Seminar/ Webinar on Clause 1 to 25- Understanding and issues

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Background

- Section 44AB of the Income Tax Act, 1961

- Trigger point – applicability
  - Business - sales, turnover or gross receipts > Rs. 1 crore
  - Profession – gross receipts > Rs. 50 Lakh
  - Presumptive taxation – 44AD, 44ADA etc.

- Due Date: 1 month prior to due date of furnishing ITR for relevant AY
  - For AY 2022-23 : 30 September 2022 (Tax Audit Report)
  - For AY 2022-23 : 30 November 2022 (Transfer Pricing Audit)

- Tax Audit Report – Form 3CA / 3CB and Form 3CD
  - Penalty - Sec 271B – lower of 0.5% of T/o or Rs.1,50,000/-

- True and Fair v/s True and Correct
  - Penalty – 271J – Rs 10,000 - for furnishing inaccurate information

What is Tax Audit?

A tax audit is the process of verification and inspection of the accounts of a taxpayer to confirm their adherence to the provisions of the Income Tax law.

<u>Purpose of Tax Audit :-</u>

- To ensure proper maintenance of books of accounts

- To ensure that the records reflect the actual income of the taxpayer and that the claims for deductions made are accurate.

- To assist AO in computation of Total Income and facilitate them to complete assessments.

Turnover / Gross Receipts

- Turnover for F&O transaction / Option Contracts
  - Favorable and unfavorable difference in absolute terms
  - Premium received on sale of options is also to be included in turnover
  - In respect of any reverse trades entered, the difference thereon, should also form part of the turnover
- Speculative Transactions
  - Favorable and unfavorable difference in absolute terms
- Delivery based transactions (considered as business activity)
  - Total value of the sales is to be considered as turnover

Applicability of Audit - Business

- Engaged in eligible business (Eligible assessee)

Turnover	Cash Receipt/ Payment	Profit (%)	Audit Applicability
More than 10 Cr	NA	NA	Yes [44AB(a)]
2 Cr – **10 Cr**	Less than 5%	NA	No
	More than 5%	NA	Yes [44AB(a)]
Upto 2Cr	NA	More than 6%/ 8%	No
	NA	Less than 6%/ 8%	Yes [44AD(4) read with 44AB(e)]

- Engaged in business (Other than Eligible assessee)

Turnover	Cash Receipt/ Payment	Profit (%)	Audit Applicability
More than 10 Cr	NA	NA	Yes [44AB(a)]
More than 1 Cr but less than **10 Cr**	Less than 5%	NA	No
	More than 5%	NA	Yes [44AB(a)]

Applicability of Audit - Profession

- Engaged in Profession

Turnover	Cash Receipt/ Payment	Profit (%)	Audit Applicability
More than 50 lakhs	NA	NA	Yes [44AB(c)]
Upto 50 lakhs	NA	More than 50%	No
	NA	Less than 50%	Yes [44AB(d) read with section 44ADA]

- Also applicable to Non-resident (for India related operations)

Applicability of Audit – Cash Receipt / Payments

- Aggregate of all amounts received / payments should be less than 5 % - what all included ?

Receipt	Payment
Trading Receipt (cash Sales, receipt from debtors, etc.)	Trading Payment (Cash Purchase, payment to creditors, etc.)
Loan accepted during the year	Loan given during the year
Sale proceeds of Capital Assets	Purchase of Capital Assets
Reimbursement / Amount contributed / withdrawn by Partners	

Procedure to Upload Tax Audit

1. Log in to income tax e-filing portal with valid username and password.
2. Navigate to the profile and click on the worklist option.
3. Under the “For your action” section, click on the accept option for the form request.
4. Clicking on accept form would take you to the pending for filing section. Click on the option to file form.
5. Verify the details presented on the screen and click on continue.
6. In the next window, upload the supporting documents such as balance sheet, profit & loss, cost audit, etc.
7. Finally, attach the DSC and submit the form.

