Valuation of Inventories	Disclosure mainly covered in Clause 14
III	Construction Contracts	
IV	Revenue Recognition	
V	Tangible Fixed Assets	All disclosures covered in Clause 18

Form 3CD-Clause 13(f)

ICDS No	Particulars	Disclosure
VII	Governments Grants	
IX	Borrowing Costs	
X	Provisions, Contingent Liabilities and Contingent Assets	

Clause 13

Contd...

- i. ICDS is a computation standard, therefore this disclosure will have to be made separately as mandated by ICDS.
- ii. If however, the accounts are maintained according to ICDS and disclosure to that effect is contained in the financial statements a reference to that disclosure should suffice.

Issue - ECB for Purchase of Machinery Contd ...

- ⑩ Since Section 43A applies only with respect to imported assets, case of indigenous assets continue to be governed by ratio laid down in TISCO
- ⑩ Courts have taken a view that where foreign currency loan is used for the purpose of acquisition of assets, the exchange difference on the loan amount would be capital in nature
 - **Sutlej Cotton Mills Ltd vs CIT (1979) (116 ITR 1) (SC)**

Issue - ECB for Purchase of Machinery

Contd...

- ⑩ Section 43AA inserted by Finance Act 2018
 - Subject to provisions of Section 43A, any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss in accordance with ICDS
- ⑩ ICDS 6 provides that in respect of monetary items, exchange differences arising on the settlement or on conversion thereof on the last day of the previous year shall be **recognized as income or expense in that previous year**
- ⑩ As per ICDS, "Monetary items" are money held and assets to be received or liabilities to be paid in fixed or determinable amounts of money. Cash, receivables, and payables are examples of monetary items
- ⑩ Pune Tribunal in **Cooper Corporation 180 TTJ 0727** has allowed the difference as Revenue Expenditure in case of indigenous Fixed Assets.

Common Error

Year	Nature of Entry	Accounted Difference	Cumulative
1	Provision	100	100
2	Provision	50	150
3	Actual payment	-20	130

The adjustment to Block of Assets will be 130 and not -20

Clause 14 : Method of valuation of Closing Stock

- Closing stock consists of RM, WIP, FG, Stores, etc.
- Normal valuation principles to be followed:
 - At lower of Cost or NRV;
 - To follow Absorption Costing;
 - To include all costs incl. excise duty (sec145A)
 - To mention how cost is determined
 - If cost arrived at as SP less GP margin—whether alright?
 - Allowed at SP in certain cases
 - SC decision of British Paints (188ITR44)
- To also value stores, packing items
- Change in method of valuation covered in Clause 13

Clause 14

Contd..

- Section 145A requires “Inclusive method” as against “Exclusive Method” mandated by AS 2
- Section 145A now requires inventory of unlisted securities or listed securities not traded regularly, to be disclosed at cost.
- Inventory other than those described above to be valued in accordance to the ICDS.
- ICAI GN on “Tax Audit u/s 44AB” mentions that in both methods, impact on profit/loss is Nil

Clause 14

Contd...

- Get list of Closing Inventory
- Confirm whether all items like RM, WIP, FG, Stores, Packing materials, consumables, etc. are valued
- Confirm method of valuation (incl. determination of cost, etc.)
- Tally inventory list with that submitted to the bank–
- Quantity should match– value may differ due to different valuation method applied
- Disclosure as per ICAI GN, if 145A not followed
- ICAI GN 2022 has removed detailed table which was given under GN 2014

Clause 14

Contd..

- Section 145A requires “Inclusive method” as against “Exclusive Method” mandated by AS 2
- Section 145A now requires inventory of unlisted securities or listed securities not traded regularly, to be disclosed at cost.
- Inventory other than those described above to be valued in accordance to the ICDS.
- ICAI GN on “Tax Audit u/s 44AB” mentions that in both methods, impact on profit/loss is Nil

Clause 15 : Conversion of Capital Asset into Stock

- Profits or gains arising on conversion of capital asset into stock-in-trade are chargeable to tax as capital gains
- Verify the minutes of the Board meeting in case of company assessee and in any other case, other supporting documents and accounting entries passed in the books to reflect the asset into stock instead of as a fixed asset
- Verify the date of acquisition and cost of acquisition from the records of the financial year of acquisition. If such verification is not possible, mention the same
- Verify the valuation report/ any other supporting document based on which the conversion is recorded in the books of account. If the same is not valued as per AS 2, consider qualifying Form 3CB

Clause 16 : Amounts not credited to P&L Account

- Verify the reserves account, or any other account to identify any item is directly credited to the same
- Only the claims lodged and admitted by authorities be reported. If such claims are not admitted, the same need not be reported
- Only those escalation claims which are accepted by the party be reported. Even partial claims admitted be reported
- If assessee disputes any item based on legal decision – to mention the same
- General disclaimer may be given that the auditor has not gone beyond the books of accounts produced to him during audit and has not conducted an investigation to find out if the assessee has not credited any amounts in the book

Clause 16

Contd.

- All instances of income which come to the notice of the auditor, while examining the accounts but which are not credited to the Profit and Loss account be reported
- Verify credits in capital accounts of the proprietor/partner, credits in the other balance sheet items
- Where the amounts are treated as capital receipts in the books and the auditor agrees - Such items be reported. e.g. premium received on issue of shares, profit on sale of assets not passed through profit and loss account

Clause 17 : Transfer of land and building

- Reporting will be required under this clause if the following conditions are cumulatively satisfied –
 - the assessee has transferred land or building or both;
 - the transfer is during the previous year;
 - consideration for transfer is less than the value adopted or assessed or assessable by any authority of a State Government
- Provisions of s. 43CA will apply for computation of income under the head
'Profits and gains of business or profession' whereas provisions of s. 50C will apply for computation of income under the head 'Capital Gains'

Clause 17

Contd...

- For provisions of s. 43CA to apply land or building or both which has been transferred during the previous year should have been held by the assessee otherwise than as capital asset whereas for provisions of s. 50C to apply land or building or both which has been transferred during the previous year should have been held as capital asset
- The definition of `transfer' given in s. 2(47) will apply for s. 50C but will not apply for the purposes of s. 43CA
- Issues-
 - Does S. 43CA apply to sale of flat under construction?
 - Does S. 43CA apply to an assessee following percentage completion method of accounting?
 - Will the provisions of s. 43CA / s. 50C apply to transfer of development rights?

Clause 17

Contd..

- In the context of S. 50C, will the provisions apply to
 - Tenancy
 - Leases
 - Development Agreement

Clause 18 : Depreciation as per IT Act, 1961

- When an asset is purchased – cost of the asset including the expenses incurred to complete the purchase i.e. customs duty, installation cost, etc is added to the block
- In the year of purchase – depreciation for full year/half year based on the date when asset is put to use. Verify relevant documents, i.e. technical experts report, etc. to determine the date when asset is put to use
- In the subsequent years, if the asset is used for the purpose of business even for part of the year, depreciation is allowable at full applicable rates
- Verify the excise records - CENVAT credit claimed to be reduced from the value of the asset
- In case of disputes regarding depreciation claim in earlier years, to clearly mention the same

Clause 18

Contd...

- Any interest paid on money borrowed for purchase/construction of asset, up to the date on which asset is put to use, be capitalized to the cost of asset. In reporting the quantum of depreciation allowable, impact of ICDS to be considered.
- Any subsidy received for acquiring the asset –be reduced from the cost of acquisition
- Section 43A – Any asset purchased from outside India – out of borrowing in foreign currency – the foreign exchange fluctuation (only to the extent of amount actually repaid) be considered as part of the cost of the asset
- New plant and machinery acquired and installed after 1.4.2005 by the assessee engaged in the business of manufacture or production of any article or in the business of generation and distribution of power, additional depreciation of 20% of the cost of plant and machinery is allowed for the first year

Clause 18

Contd...

- Lease agreement to be verified to ascertain whether the asset is on a finance lease or operating lease. Operating lease – depreciation available to lessor, Finance lease – depreciation available to lessee

Issues

- Need to verify whether any capital expenditure is eligible for deduction u/s 35(1)(iv). The definition of scientific research u/s 43(4) is wide.
- Also verify whether the assessee's business is a specified business u/s 35AD.

