



# ISSUES IN TAX AUDIT-

PRESENTATION BY:

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# Legislative Intention & Objective

- Inserted By FA 1984
- Ensure proper maintenance of books of accounts and other records
- Facilitation of proper administration of tax laws.
- Assistance to Tax officers
- Opportunity to Professionals (only CA's)



# Applicability      wrt      Certain Assessee's

- Section 44AB
- Applicability to 44AD cases
- Applicability to 12A Trusts, section 10 assessee, ICAI view, contra view by ITAT Bombay in Asstt. CIT v. India Magnum Fund [2002] 81 ITD 295 (Mum.),
- Applicability to Agriculturist etc.



# FORM 3CA & 3CB

## [See Rule 6G(1)(a)/(b)]

- True and Correct V/s True and Fair View

- TRUE AND CORRECT [Explained in ICAI Guidance Note]

**Completeness** of the information furnished, i.e., no items have been omitted in the information furnished; &

**Correctness** of the information furnished.

Factual Accuracy based on test checks



# FORM 3CA & 3CB [Contd..]

- Audit Report **to be issued** incases where the accounts of the business or profession of a person **have not been audited under any other law.**
- Tax Auditor to state whether he has **examined** BS & PL for the year ended on 31<sup>st</sup> March....& **Certify** that they are in agreement with the Books of Accounts.
- **Balance Sheet, P & L A/c** to be attached.
- To specify the **number of Branches**, [where books of accounts maintained].



# 3CA & 3CB COMMON ISSUES

## ○ **Statutory Auditors to separately disclose reliance on Branch Auditor**

“I/We have taken into consideration the audit report and the audited statements of accounts, and the statement of particulars in Form No. 3CD received from the auditors, duly appointed under the relevant law, of the branches not audited by me/us”.

## ○ **Branches out side India not Audited by Tax auditor** “I

To obtain information required by form 3CD FROM “Assessee”, who would obtain the same from overseas auditor, who has audited a/cs of foreign branch.

“I/We have taken into consideration the audit report and the audited statements of accounts, and particulars received from the auditors, appointed under the relevant law, of the overseas branches not audited by me/us”.



# 3CA & 3CB COMMON ISSUES

- **F.Note no. 3 of form 3CA**, “Where any of the requirements in this Form is answered in negative or with qualification, give reasons thereof”
- Proper Signature [**F.Note no.4**]
  - Signature
  - Name
  - Address
  - Authority under which signing
  - ICAI Membership No. of Member
  - Firm Registration No.



# 3CD [PART -B]

## Clause 7

7. (a) If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.

(b) If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change.





# 3CD Issues on Clause 7

- Applies to Firm and AOP.
- LLP also covered
- LLP's registered outside India?
- Profit sharing Ratio
- Loss sharing ratio
- Year end/All Changes
- Change in Remuneration whether required



# 3CD [PART –B]

## Clause 8

8. (a) Nature of business or profession. (if more than one business or profession is carried on during the previous year, nature of every business or profession)

(b) If there is any change in the nature of business or profession, the particulars of such change

- To Correspond to Annexure – I of form 3CD
- Permanent Discontinuance to be stated
- Temporary suspension not required
- Materiality to be seen for determination of change



# 3CD [PART -B]

## Clause 9

(a) Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.

(b) Books of account maintained. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system)

(c) List of books of account examined



# 3CD Issues on Clause 9

- Any books means the books so as to enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.
- Books of accounts defined u/s 2[12A]
- Rule 6F
- Incase of Books maintained on computer—  
printout
- Specified Profession  
Information Technology, last entrant
- Relevance of Inventory Records



# 3CD [PART-B]

## CLAUSE 12

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



# 3CD Issues on Clause 12

- Term closing stock is to be construed having regard to section 145A and AS-2
- Raw Material, WIP, Finished Goods, Spares, loose tools, etc.
- ALA firm's case (189 ITR 285) - when business is discontinued on dissolution, the stock should be valued at market price
- Section **145A is tax neutral** as long as the assessee makes payment of the duty in accordance with the provisions of section 43B.
- Adjustments are profit neutral – CIT v. Indo Nippon Chemicals Co. Ltd. 261 ITR 275 (SC)
- Reconciliation – **ICAI Guidance Note**
- Applies to **Excise duty and VAT**
- Does **not apply to service tax** on services (till 31.03.2012)