Tax Auditor Requisites

ICAI Code of Ethics to follow

- Appointment and NOC procedures
- Indebted for more than Rs. 10,000 (NOTIFICATION NO 1-CA(7) 63/2002 DT 2.08.2002)
- Non-Payment of Undisputed Audit Fees u/Co's Act or other statutes except in case of sick units
- Whether Tax Audit Fees can be more than Statutory Audit Fees?
- Compliance with Standards issued by ICAI

Eligibility for Appointment as Tax Auditor

- Same person cannot conduct Internal Audit
- A Person can not be appointed as Tax Auditor of a Firm or Company in which his relatives hold not less than 20% interest/voting power

Ceiling on Tax Audits – 60 per partner

Mentioning of UDIN

Documentation subject to Review of Quality Review Board (QRB) – 24th July 2018

Tax Audit Forms

Form 3CA:

For professionals/ businesses requiring mandatory audit under law other than Income Tax law.

Form 3CB:

For those not requiring mandatory audit under any law apart from Income Tax Law.

Form 3CD:

Particulars/ Details required to be furnished to the Income Tax Authorities in the format prescribed

Part A: Clause 1 to clause 8a

Part B: Clause 9 to 44

Clause 1 – Name of the Assessee

The name of the assessee whose accounts are being audited under section 44AB should be given.

If the tax audit is in respect of a branch, name of such branch should be mentioned along with the name of the assessee.

The name appearing of whose accounts are being audited must be the same as stated in the relevant registrar.

Name as on the last date of the previous year and also on the tax audit report date shall be stated.

Incase of change in name of the company, e.g., conversion into public Ltd co or vice versa, state both names and also state the fact of the change by way of a note.

Clause 2 – Address of the Assessee

The address to be mentioned should be same as communicated by the assessee to the income tax department for assessment purpose as on the date of signing of the audit report.

Change in address after the year end but before the date of tax audit report to be mentioned.

Incase of Company, registered office address to be stated along with other principle place of business.

Audit Procedures:

- Ask from the assessee the address communicated by him to the department
- Ask for ITR acknowledgement for the purpose of auditing the Address disclosed in Form 3CD
- Mention address at which HUF is assessed and not that of Karta.
- If the address given for assessment differ from registered addresses, we also have to mention registered address

Clause 3 – Permanent Account Number

The Permanent Account Number of the assessee whose accounts are being audited under section 44AB should be given. Aadhaar Number can also be given for Individuals.

<u>Audit Procedures:</u>

- Obtain Copy of PAN Card as shown above.
- If PAN number is not allotted and application is made, PAN application ack copy to be obtained.
- Fact regarding pendency of PAN number is to be appropriately mentioned in Form 3CD.

Clause 4 – Indirect Tax Registrations

Whether the assessee is liable to pay indirect tax. If yes, furnish the registration no./ identification no. allotted for the same. The information may be obtained and maintained in the following format:

Sr No	Relevant Indirect tax Law which requires registration	Place of Business/ profession/service unit for which registration is in place/ or has been applied for	Registration/ Identification number

Audit Procedures:

- Auditor should obtain from the assessee the list of indirect taxes applicable to him.
- Obtain Copy of Registration Certificates issued by GST/Excise/Customs/ VAT/Service Tax Authorities (including multiple registrations)
- Additional Place of business also should be mentioned for all the registrations obtained.
- Any indirect taxes laws applicable on the business or profession of the assessee but the assessee is not registered under the said law, he should report the same appropriately.

Clause 5 – Status of the Assessee

In this Clause, the status of the Assessee is to be mentioned as defined in section 2(31) of the Act.

Status can be:

- Individual
- Hindu Undivided Family (HUF)
- Company
- Firm (includes LLP)
- Association of Persons (AOP)
- Body of Individuals (BOI)
- Artificial Juridical Person
- Local Authority

Audit Procedure: The same can be checked by obtaining PAN of the assessee.