Clause 19 : Amounts admissible u/s 32AC to 35E

- Accounts to be scrutinized to identify the amount which is debited to profit and loss account
- Where deduction is available for consecutive years, and it is not the first year of claim, verify whether any condition has been violated
- If it is the first year of claim, verify whether all conditions for claiming deduction are fulfilled
- Whether considered in DTA/DTL calculation , depreciation not available on expenses written off

Clause 20(a) : Sum paid to employee as bonus or commission, which would have been otherwise payable as dividend¹

- This provision is intended to check private companies from avoiding tax by distributing its profits to the shareholders in the guise of salary or other remuneration by merely showing the beneficiary as employees
- Bonafide payment to a shareholder for services actually rendered would be allowed
- When any shareholder is paid any salary, his employment contract, nature of services actually rendered be verified

Issue Commission, Bonus, to Director etc.

- What is in lieu of dividend
- Control & Switch gear Contractors Limited Delhi HC 365 ITR 312
- Loyal Motor Services Co. 14 ITR 0647 Bombay HC

Clause 20 (b) : Contribution received from employees

- Nature of fund, amount collected from employees, due date of payment, actual amount contributed and date of payment to be disclosed
- Amount deducted from employees salary is income u/s 2(24)
- Contributed within due date (including grace days) deduction available u/s 36(1)(va)
- Obtain list of contribution to employees to PF/ESIC, etc. and dates of their payments
- Verify Challans evidencing contribution to various fund
- If data voluminous, test checks can be done and a disclosure to that effect
- **Amendment made by FA 2021. Delayed payment is disallowable**

Clause 21(a) : Capital, personal, advertisement, etc. expenditure debited to P&L

- In case of expenditure of capital nature:
 - Verify bills/vouchers of certain specific accounts e.g. Advertisement expenses, software expenses etc. to ensure that amount of capital nature are not claimed as revenue
 - In cases of controversy, auditor should report by way of abundant caution
- ❖ In case of expenditure of personal nature:
 - Scrutinize ledger accounts like telephone, motor car, entertainment expenses – whether personal expenses of any director/employee are debited to Profit and Loss a/c
 - Expenses incurred for directors/employees are perquisites in their hands.

Company can not have personal expenses

133 Expenditure on advertisement in any souvenir, brochure published by a political party

Clause 21(a)

Contd...

- Expenditure incurred at clubs as cost for club services and facilities use
 - Separate disclosure requirement w.r.t. fees and subscriptions removed
 - Cost of club services would it include entrance fees and subscription ?
 - Expenses incurred at social clubs like Lions club, rotary club-no reporting required.
 - Only expenses at recreational clubs need to mentioned
 - Incurred for employee – to be treated as a perquisite
- ❖ Expenditure incurred for any purpose which is an offence e.g hafta or which is prohibited by law not allowed as a deduction.
- ❖ Where nomenclature is penalty, needs to be disclosed
- ❖ Payment made for breach of contractual obligation- is disclosure required ??

Clause 21(b) : Amounts inadmissible u/s 40(a) (TDS non compliance)

- Amount on which tax is not deducted and where tax is deducted but not paid into Government Treasury to be disclosed under separate clauses
- Name and address of the payee, nature of payment, amount of payment and tax to be deducted to be disclosed
- ❖ In case of tax on non-monetary perquisites Verify employment contract to understand TDS liability
- ❖ Differences between 40(a)(i) / 40(a)(ia)
 - i. 40(a)(i) – If income accounted by payee, no disallowance (w.e.f. AY 20-21)
 - ii. 40(a)(ii) – Entire disallowance 40(a)(ia) – 30% of sum disallowed

Clause 21

Contd...

- In case of amount inadmissible under the proviso to section 36(1)(iii)
 - Verify the purpose of borrowing and interest paid
 - Examine the date when asset is put to use
 - This disallowance is irrespective of the treatment given in the books of accounts

Disallowance Vs. Capitalization under ICDS

Clause 21(c): Interest, salary, bonus, commission or remuneration inadmissible u/s 40(b)/40(ba)

- ❖ The remuneration payable by a firm to the partner is governed by the partnership deed. Under Income-Tax Act, remuneration and interest payable by the firm to the partner allowable only if certain conditions are fulfilled
- ❖ Verify the partnership deed in force for the previous year, to ascertain the salary payable to partners as mandated by the deed
- ❖ In this clause, computation of disallowance should be given

Clause 21(d): Payments made otherwise than by A/c Payee cheque

- ❖ Aggregate payment in a day - in cash or by bearer cheque - in excess of Rs.10,000 - entire amount disallowed.
- ❖ Examine on test check basis- report with appropriate comments if no proper evidence for verification of payment is available.
- ❖ Obtain a list of payment made in cash from client.
- ❖ Quantify amount of disallowance - transaction wise
- ❖ Name and PAN of payee, Nature and date of payment, amount paid to be disclosed separately for each transaction
- ❖ All payments to be verified whether the expenditure is to the P&L A/c or to outstanding pertaining to the earlier year

Clause 21: General Provisions

- In case of payment of gratuity not allowable under section 40A(7)
 - Provision made for gratuity shall be allowed only if contribution is to an approved gratuity fund or it is towards gratuity paid during the year
 - Approval granted to the fund by the commissioner of income tax should be verified
- ❖ Verify whether the amount is paid towards setting up or formation of or as a contribution to recognized PF/approved superannuation fund/prescribed pension fund or approved gratuity fund

Clause 21

Contd...

- In case of liability of contingent nature (reporting only if debited to P& L A/c and not on the basis of Note to the Accounts)
 - Liability crystallized, though the valuation thereof depends on a future event or quantification cannot be done with certain degree of accuracy - is not a contingent liability. e.g leave encashment, provision for warranty etc.
 - Liability not crystallized. Provision made based on the relevant Accounting Standard or the Accounting Policy adopted -it is contingent liability- e.g. provision for diminution in value of investment.
 - Understand the basis of making provision
 - Verify the provision relating to disputed claims
 - Scrutinize various account heads such as of outstanding liabilities, provisions, etc.

Clause 21

Contd...

- In case of amount inadmissible in terms of section 14A
 - Any expenditure incurred for earning income which is exempt from tax shall not allowed as a deduction.
 - Having regard to the accounts of the assessee, if the auditor can identify the expenses incurred – the same be stated in this clause.
 - When there is no direct nexus or it is not possible to identify expenditure incurred for earning exempt income by applying any reasonable method – mix bag of funds – then disallowance be computed by applying Rule 8D
 - If the assessee's contention is – no expenses are incurred or a specific amount of expenditure is incurred, which cannot be verified by the auditor, then the put an appropriate note.
 - Always advisable to attribute a certain amount of expenditure as disallowable u/s 14A on some reasonable basis

Clause 21

Contd...

- In case of amount inadmissible under the proviso to section 36(1)(iii)
 - Verify the purpose of borrowing and interest paid
 - Examine the date when asset is put to use
 - This disallowance is irrespective of the treatment given in the books of accounts

Disallowance Vs. Capitalization under ICDS

Clause 22: Interest inadmissible u/s 23 of MSME Act, 2006

- ❖ Section 23 of the Micro Small and Medium Enterprises Development Act, 2006 (MSMEDA) overrides the provisions of the Income Tax Act, 1961
- ❖ Section 23 of the MSMEDA provides that if a buyer pays interest to a supplier being, a micro or small enterprise, such interest, for the purposes of computation of Income – Tax Act, not allowed as a deduction
- ❖ Tax is deductible on such interest
- ❖ Obtain a full list of suppliers, who fall within the purview of the definition of MSME Act.
- ❖ Verify whether the payments made to such suppliers with interest

Clause 23: Payments made to persons specified under section 40A(2)(b)

- ❖ The list of persons covered by the section is quite wide and identification of such relationship can be difficult for the auditor.-Obtain a certificate to that effect from the management
- ❖ For cross verification, compare the list with related party disclosure in the audited accounts and entries in register maintained under the Companies Act
- ❖ The reporting is only for payments made and not for amounts received
- ❖ The auditor to only report the amounts paid and not required to give his opinion on reasonability thereof

Clause 24: Deemed profits and gains u/s 32AC or 32AD or 33AB or 33ABA or 33AC

- Amounts which become chargeable to tax on account of infringement of a condition on the basis of which the deduction was availed of to be verified and disclosed

Clause 25: Amount of profit chargeable to tax u/s 41

- As per ICAI, this is to be reported only if the amount is not credited to P & L already
- Earlier years records to be verified to ascertain deduction claimed and allowed in respect of loss, expenditure, trading liability or bad debts written off, which are recovered
- Consider the judicial pronouncements particularly in regard to one time settlement with banks which results in a write back of Capital sum borrowed
- Sulzer India Case as regard payment of Deferred Sales Tax Liability at NPV

Issue - Waiver of loan

- **Applicability of Section 28(iv)**
 - ⊙ One of the primary conditions for applicability of Section 28(iv) is receipt of benefits or perquisite in any form other than cash
 - ⊙ In light of decision of SC in case of Mahindra And Mahindra Ltd. (302 CTR 213), waiver of loan for capital purpose not be liable for tax u/s 28(iv)
- **Applicability of Section 41(1)**
 - ⊙ There is difference between “trading liability” and “other liability”. Section 41(1) deals with remission of trading liability. Waiver of loan amounts to cessation of liability other than trading liability and hence, remission of loan should not be taxed under Section 41(1).