# 3CD [PART-B]

## CLAUSE 12A

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

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



# 3CD Issues on Clause 12A

- Considered **Deemed Transfer** u/s 2[47]
- **Chargeable to Tax** in the year, in which, **such stock in trade is sold.**
- Description of Capital Asset is to be stated.
- Date of Acquisition, cost of Acquisition is to be stated.
- Depreciable Asset—WDV/cost of purchase?
- Date of Transfer of such stock in trade?
- **Reverse situation, not in contemplation**, i.e conversion of stock in trade in capital asset. Relevant to Builders, and stock brokers moreso, in sluggish times.(ITA 6374/MUM/2004, ACIT v Bright Star Inv P Ltd





# 3CD [PART-B]

## CLAUSE 13

Amounts not credited to the profit and loss account, being,—

- a) the items falling within the scope of section 28;
- b) the Performa credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;
- c) escalation claims accepted during the previous year;
- d) any other item of income;
- e) capital receipt, if any.



# 3CD Issues on Clause 13

- Sub clause (a) – Chargeability of Income u/s 28 (free gifts, tours, etc.)
- Sub clause (b)-Only undisputed credits of CED, VAT & Service Tax need be stated.
- unilateral claims not admitted by the relevant authorities?
- Income Tax Refunds?
- Sub clause (c)-Escalation claims accepted during the year? If pending determination?
- Sub clause (d)- Any other item of income not credited to P & L a/c [eg. Employee contribution to statutory dues].
- Items falling u/s 10 need not be stated.
- “Capital receipts” for this clause not cover share capital or item of gift etc.
- Capital Subsidy, surplus on sale of FA not passed thru P & L A/c are includible.



# 3CD [PART-B]

## CLAUSE 16

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

- Legislative Intention
- Dalal Broacha Stock Broking P. Ltd. v. Addl CIT 010 ITR Trib. 0357 (ITAT Mumbai-Spl Bench)
- AMD Metplast P. Ltd. v. DCIT 341 ITR 563 (DEL).



# 3CD [PART-B]

## CLAUSE 17

### 17. (a) Expenditure of Capital Nature

- Expenses on issue of shares / increase in authorised capital- 225 ITR 795 (SC)
- Discount on Debenture CIT- 225 ITR 802 (SC)
- Expenses by way of stamp duty & registration for issue of bonus share 286 ITR 232 (SC)
- Software—ERP package—nature thereof ? ITAT Spl Bench in case of Amway

### 17. (b) Expenditure of Personal Nature

- “Personal” is confined & related with assessee only
- Disallowance for personal use in case of Companies-Sayaji Iron and Engg. Co. v. CIT[2002] 253 ITR 749(Guj.)



# 3CD [PART-B]

## 17(e) Penalty

- (i) Expenditure by way of penalty or fine for violation of any law for the time being in force;
  - (ii) Any other penalty or fine;
  - (iii) Expenditure incurred for any purpose which is an offence or which is prohibited by law;
- 
- Expenditure incurred in course of illegal business
  - Penalty by Stock Brokers to SEBI/BSE/NSE
  - Legal Expenses incurred for defending suits.



# 3CD [PART-B]

17(f) Amount inadmissible u/s 40(a)

40(a)(ia)

Tax auditor must refer to TDS returns, challans, etc.

Amendment to s.40(a)(ia) w.e.f. 1.4.10

- Deduction permissible if **TDS of entire year, deposited on or before 'Due Date'**
- TDS not deposited till date of Tax Audit Report.
- Applicable to Revenue Payments. **Capital Payments whether covered?**
- Salaries to resident employee paid in India still outside the purview of 40(a)(ia).
- Late deposit of TDS, **payment of interest u/s 201(1A)-mandatory** Hindustan Coca-Cola 293 ITR 226 [SC] Hindustan Coca Cola Beverage P. Ltd. V CIT.
- Incase of Difference of opinion wrt any payment, state both views.



# 3CD [PART-B]

## 17(g) Interest, salary, remuneration, etc inadmissible u/s 40(b) and its calculations

- Only inadmissible amounts need be stated
- New Slabs As per FA (No.2) of 2009, to be used.

## 17(h) Payments for expenditure not made through account payee cheque or drafts

- **Expenditure** meaning thereof (Attar Singh Gurmukh Singh vs. ITO 191 ITR 667 (SC))
- Payments made in circumstances stated under Rule 6DD even if violative of section 40A(3) not to be disallowed.
- Supreme court in Aloo Suplly Co., impliedly over-ruled post amended by FA 2007. 'meaning of payment, date, non-obstante clause, etc.