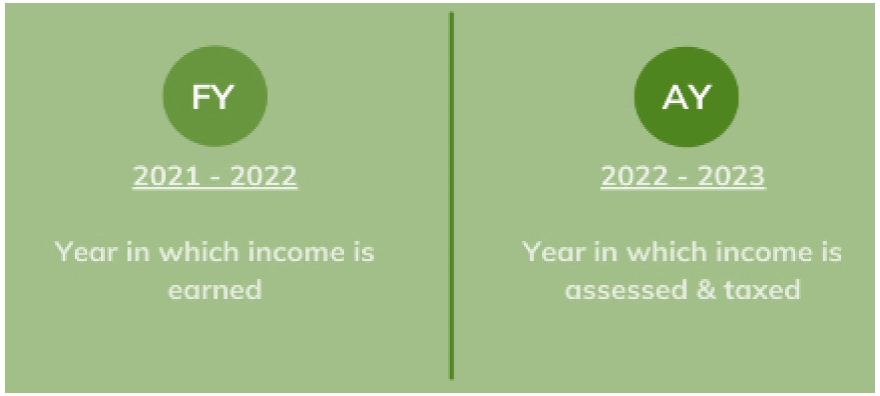
Clause 6 – Previous Year & Clause 7 – Assessment Year

The period of the previous year has to be stated.

Since the previous year under the Act now uniformly begins on 1st April and ends on 31st March, the relevant previous year should be mentioned.

In case of amalgamations, demergers, reconstitution, new business, closure of existing business etc. where previous year can be different – appropriate reporting to be done.

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

Auditor has to report the clause of the section under which audit is conducted.

Examples are as under:

- Assessee is carrying on business and his total sales, turnover or gross receipts exceeds one crore rupees : 44AB (a)
- Assessee is carrying on profession and his gross receipts exceeds fifty lakh rupees : 44AB (b)
- Audit being conducted by virtue of provisions of section 44AE, 44BB and 44BBB: 44AB (c)
- Audit being conducted by virtue of provisions of section 44ADA : 44AB (d)
- Audit being conducted by virtue of provisions of section 44AD (4) : 44AB (e)

If the assessee falls into more than one clause, reporting to be done under??

Clause 8a – option for taxation u/s 115BA/115BAA/115BAB/115BAC/115BAD

Special rates of tax made available for assessee to be opted for payment of taxation by foregoing certain deductions as under:

	115BA	115BAA	115BAB	115BAC*	115BAD
Applicability	Any domestic manufacturing company	Any Domestic Companies	New Manufacturing or electricity generating domestic companies	Individual & HUF	Co-operative society resident in India
Effective rate of tax (including surcharge & HEC)	**28.6%** [Tax @ 25% + Surcharge @10% + HEC @ 4%]	**25.168%** [Tax @ 22% + Surcharge @10% + HEC @ 4%]	**17.16%** [Tax @ 15% + Surcharge @10% + HEC @ 4%]	Tax to be paid at concessional tax slab rates	**25.168%** [Tax @ 22% + Surcharge @10% + HEC @ 4%]
Relevant Form to be furnished	10 – IB	10 – IC	10 – ID	10 – IE	10 – IF
Effective from	1st April 2017	1st April 2020	1st April 2020	1st April 2020	1st April 2021

Once opted the same cannot be withdrawn in any previous year.

*can be withdrawn only once in subsequent year and then cannot be re-exercised.

Clause 9 – Particulars of Members/Partners in case of Firms/ AOP

In this clause, name of the partners/ members and their profit-sharing ratio is to be mentioned.

If a partner of a firm/AOP acts in a representative capacity, the name of beneficial partner/member should be stated along with such fact.

If there is any change in the partners or members or in their profit-sharing ratio, the particulars of such change are to be mentioned in this clause.

Audit Procedures:

- To obtain and verify Partnership Deed to check relevant details.
- To verify whether relevant documents have been filed with the concerned authorities.
- To verify whether notice of changes, if any, has been given to the registrar of firms.

Note: As per section 2(23) of the Income-tax Act, 1961, the term “Firm” includes “LLP” as defined in Limited Liability Partnership Act, 2008.