Issue - Waiver of loan

Contd..

- ⑩ SC's conclusion in case of Mahindra And Mahindra Ltd. that waiver of loan cannot be taxed u/s 41(1) appears to apply to both types of loans – working capital loan and loan for capital purpose
 - **Applicability of Section 56(2)(x)**
- ⑩ It may be contended that there is no constructive receipt in the hands of debtor at the time of waiver and hence section 56(2)(x) may not be triggered
- ⑩ Considering waiver of loan is because of commercial arrangement or has a commercial rationale, one may argue that the same is not without consideration and hence Section 56(2)(x) is not applicable

Issue - Waiver of loan Contd..

- ⑩ Clause (a) of Section 56(2)(x) refers receipt of 'any sum of money, without consideration' and adequacy of consideration is not a condition. On literal interpretation, repayment of part loan could be considered as consideration for waiver of loan. Hence, it could be contended that waiver is not without consideration
- ⑩ Where loan is obtained for the purpose of business, taxability of waiver of loan needs to be examined u/s 41(1) or 28(iv) and could not be charged as IFOS u/s 56

Clause 26: Allowances and Disallowances u/s 43B

- Amount pre-existing on the first day of the previous year not allowed in any preceding previous year and paid during the year - this amount will not be debited to current years account but will be allowed as a deduction on payment basis
- ❖ Deduction of certain expenses only on payment basis irrespective of the method of accounting followed
- ❖ Arithmetically reconcile the details with previous years tax audit and current years accounts, and presentation in the computation / return
- ❖ Verify the challan, receipts and entries in the books to ascertain the amounts paid and remained unpaid during the year.
- ❖ State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost, etc., is passed through the profit and loss account - if not routed through the Profit and Loss Account – not paid during the year – whether disallowed u/s 43B ?

Issue -Transfer of liabilities by demerger Contd..

- ⑩ Deduction for liabilities under section 43B was allowable to the transferee on the reasoning that the transferee had taken over all the assets and liabilities of the transferor under slump sale
- **Huntsman International (India) Private Limited (ITA No.3916 and 1539/Mum/2014)**
- ⑩ It is advisable to give reference to liabilities (eligible for deduction under section 43B) in the merger scheme to be approved by the NCLT
- ⑩ Also, it is advisable to provide an explanatory note in the tax audit report of transferor and transferee company

Issue - Transfer of liabilities by demerger

Clause 26 of Form 3CD

- Company A has two undertakings namely - real estate business and manufacturing business
- During FY 2021-22, Company A completed the tax-neutral demerger of its manufacturing undertaking to Company B on 1 July 2021 with appointed date as on 1 April 2021
- The liabilities transferred by Company A pursuant to above demerger *inter alia* included unpaid bonus to the employees
- ⑩ The said unpaid bonus was paid by Company B on 1 August 2021
- ⑩ Analyse the impact of tax-neutral demerger on allowability of bonus u/s Section 43B in the hands of transferor or transferee

Issue - Transfer of liabilities by demerger

Contd..

- ⑩ S. 43B silent about effect of restructuring of entity
- ⑩ Unlike other sections (viz. Section 32, 35D, etc.), Section 43B do not deal with the availability of
 - deduction, in case of demerger and any other modes of restructuring
 - **View 1: Deduction allowable to transferor**
- ⑩ Section 43B uses the phrase 'deduction otherwise allowable under this Act', which means that the prescribed expenses are allowable to the person who has incurred such expenditure. Accordingly, based on the literal interpretation of the provision, the transferor is only entitled to claim the deduction irrespective of payment made by transferee

Issue - Transfer of liabilities by demerger Contd..

- **Pembril Engineering (P) Ltd. (155 ITD 72) (Mumbai – Trib.)**
- In context of slump sale, the Tribunal observed that the transferor cannot by contract, shift his statutory obligation to the transferee and thus, there was no basis to hold that impugned liability stands discharged by the transferor upon sale of its undertaking on slump sale basis
- **Diza Electricals (238 ITR 924) (Kerala HC)**
- In context of assets and liabilities of dissolved firm taken over by the company, the Tribunal held that deduction of payment towards sales tax liability made by transferee company on behalf of transferor firm was allowable in the hands of the transferor firm

Issue - Transfer of liabilities by demerger Contd..

- **View 2: Deduction allowable to transferee**
 - ⑩ In a demerger, assets and liabilities that are transferred by the transferor, belong to the transferee after the demerger, Thus, it may be argued that the transferee has stepped into the shoes of transferor and deduction under section 43B could be allowed in the hands of transferee
- **Veerabhadra Rao, K Koteswara Rao & Co. (155 ITR 152) (SC)**
- Dealing with the allowability of bad debts written off by the transferee with respect to debts created by the transferor, transferee company was allowed the deduction, although the debts were not offered by the transferee company

Issue - Transfer of liabilities by demerger Contd..

- Deduction for liabilities under section 43B was allowable to the transferee on the reasoning that the transferee had taken over all the assets and liabilities of the transferor under slump sale
- **Huntsman International (India) Private Limited (ITA No.3916 and 1539/Mum/2014)**
- It is advisable to give reference to liabilities (eligible for deduction under section 43B) in the merger scheme to be approved by the NCLT
- Also, it is advisable to provide an explanatory note in the tax audit report of transferor and transferee company

Clause 27(b): Prior Period Expenditure and Income

- This clause is applicable only where the mercantile accounting system is followed, in the case of non-corporate entity maintaining accounts on cash basis, this clause is not applicable
- The income / expenditure relating to any earlier year, which has crystallized during the year can not be considered as prior period item. To illustrate, if there was some dispute in wages for the year ended 31st March 2018. The dispute was settled during the year ended 31st March 2019 and wages are accounted during the financial year 2018-19 then this is not an error or omission in preparation of account of earlier year. But this is the liability which though related to previous year has crystallized in current year, this can not be regarded as a prior period item

Clause 27(b)

Contd...

- For corporate entities information available from annual accounts
- Prior period items are generally infrequent in nature
- Generally Prior period expenses are not allowed to be deducted from current year's Income
- As per AS 5 – change in estimates is not a prior period item
- As per AS -5 expenses or income which arise in the current year as a result of errors or omissions in the accounts of earlier years will be considered as prior period items

Clause 28: Share received without consideration from Private Limited company

- The clause makes a reference to s. 56(2)(viiia) and therefore will apply only to firm and a company in which public are not substantially interested
- S. 56(2)(viiia) applies to firm or a company not being a company in which the public are substantially interested (a closely held company)
 - which receives
 - from any person or persons
 - on or after 01.06.2010
 - any property being shares of a company not being a company in which the public are substantially interested
 - such receipt is without consideration, and the aggregate FMV of which exceeds Rs. 50,000; or
 - for a consideration which is less than the aggregate FMV of the property by an amount exceeding Rs. 50,000

Clause 28

Contd...