# 3CD [PART-B]

## 17(k) Liability of Contingent nature

The present value of contingent liability, like warranty expense, if properly ascertained & discounted on accrual basis is allowable **CIT vs. Wipro GE Medical Systems Ltd. 314 ITR 062 (SC)**.





# 3CD [PART-B]

## 17. (1) Deduction inadmissible u/s 14A

- Legislative History SC in Rajasthan state warehousing corporation (242 ITR 450)
- Introduced by Finance Act 2001 with retrospective effect from 1.4.1962
- For computing income under Chapter IV, no deduction allowable in respect of expenditure incurred in relation to income which does not form part of total income
- Sub-sections (2) & (3) inserted w.e.f. A.Y. 2007-08
  - (2) AO shall determine amount of expenditure incurred in relation to such income in accordance with such method as may be prescribed, if the AO, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure...
  - (3) Provisions of ss.(2) shall also apply where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income.....



# 3CD [PART-B]

## 17. (1) Deduction inadmissible u/s 14A

- No method prescribed till 24th March 2008
- Rule 8D notified on 24th March 2008 effective 24.3.2008 – therefore applicable for A.Y. 2008-09 – BHC in Godrej Boyce & Co. SLP pending with SC.
- Expenditure in relation to exempt income shall be aggregate of:

8D[1] Amount of expenditure directly relating to exempt income

8D[2] If interest paid not directly attributable to any particular income or receipt, interest (other than direct interest) in ratio of average Investments with exempt income to average total assets

8D[3] ½% of average investments

**Latest DHC in Maxopp Investments and BHC in Delite Enterprises, also Mumbai ITAT in Reliance.**



# 3CD [PART-B]

## 14A ICAI Guidance Note

The broad principles enunciated in the guidelines of the council of ICAI may be kept in mind while verifying the amount of inadmissible expenditure. **After verifying the amount of inadmissible expenditure**, if the tax auditor:

- (a) is in agreement with the assessee, he should report the amount with suitable disclosures of material assumptions, if any.
- (b) is not in agreement with the assessee with regard to the amount of expenditure determined, he may give:

A qualified opinion:

An adverse opinion:

The disclaimer of opinion



# 3CD [PART-B]

## 18. Payment made to person specified u/s 40A(2)(b)

- Reporting requirements
- List of specified persons
- Applicability to sales/services rendered to specified persons?
- Circular 6P DT 06-07-1968-primary onus and ultimate burden.



# 3CD [PART-B]

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

- Expenditure must have been allowed earlier.
- Expiration of Limitation period under The Limitation Act?
- Waiver of principal Balance of Loans under OTS scheme of Banks, whether 41[1] applicable.

331 ITR 317 MHC, Mahindra & Mahindra Ltd. v. CIT 261 ITR 501 (Bom)



# 3CD [PART-B]

## 21 Section 43B

- Purpose of s.43B – to avoid delayed payment of tax, cess, duty or fees, etc.
- If assessee is following cash system of accounting, then tax auditor should write “Not applicable since cash system followed by the assessee” against clause 21
- On belated payment of ESIC, EPF, etc. SC Decision in case of Alom Extrusion 319 ITR 306, DHC in P.M.Electronics 313 ITR 161.
- 5 days of Grace available.
- Not applicable to Professional Tax collected from Employees.
- Payment within extended due date DHC 332 ITR 483 [Del.]



# 3CD [PART-B]

## 21 Section 43B

- **Excise Duty**– Advance paid in PLA Account.  
Unadjusted credit in Modvat Receivable Ac/  
Ratio of Special Bench in GLAXO. Also Delhi ITAT in  
Maruti Udyog.
- Applicability to Service Tax – Itat Chennai in Real Image  
Technologies Pvt Ltd. [2008] 306 ITR (A.T.) 0106
- Rescheduling of Loans and interest unpaid being converted  
into Loans. **Explanation 3C & 3D TO SEC 43b**



# 3CD [PART-B]

**22** (a) Amount of Modified Value Added Tax credits availed of or utilized during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.

(b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.

- Regarding Modvat Utilization, preferable to state the opening and closing balances too.
- Refer Excise records, RG 23 (both parts).
- One may refer to working done for cl.12[section 145A]
- While reporting on cl 22[b] AS-5 of ICAI may also be referred.