Clause 10 – Nature of Business

NATURE OF BUISNESS

- Clause 10(a): Nature of business carried on during previous year
- Clause 10(b): Changes in business or profession and particulars of such changes

<u>Audit Procedures:</u>

- Principle line of business as informed by the assessee needs to be verified.
- Sectors (along with sub-sectors) should be reported.
- Ensure that every type of business is disclosed in clause 10(a).
- Change from one business to another, addition/deletion will be considered as change.
- Minutes of the meetings and such other management report to be reviewed for changes made in business, if any.
- Review/ Examination of financial statements to ascertain any changes in business or profession.
- Obtain representation from the management.

For the purpose of business code refer

Business Code List

Clause 11 – Books of Accounts

11 (a): Whether books of accounts (BOA) are prescribed under section 44AA, if yes, list of books so prescribed.

- Income tax Act defines BOAs to include ledgers, day-books, cash books, account-books and other books
- Section 44AA of Income Tax Act states that every person carrying on the below profession must compulsorily maintain books of accounts:
  i) Legal
  ii) Medical
  iii) Engineering or Architectural profession
  iv) Accountancy or Technical consultancy
  v) Interior decoration
  vi) Film Artist or such other as may be prescribed.

<u>Audit Procedures:</u>

- Auditor to obtain all such BOAs (financial and non-financial) maintained by the Assessee.
- Auditor to comment whether such prescribed BOAs are maintained properly by the Assessee.
- If all BOAs not maintained/ produced for verification, appropriate reporting requirements to be followed in Form 3CA/ 3CB.

Clause 11 – Books of Accounts

11 (b) & (c): List of books of accounts (BOAs) maintained and address at which the BOAs are kept.

- In case BOAs are maintained in a computer system, BOAs generated by such computer system to be mentioned.

(example: Tally Prime, SAP, Oracle, TCS etc.)

- If the BOAs are not kept at one location, addresses of all such locations along with the details of books of accounts maintained at each location to be given.
- Format of Disclosure:

Sr. No.	List of books of account	Principal place of Maintenance of books of account

Audit Procedures:

- BOAs maintained in Computer system or online/ Cloud, address of Server location or IP Address (unique) to be mentioned respectively.
- Appropriate documentation to be done including extraction of various books of accounts from computer system, print outs of such BOAs etc.

Clause 12 – Presumptive Income

Where the profits and gains are assessed on a presumptive basis under any of the sections mentioned below, the amount of such profits and gains credited/debited in the profit and loss account should be stated:

Section	Provisions	Presumptive Income
44AD	Applicable to resident individuals, partnership firms, and HUFs whose turnover is less than Rs. 2 crore.	8% of Total gross turnover
44AE	Assessees in the business of plying, hiring, or leasing goods carriages owning not more than 10 goods carrier vehicles at any time in the FY.	Non heavy goods vehicle: 7500 p.m. per vehicle Heavy goods vehicle: 1000 p.m. per tonne of gross vehicle weight.
44B	Non-resident engaged in the business of operation of ships.	7.5% of the amounts received or deemed to be received by such assessee as specified in 44B (2)
44BB	Non-resident engaged in the business of exploration of mineral oils.	10% of the amounts received or deemed to be received by such assesee as specified in 44BB (2)
44BBA	Non-resident engaged in the business of operation of aircraft.	5% of the amounts received or deemed to be received by such assessee as specified in 44BBA (2)
44BBB	Foreign companies engaged in civil construction, etc. in turnkey power projects.	10% of the amount paid or payable to such assessee as specified in 44BBB (1)
44ADA	Resident individual or partnership firm engaged in a profession whose total gross receipts do not exceed Rs 50 lakh in the PY.	50% of the total gross receipts of the assessee in the previous year on account of such profession.

Chapter XII – G (Shipping Business) & First Schedule (Insurance business) are also covered here.

Clause 13 – Method of Accounting & ICDS

a) Method of accounting employed in the previous year. [Mercantile/ Cash]

b) Whether there has been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year. [Yes/ No]

c) If answer to (b) above is affirmative, give details of such change, and the effect thereof on the profit or loss.

Serial Number	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)

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). [NA for Cash accounting]

e) If answer to (d) above is in the affirmative, give details of such adjustments

ICDS	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)	Net effect
ICDS I to X	Name of each ICDS			

f) Disclosure as per ICDS

Clause 13 – Method of Accounting & ICDS

ICDS I : Accounting Policies

- This ICDS recognizes certain accounting assumptions such as going concern, consistency and accrual concept but excludes prudence and materiality concept.
- Treatment & presentation of transaction shall be based on substance over legal form.