- If all the conditions stated above are satisfied then in a case where receipt is without consideration the whole of the aggregate FMV of such property, or where the receipt is for inadequate consideration then aggregate FMV of such property as exceeds such consideration shall be chargeable under s. 56(2)(viia)
- First proviso to s. 56(2)(viia) provides that the clause does not cover certain transactions which are not regarded as 'transfer' under clauses (via), (vic), (vib), (vid) or (vii) of S. 47
- Rules 11U and 11UA apply to s. 56(2)(viia)

Clause 29: Consideration received for issue of shares

- This clause will be applicable only in case the assessee is a closely held company which has during the previous year received consideration for issue of shares
- The tax auditor will be required to compare the consideration for issue of shares with the fair market value of the shares issued and in case the consideration exceeds such fair market value, the difference between the fair market value and the consideration is to be charged to tax under s. 56(2)(viib)
- What would be reporting requirement in case consideration received does not exceed fair market value of the shares as referred to in section 56(2)(viib)?
- In terms of various notifications / circulars startups issuing shares to angel investors are exempted from the rigours of the section

Clause 29A: Amount chargeable under Section 56(2)(ix) (Forfeited advance for sale of capital assets)

1. Verify whether any negotiations have been conducted by assessee for transfer of capital asset
2. Ascertain whether any sum of money or advance has been received
3. Whether the sum has been forfeited. If so, the said sum / advance to be disclosed along with the nature of income

Clause 29B: Section 56(2)(x)

- ✓ Receipt of money
- ✓ Without consideration
- ✓ In excess of Rs. 50,000

Clause 29B

Contd...

- Receipt of immovable property
 - ✓ Without consideration
 - ✓ with payment of consideration less than the FMV
 - ✓ Difference between Consideration & FMV in excess of Rs. 50,000
 - ✓ In excess of 10% of the consideration

- FMV to be lesser of :
 - ✓ Stamp duty value
 - ✓ Valuation by DVO

Issue - Receipt of Bonus shares Contd..

- Relevant extract of Section 56(2)(x)

“ where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,—

(a) Any sum of money...

(b) Any immovable property...

(c) any property, other than immovable property,—

A) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration”

Issue - Receipt of Bonus shares

Contd..

- There is no increase in wealth of the Shareholders
- % Shareholding in company remains constant
- Sudhir Menon HUF [2014] 148 ITD 260 (Mumbai Tribunal)
 - - Pending before High Court

Issue - Restriction on Cash Transactions S. 56 vis-à-vis S. 269 ST

Rs. 2,50,000 from his father in a single day

Rs. 2,50,000 from Friend on the occasion of marriage

- Section 269ST, *inter alia*, states that –
“No person shall receive an amount of two lakh rupees or more
(a) in aggregate from a person in a day; or
(b) in respect of a single transaction; or
(c) in respect of transactions relating to one event or occasion
from a person,
otherwise than by an account payee cheque or an account
payee bank draft or use of electronic clearing system
through a bank account:”

Issue - Restriction on Cash Transactions Contd..

- Gift from father – Rs. 2,50,000 each

Any sum received from relatives shall not be Taxable u/s 56(2)(x)

Section 269ST provides that no amount shall be received in excess of Rs. 2 lakhs from a person on a single day otherwise than specified mode Hence, cash gift from father and brother, though exempt u/s 56(2)(x), shall be liable for penalty u/s 271DA. Similarly, gift on the occasion of marriage exceeding Rs. 2 Lakhs will also attract S. 269 ST and consequently S. 271DA

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib)

Clause 29 of Form 3CD

- Company A is a private limited company has received share application money of Rs. 50 lakhs on 20 February 2021 from resident individuals
- On 10 April 2021, 25,000 shares of face value Rs. 100 each were allotted by Company A to the residents at premium of Rs. 100 per share

Analyze -

- a) Point of applicability of provisions of Section 56(2)(viib) in the FY 20-21
- b) Applicability of Section 56(2)(viib) in case where shareholders were residents of India during FY 2020-21 and become non-resident during FY 2021-22

Point of time for determination of valuation of shares under Rule 11UA

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

- Relevant extract of Section 56(2)(viib)

where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

Provided that this clause shall not apply where the consideration for issue of shares is received ...

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

- *Explanation.—For the purposes of this clause,—*
(a the fair market value of the shares shall be the value-
- *(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature,*

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

- Relevant extract of Rule 11UA
- *(2) Notwithstanding anything contained in sub-clause (b) of clause*
- *(c) of sub-rule (1), the fair market value of unquoted equity shares for the purposes of sub-clause (i) of clause (a) of Explanation to clause (viib) of sub-section (2) of section 56 shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner under clause (a) or clause (b), at the option of the assessee, namely*
- Relevant extract of Rule 11U
- *"valuation date" means the date on which the property or consideration, as the case may be, is received by the assessee.*

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

- *balance-sheet", in relation to any company, means,—*
 - (i) for the purposes of sub-rule (2) of rule 11UA, the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956 (1 of 1956) and where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company; and*

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

- View 1: Section 56(2)(viib) is applicable on receipt of share application money
- ⑩ On literal reading of Section 56(2)(viib), the provisions are triggered on receipt of consideration for issuance of shares
- ⑩ Diach Chemicals & Pigments Pvt. Ltd. (ITA No. 546/Kol/2017)
- View 2: Section 56(2)(viib) is applicable on allotment of shares
- ⑩ Transaction of issue of shares is crystallized only on allotment of shares and hence the share premium is required to be examined u/s 56(2)(viib) only in the year of allotment
- ⑩ Amount received pursuant to share application is constructively received only after allotment of shares to trigger taxability u/s 56(2)(viib)

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

- **Date of valuation of shares under Rule 11UA**
- Valuation of shares may undergo significant movement in the duration between the share offer and share allotment. Hence, question arises that commercial of which year would be considered relevant for the purpose of valuation under Rule 11UA (i.e. year of share allotment or year of receipt of share application money)
- **View 1: Date of allotment shall be relevant for valuation**
 - Explanation (a)(ii) to Section 56(2)(viib) of the Act refers to valuation as on date of issuance of shares
 - It is well-settled principle that the computation provision does not precede the charging provision. Computation of fair valuation under Rule 11UA is made only once charge under section 56(2)(viib) is triggered

Issue - Receipt of share application money whether attracts provisions of 56(2)(viib) Contd..

View 2: Date of receipt of share application shall be relevant for valuation

-Referring to the Finance Minister's speech that the provisions of Section 56(2)(viib) were introduced by Finance Act 2012 only to deter generation and use of unaccounted money, it may be contended to consider the tainted intentions prevailing at the time of infusion of funds in the form of share application money irrespective of the valuation as on the date of share allotment

-Allotment of shares without any modification to the share offer is merely a formal event to confirm the previous commitment between the shareholders and issuer company

Clause 29B (Contd.) Receipt of movable property

- ✓ Without consideration
- ✓ For payment of consideration less than the FMV where difference exceeds Rs. 50,000

Clause 29B (contd.) – Audit Process

1. Verify whether any sum of money or property has been received other than in the ordinary course of business.
2. Ascertain consideration and compare to the FMV
3. Verify whether transaction falls within the exceptions/ exemptions
4. If income chargeable, disclosure

Clause 30: Details of amount borrowed on Hundi, etc.

- ❖ Hundi is not defined in the Income tax Act. It is indigenous form of Bill of Exchange in vernacular language, which is used by the merchant community
- ❖ This clause applies to Hundis only and not to other borrowings
- ❖ In case of practical difficulties in verification, auditor may obtain management representation

Clause 30A: Section 92CE Secondary adjustment– TP issue

- ❖ Whether primary adjustment has been made/ accepted and is in excess of Rs.1 crore.
- ❖ Whether excess money available with AE is required to be repatriated to India
- ❖ If yes whether repatriated within the prescribed time which is 90 days
- ❖ If no the quantum of imputed interest computed as per rule 10CB on the excess money not repatriated to be disclosed
- ❖ One time settlement by paying 18% plus surcharge 12%

Clause 30A: Audit Process

- ❖ In case of Suo moto adjustment verify Transfer Pricing Report
- ❖ In case adjustment by TPO is accepted, nature of adjustment, if appealed stage of litigation
- ❖ If order final, whether funds are available with AE
- ❖ Whether the auditee is adopting the option contemplated u/s 92(2A)

Clause 30B: Disallowance u/s 94B- thin capitlisation

- ❖ Is the expenditure by way of interest or similar payment in excess of Rs.1crore
- ❖ Does it exceed 30% of EBITDA
- ❖ Details of interest expenditure B/F u/s 94B(4)
- ❖ Details of interest expenditure C/F u/s 94B(4)
- ❖ Issue – EBITDA whether Income Tax or Financial ?
- ❖ Issue – Whether interest paid in India to be considered?