**Modvat Credit—whether an income!!!!**





# 3CD [PART-B]

**24(a) & 24 (b)** Acceptance/repayment of Loans and deposits in amounts exceeding limits stated u/s 269SS & u/s 269T respectively otherwise then by way of a/c payee cheque or a/c payee draft.

- Difference between Loan & Deposits.

A. M. Shamsudeen v. UOI 244 ITR 266 (Mad)

Baidya Nath Plastic Industries (P.) Ltd. v. ITO 230 ITR 522 (Delhi)

- Payments through RTGS, NEFT, TT, etc.

- Legislative Intention and Insertion vide FA 1984.

- Scope of Transfer Entry/Book Adjustments.



# 3CD [PART-B]

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

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

- Details of Losses, can be verified from earlier year ITR's, CARO [incase of corporates]
- Incase of pending Litigation, details may be given till the stage of last order and state fact relating to litigation in remarks.
- Sec 79 is not applicable to Change in shareholding by virtue of gift, inheritance, etc.
- In cl 25[b], the tax auditor is merely to state Yes/No relevant for section 79 and not to provide the extent of change.



# 3CD [PART-B]

## 26-Section wise detail of deduction admissible under Chapter VIA

- Payments made outside books subject to audit?
- Meaning of 'Derived From', Liberty India-318 ITR (SC)?
- Certificates under respective Sections?



# 3CD [PART-B]

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

(b) If the provisions of Chapter XVII-B have not been complied with, please give the following details, namely

(i) Tax Deductible and not deducted at all

(ii) Shortfall on account of lesser deduction than required to be deducted

(iii) Tax deducted late

(iv) Tax deducted but not paid to the credit of the Central Government



# 3CD [Clause 27]

- Refer cl. 17(f) also
- Tax auditor not required to state compliance wrt TDS returns, TDS certificates.
- Reporting on TCS compliances??
- Lower rate/Nil rate certificates u/s 197/195.
- Disagreement with Auditee on exigibility of WHT provisions on payments.



# 3CD [PART-B]

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

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

- Principal Items are those items which constitute more than 10% of the aggregate value of purchase, consumption or turnover.



# 3CD [PART-B]

**29-** In the case of a **domestic company**, details of tax on distributed profits under section 115-O in the following form :—

- (a) total amount of distributed profits;
- (b) total tax paid thereon;
- (c) dates of payment with amounts

- DDT is 15%
- To be deposited within 15 days of declaration, distribution or payment, whichever is earliest.
- Not required to verify availability of reserves/accumulated profits.
- 2[22][e] whether also covered?



# 3CD [PART-B]

**30-** Whether any cost audit was carried out, if yes, enclose a copy of the report of such audit section 139(9)].

**31.** Whether any audit was conducted under the Central Excise Act, 1944, if yes, enclose a copy of the report of such audit.

- If audit pending, state fact.
- Tax auditor's whether can comment on such audit report.
- Excise Audit/Cost audit for period other than covered by Tax Audit?





# 3CD [Clause 32-Ratios]

Accounting ratios with calculations as follows :—

- (a) Gross profit/Turnover;
  - (b) Net profit/Turnover;
  - (c) Stock-in-trade/Turnover;
  - (d) Material consumed/Finished goods produced.
- 
- Sales, purchases, Inventory, which values?
  - Stock Turnover Ratio, whether raw material includible?
  - Product wise ratio/ business segment wise, whether permissible?
  - Variation in numerator and denominators ?
  - Builders, construction companies, GP ratio, whether permissible?



## Miscellaneous Issues?

- Changes in Annexure post revised Schedule –VI?
- Digitalisation of Tax Audit Report and Progress?
- Extention of Due date u/s 139(1)
- Late filing of ITR beyond due date in cases subjected to 44AB-scope of 271B
- 271A and 271B whether simultaneously permissible?
- Multiple Reports in Form 3CD for multiple business of an assessee?



## CBDT Instruction No.9/2008 dated 31.7.2008, 40-A BCAJ 778 (Sept 2008)

- Information available in tax audit reports not being properly analysed during assessment proceedings.
- Tax audit reports and other statutory audit reports should be critically examined along with connected records and other available evidence.
- Information available in reports should be effectively utilised while finalising assessment.
- AO should not merely rely on certificate regarding payments/ loans otherwise than by account payee cheque/draft, but test check and keep results of test check on record.
- In cases of factual misrepresentation by CAs, suitable action u/s.288 should be taken – disciplinary action through ICAI.



**THANK YOU !!!**

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