ICDS II : Valuation of Inventories

- Inventories shall be value at cost or NRV which ever is lower.
- In case of dissolution of firm, AOP and BOI irrespective of continuance of business, the inventories shall be valued at NRV.

ICDS III : Construction Contracts

- The contract revenue and contract cost of the construction contracts, are to be recognized based on percentage of completion method.

ICDS IV: Revenue Recognition

Revenue Type	Method of accounting
Sale of goods	Significant risk & rewards of ownership are transferred & there is reasonable certainty of its ultimate collection
Revenue from service transaction	Percentage completion method/Straight line method/project completion method

Clause 13 – Method of Accounting & ICDS

ICDS V : Tangible Fixed Assets

ICDS V requires disclosures similar to clause 18 of Form 3CD as under:

- Description of asset or block of asset
- Rate of Depreciation
- Actual cost or written down value
- Additions or deductions during the year with dates
- Depreciation allowable &
- Written down value at the end of the year

ICDS VI : Changes in Foreign Exchange Rates

- ICDS VI stipulates no disclosure requirement.

ICDS VII : Government Grants

ICDS VII requires to disclose:

- The nature and extent of government grants recognized by way of deduction from the actual cost of the asset and/or as income during the year.
- The nature and extent of government grants not recognized by way of deduction from the actual cost of the asset and/or as income during the year and reason thereof.

Clause 13 – Method of Accounting & ICDS

ICDS VIII : Securities

- ICDS VI stipulates no disclosure requirement.

ICDS IX : Borrowing Costs

- ICDS IX requires the disclosure requirement related to accounting policies adopted for borrowing costs and the amount of borrowing costs capitalized during the year.

ICDS X : Provisions, Contingent Liabilities and Contingent Assets

ICDS X requires disclosures as under:

- A brief description of the nature of the obligation/asset and related income.
- The carrying amount at the beginning and at the end of the year.
- Additional provision made/asset and related income recognized during the year.
- Amount used and charged against the provision.
- Amount of provision/asset and related income reversed during the year.

Refer Technical Guide on ICDS issued by ICAI.

Technical Guide on ICDS

Clause 14 – Valuation of Closing Stock

Clause 14 (a) : Method of valuation of closing stock employed in the previous year.

- Method of valuation of all items of inventories will have to be given under sub-clause (a) separately.
- The items of inventories include:

Raw Materials	Maintenance Supplies
Work in Progress	Consumable Goods
Finished Goods	Loose Tools

- It is not necessary to indicate any change in the method of valuation of closing stock under this clause.
- Any such change in method of valuation → change in an accounting policy → to be disclosed in financial statements as required by AS 1/ Ind AS 1.

<u>Audit Procedures:</u>

- List of inventory at the year end along with valuation thereof to be obtained.
- Ensure that method adopted is consistently followed and if there is a change the same is appropriately captured in accounting policy.

Clause 14 – Valuation of Closing Stock

Clause 14 (b) : Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss to be furnished in the following format:

Serial Number	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)

- Section 145A provides for valuation of various types of inventories for the purpose of calculation of income chargeable to tax under the heads "Profits and Gains from Business or Profession" and "Income from Other Sources".

Valuation of inventory	Lower of actual cost or net realisable value
Valuation of purchase and sale of goods or services and of inventory	Amount of any tax, duty, cess or fees paid or incurred by the assessee to bring goods or services to the location shall be included.
Valuation of inventory being securities not listed or listed but not quoted on a recognized stock exchange	Valued at actual cost initially recognized.
Valuation of inventory being listed securities.	Lower of actual cost or net realizable value
Valuation of inventories held by a scheduled bank or public financial institution.	Lower of actual cost or NRV after taking into account, the extant guidelines of the RBI.

- The effect of section 145A is to reflect the figures on “inclusive method” which is not permitted by AS 2/ Ind AS 2.