Clause 30C (Form 3CD)

- (a) Whether the assessee has entered into an impermissible avoidance arrangement, as referred to in section 96, during the previous year? (Yes/No)
- (b) If yes, please specify:-
 - (i) Nature of the impermissible avoidance arrangement:
 - (ii) Amount (in Rs.) of tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement.

S. 95 not to apply (Rule 10U)

- Tax Impact not exceeding Rs. 3 crore
- Foreign Institutional Investor, who has not taken DTAA benefit and has invested in unlisted shares with the prior permission of SEBI
- A non-resident who has invested in FII
- Transfer of investments made before 1-04-2017

S. 96 -Impermissible avoidance arrangement. *Presumption and Onus of Proof*

(2) An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

S. 96- Impermissible avoidance arrangement.

Impermissible avoidance arrangement.

96.(1) An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it—

- (a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
- (b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
- (c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or
- (d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes.

S. 97 -Arrangement to lack commercial substance.

97. (1) An arrangement shall be deemed to lack commercial substance, if—

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

(b) it involves or includes—

(i) round trip financing;

(ii) an accommodating party;

(iii) elements that have effect of offsetting or cancelling each other; or

(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

S. 97 (1)(c) and (d)

(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party; or

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).

S. 97 (2)

(2) For the purposes of sub-section (1), round trip financing includes any arrangement in which, through a series of transactions—

(a) funds are transferred among the parties to the arrangement; and

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),

S. 97 (2)

- without having any regard to—
 - (A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;
 - (B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or
 - (C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

S. 97(3)

(3) For the purposes of this Chapter, a party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter) for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

S. 97 (4)

(4) For the removal of doubts, it is hereby clarified that the following may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not, namely:—

- (i) the period or time for which the arrangement (including operations therein) exists;
- (ii) the fact of payment of taxes, directly or indirectly, under the arrangement;
- (iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

ICAI Guidance Note If details are not available

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

ICAI Guidance Note – Precedence

The tax auditor should examine whether the Principal Commissioner or the Commissioner or the Approving Panel has, in any earlier previous year, declared any arrangement as IAA. In case, if any arrangement has been declared to be an IAA in any earlier previous year, the tax auditor should further examine if any transaction pertaining or in connection with such declared IAA has taken place during the previous year under the audit.

ICAI Guidance Note – Precedence

The Auditor should examine if, in any earlier previous year, whether any reference has been made for declaring an arrangement as an impermissible avoidance arrangement, If such references been made, the auditor should report the fact in form 3CA or form 3CB, as the case may be. The auditor should further examine if any transaction pertaining or in connection with such arrangement in respect of reference has been made has taken place during the previous year under the audit. If any transaction pertaining or in connection with such arrangement has taken place during the previous year under the audit, the tax auditor should report this fact. The Tax Auditor should also report tax benefit in the previous year arising from such transaction to all the parties to the arrangement

ICAI Guidance Note – Precedence

In either case, where the assessee has given response to any show cause notice or has preferred an appeal, along with outcome thereof should be taken into consideration while reporting.

The precedence may not be applicable for A.Y. 2022-23

Poser ??

Merger of a loss making company involving tax impact of more than 3 Crore – No precedence?

Clause 31: Loans u/s 269SS and 269T

- ❖ Applicable to each Loan or Deposit and money against sale of Immovable property in excess of Rs.20,000/-
- ❖ Section 269SS and 269T do not apply to loans taken from or loan repaid to Govt. company/corporations and Banking company
- ❖ Section 269T applicable to Government companies and Banking companies
- ❖ Payment through NEFT/RTGS/Credit cards/accounting entries / renewal of loan or deposit
- ❖ Interest free loans
- ❖ Advance against sale of goods
- ❖ In case of difficulty in verification – put a disclaimer
- ❖ Tax Auditor to certify based on examination of books of account and other documents

Clause 31(ba)/ (bb): 269ST

- ❖ In respect of receipt of an amount exceeding the limit prescribed u/s 269ST (Rs.200,000) by way of cash/ cheque or bank draft other than account payee cheque/ draft
 - a) From a person in a day
 - b) In respect of a single transaction
 - c) In respect of transactions relating to one event or occasion during the previous year

The following disclosures to be given:

- i. Name address and PAN (if available)
- ii. Nature of transaction
- iii. Amount of receipt
- iv. Date of receipt

* In case of receipt by cheque or bank draft other than account payee

199 cheque or bank draft, the date need not be given

Clause 31(bc): 269ST

- ❖ In respect of payment made of an amount exceeding the limit prescribed u/s 269ST by way of cash/ cheque or bank draft other than account payee cheque/ draft
 - a) To a person in a day
 - b) In respect of a single transaction
 - c) In respect of transactions relating to one event or occasion of the person

The following disclosures to be given:

- i. Name address and PAN (if available)
- ii. Nature of transaction
- iii. Amount of payment
- iv. Date of payment

* Receipts of payments to Govt. company, banking company, Post office savings bank, Co-operative banks or notified entities need not be given

Clause 32(a): Details of b/f losses and depreciation allowance

- ❖ Losses in the nature of business loss, speculation loss, unabsorbed depreciation, capital loss be shown separately. – as per return and as per assessment/appeal order
- ❖ To check whether the return of income of each year, where the loss has occurred was filed within the due date
- ❖ Carry forward of loss is permissible for specific no. of years
- ❖ If any appeal/rectification application is filed, which has bearing on the amount of loss assessed , the same should be mentioned

Clause 32(b): Disallowance of S.79 losses in case of change in shareholding of company

- ❖ Applicable only to closely held companies
- ❖ Brought forward loss can be set off during the year only if 51% of the voting power is beneficially held on the last day of the year by the same set of shareholders who beneficially held 51% of voting power on the last day of the year, in which loss occurred
- ❖ Exceptions provided in the section (change in Section 79 for AY 2020-21)
- ❖ Carry forward and set off Unabsorbed Depreciation is not hit by change in shareholding
- ❖ Verify shareholders register to ascertain any change in the shareholding

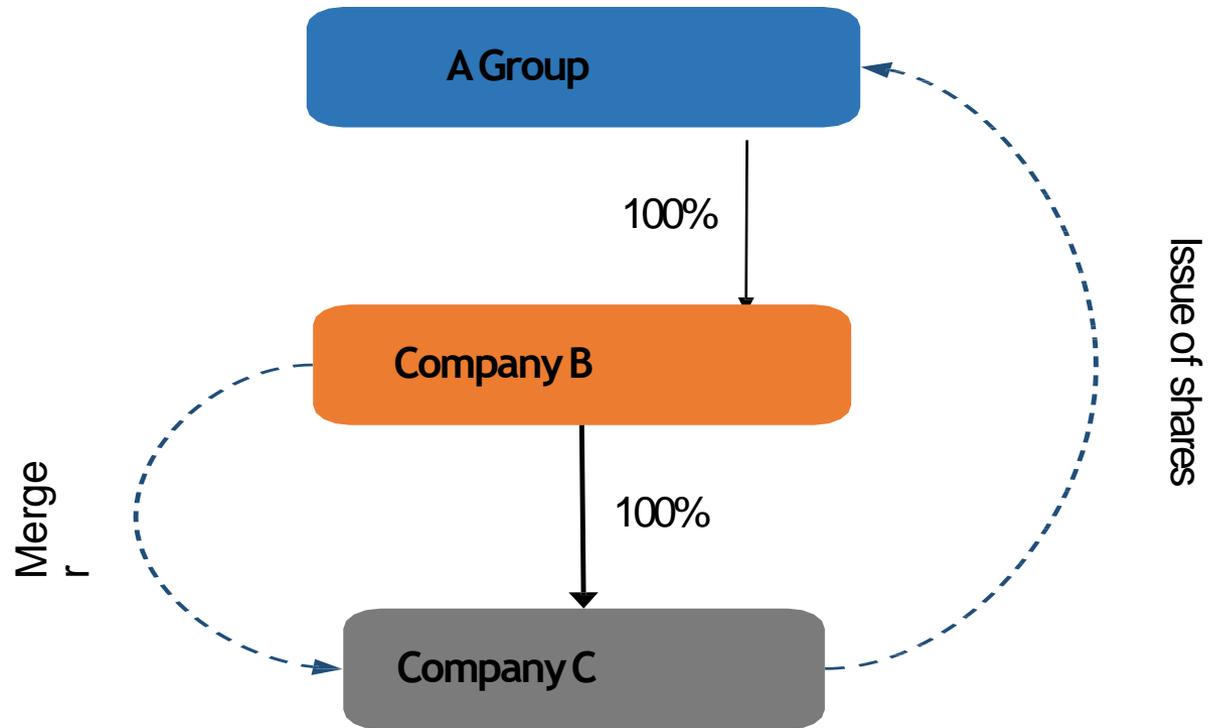
Issue - Change in shareholding

Clause 32(b) of Form 3CD

- Company C, a loss-making company, is a WOS of Company B. Company B is ultimately owned by A Group of Companies. Company C has carried forward business losses and unabsorbed depreciation
- During FY 2018-19, Company B merges with Company C
- Company C issues shares to the shareholders of Company B as consideration
- There is 100% change in shareholding of Company C from Company B to Company A
- Whether Company C is eligible to carry forward and set-off business losses and unabsorbed depreciation?

Issue - Change in shareholding

Clause 32(b) of Form 3CD



Issue - Change in shareholding Contd..

- Ultimate beneficial ownership of company C remains within the same Group
- **Acceptance of the ultimate beneficial ownership argument –**
 - Select Holiday Resorts (P.) Ltd (217 Taxman 110) (Delhi HC)
 - Amco Power Systems Ltd (379 ITR 375) (Karnataka HC)
 - Wadhwa & Associates Realtors (P.) Ltd (92 taxmann.com 37) (Mumbai Tribunal)
- **Unfavourable rulings –**
 - Yum Restaurants (I) Pvt. Ltd (380 ITR 637) (Delhi HC)
 - Just Lifestyle Pvt. Ltd. (ITA No. 2638/Mum/2012)
 - M/s Tainwala Trading & Investments Ltd. (ITA No. 5120 / Mum / 2009)

Issue - Change in shareholding Contd..

- **No effect on unabsorbed depreciation**
 - Shri Subhulaxmi Mills Ltd 249 ITR 795) (Supreme Court)
 - Swiss Re-health Services P. Ltd. (ITA No. 635 / Bang / 2015)
 - Credila Financial Services Private Ltd. (64 ITR(T) 324) (Mumbai Tribunal)

Issue- Change in shareholding between the years

Clause 32(b) of Form 3CD

Particulars	Year 1	Year 2	Year 3
Profit / (Loss)	(10,00,000)	(15,00,000)	30,00,000
Composition of beneficial shareholding			
Mr. A	80%		5%
Mr. B	20%	30%	50%
Mr. C	-	70%	45%

- For the purpose of carry forward of loss incurred in a particular previous year, whether it is necessary that conditions stipulated under section 79 are required to be satisfied in each of the subsequent previous years until the previous year in which the set off is claimed?

Issue- Change in shareholding between the years Contd..

79 . Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year,—

(a) in the case of a company not being a company in which the public are substantially interested and other than a company referred to in clause (b), no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, unless on the last day of the previous year, the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred;

Issue- Change in shareholding between the years

Contd.

Favourable View 1: Loss is allowable in year 3 as 51% of beneficial shareholders at year 3 matches with similar shareholding at year 1

- On strict interpretation of Section 79, parity of beneficial holding is required with respect to the year of which loss is contemplated to be set off

- **M.D. Traders & Chit Fund Financiers (P) Ltd (178 ITR 388) (P&H)**

The change in the shareholding which was contemplated in the section was one which was found on the comparison between the position of voting power on the last date of the previous year for which the assessment was sought to be made and corresponding position of earlier year in which the loss was incurred which was claimed to be set off

Issue- Change in shareholding between the years

Contd.

Unfavourable View 2: If section 79 limitation is attracted in year 2, further carry forward of loss is not permissible

- The loss of year 1 has to enter computation process of year 2. Since there is change in shareholding in year 2, limitation of Section 79 is triggered in year 2 and hence no part of loss of year 1 can be carried forward and set off in year 2.

- Since loss is not successfully carried forward from year 1 to year 2, the same cannot be carried forward to year 3. As a result, loss of year 1 is not available for set off in year 3 even when the shareholding of year 3 is section 79(a) compliant

Issue - Applicability of Section 79

Clause 32(b) of Form 3CD

- Whether wholly owned subsidiary of a listed company is a company in which Public are substantially interested for the purpose of Income Tax and therefore not hit by S. 79?
- Issue is whether Company Law Definition can apply for Income Tax?

Issue - Applicability of Section 79

Contd...

- Relevant extract of Section 2(18)
- *"company in which the public are substantially interested" a company is said to be a company in which the public are substantially interested-*
 - (b)if it is a company which is not a private company as defined in the Companies Act, 1956 (1 of 1956), and the conditions specified either in item (A) or in item (B) are fulfilled, namely:"*
 - (A)Shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) were, on last day of relevant previous year, listed in recognized stock exchange in India...*

Issue - Applicability of Section 79

Contd...

(b) shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than fifty per cent of the voting power have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by—

-
- *(c) any company to which this clause applies or any subsidiary company of such company if the whole of the share capital of such subsidiary company has been held by the parent company or by its nominees throughout the previous year.*

Issue - Applicability of Section 79

Contd...

- Relevant extract of Section 2(68) of Companies Act, 2013
- ***Private company*** means a company having a minimum paid-up share capital prescribed, and which by its articles,—
 - (i) restricts the right to transfer its shares;
 - (ii) except in case of One Person Company, limits the number of its members to two hundred:
- Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member
-
- Relevant extract of Section 2(71) of Companies Act, 2013
- ***Public company*** means a company which—
 - (a) is not a private company;

Issue - Applicability of Section 79

Contd...

(b) has a minimum paid-up share capital as may be prescribed:

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles

Issue - Applicability of Section 79

Contd...

- Clause (b) of Section 2(18) is not applicable to private company defined under the Companies Act
- As per Section 2(71) of the Companies Act, 2013, a company which is subsidiary of a company, not being a private company, shall be deemed to be public company even where such subsidiary company continues to be private company
- However, Company B private company as per the companies Act and exception provided to subsidiary of public company would not apply for the purpose of Section 2(18) of the Income-tax Act
- Accordingly, provisions of Section 79 would apply to Company B

Clause 32(c): Speculation loss incurred u/s 73

- ❖ Speculative transaction is defined in section 43(5)
- ❖ Verify the transactions –to understand whether speculative
- ❖ Take a confirmation from the client –where verification is not possible

Clause 32(c): Losses incurred by specified business 73A

- ❖ Section 73A refer to the losses incurred in “specified business” as referred to in Section 35AD(2)
- ❖ Verify whether assessee is engaged in any business as referred to section 35AD (2) and whether the conditions prescribed in the said section are fulfilled

Clause 32(e): Whether company deemed to be carrying speculative business u/s 73

- ❖ Verify various activities carried on by the company
- ❖ If the activities consists of purchase and sale of shares of other companies – the profit/loss from such activity is speculative profit/loss.
- ❖ This section does not apply to companies, whose GTI consists mainly of interest on securities, income from house property, capital gains and income from other sources and also to companies whose principal business is of banking or granting of loans and advances

Clause 33: Deductions u/s VI-A / or S. 10A/ 10AA

- ❖ Chapter VI-A covers section 80A to 80U
- ❖ Section 10A/ 10AA special provisions in respect of newly established undertaking in free trade SEZ, etc.
- ❖ The auditor has to satisfy himself that all the necessary conditions for claiming a deduction are fulfilled before he certifies that a particular deduction is available to the assessee
- ❖ To state if the auditor relies on the certificate issued by any other consultant quantifying the deduction

Issue - Adjustment of losses for S. 80IA Computation

- Section 80-IA(5)
- *“(5) Notwithstanding anything contained in any other provision of this Act, the profits and gains of an eligible business to which the provisions of sub-section (1) apply shall, for the purposes of determining the quantum of deduction under that sub-section for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year up to and including the assessment year for which the determination is to be made.”*

Issue - Adjustment of losses Contd..

- For claiming deduction under section 80-IA initial assessment year in section 80-IA(5) would only mean year of claim of deduction under section 80-IA and not year of commencement of eligible business
- Decisions:
 - ⊙ **Velayudhaswamy Spinning Mills 38 DTR 57**
 - CBDT Circular 1/2016 – Clarification on term Initial Assessment Year in Section 80IA(5)
 - ⊙ The term initial assessment year would mean the first year opted for by the assessee for claiming deduction u/s 80IA
 - ⊙ However, the total number of years for claiming deduction should not transgress the prescribed slab of fifteen or twenty years
 - ⊙ Period of claim should be availed in continuity

Issue - Allocation of common expenses

Clause 33 of Form 3CD

Whether expenses incurred by HO are required to be allocated to eligible undertaking to compute deduction under section 80-IA?

Particulars	Eligible entity	Head Office
Turnover	100	300
Direct expense	(20)	(50)
Gross Profit	80	250
Indirect expense		40
Net Profit	80	210

Issue - Allocation of common expenses

Contd..

- Section 80IA – profits and gains “derived from” the industrial undertakings
- Derived from is narrower than “attributable to”
- **Favourable rulings**
 - National Fertilizers Ltd [2005] 142 Taxman 5 (AAR)
 - DCW Ltd [2010] 37 SOT 322 (Mumbai - Trib.) - *“income and expenditures which are not directly relatable to that industrial unit cannot but be ignored, in other words, such income and expenditure need not to be considered”*

Issue - Allocation of common expenses Contd..

- Adverse

- Asea Brown Boveri Ltd. [2007] 14 SOT 18 (Mumbai - Trib.)

- Rajasthan State Mines & Minerals [2018] ITA 704 (Jaipur – Trib)

- *“The Head Office maintained by the assessee was essentially a cost centre in that it incurred expenditure for providing the facilities and services, which was common to all the units. The Head Office does not exist for its own sake. Its existence is relevant for all the activities undertaken by various divisions, units and profit centres. The very existence of the divisions, units and profit centres will be in jeopardy if there is no Head Office.”*

Clause 34(a) : Applicability of provisions of Chapter XVII-B or XVII –BB ---TDS/TCS compliances)

- ❖ Details of all the amounts (payable to residents as well as non-residents) on which tax is deductible/collectible to furnished and not only the cases where there is non-compliance
- ❖ Details of short deduction of tax also to be reported – TDS deducted under different section/rate based on the interpretation – is it short deduction?
- ❖ Date-wise details not required – Party-wise details to be reported.
- ❖ Delay in deduction/depositing of tax – no disclosure under this clause

Clause 34(b) : Compliance procedures in case of TDS/TCS

- ❖ Details to be furnished only if the TDS / TCS returns are not filed within the time
- ❖ Ledger to be scrutinized closely. Expenses on which TDS deductible can be revenue/capital
- ❖ TDS returns /revised returns filed to be verified to certify whether all transactions are reported

Clause 34(c): Liability u/s 201(1A)/206C(7)

- ❖ Interest is for delay in deduction/collection or delay in depositing the tax
- ❖ Verify the date when tax was deductible, the date when tax was deducted and date when tax was deposited
- ❖ To provide details of interest payable, interest paid and date of payment

Clause 35 : Quantitative details of goods traded and manufactured

- Factual clause. Service companies do not in the scope of this clause
- Quantitative information should be as per books of account and should be disclosed only for principal items
- Principal items are those who which constitute more than 10% of the aggregate value of purchases, consumption or turnover
- Report whether stock records maintained properly, as reporting will be dependent on that
- Materiality is to be considered. Sometimes not possible at all to provide this – Projects company with numerous small items

Clause 35 : Quantitative details of goods traded and manufactured

- Information about 'yield', 'percentage of yield' and 'shortage/excess' is required to be given only to the extent such information is available in the records of the business
- Where the input and output is recorded in different units, effort should be made to relate the output to the input to compute the percentage of yield

Clause 35

Contd..

- Where the Percentage cannot be computed, the fact should be stated
- By-products represent products whose manufacture results incidentally from the manufacture of main product or where the waste arising in the manufacture of main product is further processed to create a by-product
- Where the by-product so produced or is continuously generated it should be treated for the purpose of sale and disposal at par with any other product produced by the company and similar records should be maintained

Clause 36: Profits distributed u/s 115-O

Omitted

Clause 36A: Receipt of Dividends u/s 2(22)(e)

- ❖ If assessee has received an amount in the nature of dividend & of the nature referred to in Section 2(22)(e), following details to be disclosed:
 - a. Amount received
 - b. Date of receipt

Clause 36A: (Contd.) Audit Process

1. Verify from assessee whether he/it holds shares of 10% or more in a closely held company
2. If assessee is a Firm / LLP/ Company whether partner/s or shareholder/s hold shares of 10% or more in a company and such partner or shareholder holds 20% stake in the auditee company
3. Verify transactions of auditee with that company and ascertain whether the transaction is in the nature of loan /advance
4. Ascertain whether the payer company has accumulated profits
5. If any information not available to issue disclaimer

Issues

- Is the specified shareholder required to be a registered and /or beneficial shareholder?
- Are inter-corporate deposits treated as loan/advance for the purpose of section 2(22)(e)?
- What is the meaning of accumulated profits?
- Are current accounts of directors covered?

Clause 37: Details of Cost Audit

- The tax auditor should ascertain from the management whether cost audit was carried out for any period but during the audit period
- The tax auditor will be required to study the report to ascertain if it contains any disqualifications or disagreement on any matter / item / value / quantity
- The format in which the details are to be provided is not stated
- The tax auditor need not express any opinion in a case where such audit has not been ordered but the same has not been carried out
- In cases where cost audit might have been ordered but is not completed by the time the tax auditor gives his report, he must state the same in this report

Clause 38 : Details of Excise Audit

- The tax auditor should ascertain from the management whether any audit was conducted under the Central Excise Act, 1944 and if such audit was carried out for any period but during the audit period.
- The tax auditor will be required to study the report to ascertain if it contains any disqualifications or disagreement on any matter / item / value / quantity
- The format in which the details are to be provided is not stated
- The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out
- In cases where excise audit which might have been ordered is not completed by the time the tax auditor gives his report, he has to state the same in his report
- The period for which the audit was conducted is not relevant but what is relevant is that the audit was conducted under the Central Excise Act, obtain the report

Clause 39: Details of audit for valuation of taxable services

- The tax auditor should ascertain from the management whether audit was conducted u/s 72A of the Finance Act, 1994 for any period but during the audit period
- The tax auditor will be required to study the report to ascertain if it contains any disqualifications or disagreement on any matter / item / value / quantity
- The format in which the details are to be provided is not stated
- The tax auditor need not express any opinion in a case where such audit has not been ordered but the same has not been carried out
- In cases where audit might have been ordered but is not completed by the time

the tax auditor gives his report, he must state the same in this report

- The period for which the audit was conducted is not relevant but what is relevant is that the audit was conducted under section 72A of the Finance Act, 1994

Clause 40: Accounting Ratios

- ❖ Preceding years ratios also to be stated
- ❖ Ratios to be calculated for assessee engaged in trading, manufacturing as well as rendering services
- ❖ The terms to have meaning as per the accepted accounting principles
- ❖ Gross profit/Turnover/Net profit is defined by ICAI in the Guidance note on the terms used in Financial Statements
- ❖ Computation of various components is to be stated
- ❖ Only closing stock of finished goods(not of raw material and WIP) to be considered
- ❖ Material consumed would include stores, spare parts
- ❖ There should be consistency in numerator and denominator

Clause 41: Details of demand and refund under other than IT Act, 1961 and Wealth Tax Act, 1957

- The auditor will have to ascertain from the records if any demand was raised or refund issued during the previous year under any tax laws other than income- tax Act and Wealth-tax Act
- He will have to obtain from management a representation as regards proceedings under various tax laws and also obtain a list of consultants who are representing the assessee in such matters
- He can obtain from each of such consultants a confirmation about the proceedings under various tax laws which have culminated into either a demand or a refund

Clause 41

Contd...

- The details of demand raised or refund issued will have to be provided even though the assessee may be in appeal against the said proceedings or may not have accepted the demand raised / refund issued
- The particulars will have to be furnished even if the said demand has not been paid during the previous year
- He will have to examine the bank book / books of accounts of the previous year and few months of the subsequent year so as to ascertain the date of completion of proceedings

Clause 42: Assessee required to furnish statement in form 61 / 61A/ 61B

1. Verify whether auditee is one of the reporting entities u/s 285BA for reporting specified financial transactions (SFT)
2. If yes furnish:
 - i. Identification number
 - ii. Type
 - iii. Due date for furnishing statement which is 31st May in respect of the reportable transactions in the immediately preceding financial year
 - iv. Date of furnishing statement
 - v. Whether form contains all details

Clause 42: Assessee required to furnish statement in form 61 / 61A/ 61B

3. If no furnish details of transactions not reported
4. Most common reportable transactions will be receipt from any person of an amount in excess of Rs. 10 lakhs for issue of shares and receipt of cash payment in excess of Rs. 2 lakhs for sale by a persons whose accounts are liable for tax audit u/s 44AB

Reportable SFT – Commonly applicable

- Company issuing a shares through a public or right issue (Rs. 10 Lakhs or more in a year)
- Company or institutions issuing bond or debenture (Rs. 10 Lakhs or more in a year)
- Receipt of cash exceeding Rs. 2 Lakhs for sale etc. (all persons liable for S. 44AB Audit)
- Authorized dealers selling foreign exchange of Rs. 10 Lakhs or more (limit for each customer)
- Dividends by a company
- However, the list is big in respect of all banking companies

Clause 43: Reporting u/s 286

1. Whether report has been furnished by reporting entity / alternate entity
 1. Master file – Group Turnover INR Rs 500 Cr + Rs. 50 Cr International Transaction in total or Rs. 10 Cr. International transactions relating to intangible assets)
 2. CBCR reporting when group turnover exceeds Rs. 5,500 Cr
2. Name of Parent / alternate entity
3. Date of furnishing report

Clause 44: Break up of total expenditure of entities registered/ not registered under GST

44. Break-up of total expenditure of entities registered or not registered under the GST:

<i>Sl. No.</i>	<i>Total amount of Expenditure incurred during the year</i>	<i>Expenditure in respect of entities registered under GST</i>			<i>Total</i>	<i>Expenditure relating to entities not registered under GST</i>
		<i>Relating to goods or services exempt from GST</i>	<i>Relating to entities falling under composition scheme</i>	<i>Relating to other registered entities</i>		
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(4)</i>	<i>(5)</i>	<i>(6)</i>	<i>(7)]</i>

Real case query in case of a Coop. Bank

6. It is seen that you have shown substantial expenses relating to the entities not registered under GST (please refer to sr. no. 44 of form 3CD filed by you for the year under consideration). In this connection, it is requested to furnish following details of the parties to whom such expenses have been incurred:

Sr. no.	Name of the party	PAN	Address and email id	Amount	Nature/details of the transaction done with the party

You are also requested to furnish ledger accounts of

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ICAI GN – As regard coverage of information

- 82.15 In the table under clause 44, the language used is “expenditure in respect of”. Since, the word used is ‘expenditure’, it is necessary that the capital expenditure should also be reported in the format prescribed. Separate reporting of capital expenditure will provide ease in reconciliation.
- 82.16 This report may be prepared for an entity as a whole or for a branch thereof, as may be audited and accordingly the information in these columns may have to be filled up consolidating the expenditure incurred under various GST registrations.

ICAI GN – Data to be obtained from the Assessee

82.17 In order to verify the details filled in, the tax auditor needs to obtain from the assessee the required details in the below tabular format (an illustrative format which may be modified by the Tax auditor according to the facts and circumstances). The Tax auditor should verify the details furnished with the underlying document on a test check basis and retain the same as part of his working papers.

Expenditure head	Name of the entity to whom payment is made	GSTIN of the entity	Value debited to expenditure account	Value for which input tax credit is taken	Total amount paid to the vendor	Reason for NIL GST	General Remarks, if any

Meaning of Expenditure (as per ICAI)

Description	Example	(Rs.)
Total value of expenditure in P&L for the year		XXX
Add: Total value capital expenditure not included in P&L for the year	Other than land	XXX
Less: Total value of non-cash charges considered as expenditure	Depreciation	XXX
Less: Total value of expenditure excluded for being transactions in securities and transactions in money		XXX
Less: Total value of expenditure excluded by virtue of Schedule III to the CGST Act, 2017	Services by an employee	XXX
Balance being value of expenditure for clause 44		XXX

Classification suggested

- Head wise, nature wise bifurcation not envisaged.
- However, one may give capital expenditure as a separate item
- ICAI of course does not even talk about such bifurcation and according to ICAI total expenditure including capital expenditure as arrived at in the earlier slide is enough
- Working papers still will need such detailed bifurcation to help the Auditor as well as assessee in case of any query

Section 2(47) of the CGST Act, 2017 defines exempt supply as follows:

“exempt supply means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods and Services Tax Act, and includes non-taxable supply”.

Some important notification for exempt supply

- (A) Notification No. 1/2017 CT (R), which prescribes rates for intra-State supply of goods
- (B) Notification No. 2/2017 CT (R), which prescribes intra-State supply of goods which are exempt
- (D) Notification No. 12/2017 CT (R), which prescribes intra-State supply of services which are exempt
- (F) Notification No. 2/2017 IT (R), which prescribes rates for inter-State supply of goods which are exempt
- (H) Notification No. 9/2017 IT (R), which prescribes rates for inter-State supply of services which are exempt

Some important notification for exempt supply Contd..

- Section 2(78) of the CGST Act, 2017 as follows:

“non-taxable supply” means a supply of goods or services or both which is not leviable to tax under this Act or under the Integrated Goods and Services Tax Act”

- As per section 9 of the CGST Act, 2017 / section 5 of the IGST Act, 2017, the following supplies are not leviable to GST:

i) supply of alcoholic liquor for human consumption

ii) supply of petroleum crude, high speed diesel oil, motor spirit, natural gas and aviation turbine fuel

Hence, the above supplies, being not leviable to GST, are exempt supplies

Expenditure relating to entities under composition scheme

- a) A composition dealer cannot charge GST in the invoices.
- b) A composition dealer cannot make inter-State supply.
- c) A composition dealer can issue only bill of supply and not a tax invoice.
- d) The composition dealer should have mentioned the specified words at the top of the bill of supply issued by them.

RCM paid expenditure – an issue

- ICAI Guideline does not have any discussion in this regard but most of the time RCM paid expenses are for the payments to non-registered entities such as advocate. It is also possible that some of the supplies are cross border supplies, mainly software.
- If not separated out, the last column (No. 7) will show inflated figure.
- There are two ways of doing it
 - Remark with amount of RCM paid expenses
 - The adaptation of ICAI Guidelines discussed in earlier slide by adding one more line item, namely, Less: RCM paid expenses

Issue of consolidated Financials

- There does not to be any clarification on the subject in the guidelines
- GST is statewise while Income Tax Financials are consolidated after eliminating contra entries between interstate intra entity transactions. Therefore, the purchase details as per GST records may not tally with the Income Tax Financials. The effect need to be considered while reporting
- CPC/IT Department action on account of variation in direct GST information???

ICAI GN –Reporting Guideline

82.18 * An appropriate disclosure should be made by the Tax auditor in Form 3CA/3CB, as the case may be, for the view taken by the assessee in relation to the meaning of “Total expenditure” and the method of filling up the appropriate columns.

* If the assessee is not in a position to give the details as required in clause 44, an appropriate disclosure/ disclaimer may be made by the auditor in Form 3CA/3CB. Where the assessee has provided reason for not being able to provide details, the same may be reported, if found appropriate.

Drafts of Probable Disclaimer (To Be Debated)

- We have been informed by the assessee that the information required under this clause has not been maintained by it in absence of any disclosure requirements under the GST Act.
- It is not possible for us to determine the breakup of total expenditure of entities registered or not under the GST as necessary information is not maintained by the assessee In its books of accounts.
- Further, the standard accounting software used by the assessee is not configured to generate any report in respect of such historical data in absence of any prevailing statutory requirements regarding the requisite information in this clause
- In view of above, we are unable to verify and report the desired information in this clause.
- In absence of the proper system of assessee, we are unable to comment and give the details as required in Clause 44.

Thank You