Clause 14 – Valuation of Closing Stock

Audit Procedures:

- Ascertain the method of valuation of stock employed during the previous year by reviewing the financial statements.
- The basis for ascertaining the cost should be examined (whether inclusive/ exclusive)
- It is necessary to ensure the basis is followed consistently and the method followed in valuation of stock results in disclosure of correct profit and gains.
- Double deduction of same expenditure should not be claimed by way of such adjustment.
- The adjustments envisaged by section 145A will not have any impact on the gross profit in the trading account of the assessee.

Clause 15 – Conversion of asset into stock-in-trade

Description of Capital Asset	Date of Acquisition	Cost of Acquisition	Amount at which the asset is converted into stock-in-trade

For furnishing the above particulars, the following provisions have to be kept in mind:

Section 2(14) : Capital Asset means any kind of property held by the assessee excluding Stock-in-trade, raw materials, personal effects of movable nature, rural agricultural land & gold deposit bond.

Section 2(47) : Conversion of asset into stock-in-trade is treated as transfer as per section 2(47).

Section 45(2) : As per this section, such a conversion or treatment of capital asset into stock-in-trade will be deemed to be a transfer of the previous year in which the asset is so converted or treated as stock-in-trade.

Section 47(iv) : Transfer by a Holding Company to its 100% Subsidiary Company.

Section 47(v) : Transfer by a 100% Subsidiary Company to its Holding Indian Company.

Clause 15 – Conversion of asset into stock-in-trade

Description of Capital Asset	Date of Acquisition	Cost of Acquisition	Amount at which the asset is converted into stock-in-trade

The capital gains exempted by virtue of clause (iv) or clause (v) of section 47 may become chargeable under certain circumstances. The provisions of section 47A are relevant here.

If the transferor fails to hold the entire holding of transferee , then capital gains exempted shall be taxable in the hands of transferor company.

Audit Procedures:

- Check whether the assessee has converted any capital asset into stock-in-trade during the year under audit.
- If yes, then obtain the details as to nature of such capital asset, its date and cost of acquisition and the amount at which the asset has been converted into stock-in-trade.

Clause 16 – Amounts not credited to P&L

The items falling within the scope of Section 28.	• Scrutiny of items on the credit side to be done.
The Performa credits, drawbacks, refund of customs or excise duties or service tax or sales tax or VAT where such credits, drawbacks or refunds are admitted as due by the authorities concerned.	• Enquire and obtain a schedule from the assessee indicating all such claims admitted but not credited to the P&L during the year. **Format**
Escalation claims accepted during the Previous Year	• Where assessee follows cash basis of accounting, whether details of escalation claims accepted without actual receipt is to be reported.
Any other item of income	• Scrutiny of items as per above to be done keeping in mind AS 9 or IND AS 115.
Capital receipt, if any.	• Professional judgement to be applied to determine the nature of receipt on scrutinizing all credits/ income.

Clause 17 – Land or building or both is transferred as per section 43CA or 50C

Where any land or building or both is transferred during the previous year for a consideration less than the value adopted or assessed or assessable by any authority of a State government referred to in Section 43CA or 50C.

Details of Property	Consideration received or accrued	Value adopted or assessed/assessable	Whether provisions of second proviso to sub-section (1) of section 43CA or fourth proviso to clause (x) of sub-section (2) of section 56 applicable? [Yes/No]

Section 43CA: Transfer of asset (other than capital asset) being Land or Building or both at a value less than Stamp duty value.

Section 50C: Transfer of capital asset being Land or Building or both at a value less than Stamp duty value.

- If the stamp duty value adopted does not exceed 110% of the actual consideration, such actual consideration received/receivable by the taxpayer would be considered as the full value of consideration.

- The limit of 110% was increased to 120% for specific class of assets, subject to the following requirements:

a) ‘Residential units’ of value upto Rs. 2 crores.
b) Transfer being first allotment to any person i.e. it’s the first house.
c) Sold during the period 12.11.2020 to 30.06.2021

Clause 17 – Land or building or both is transferred as per section 43CA or 50C

Audit Procedures:

- Verify BS and P&L to check whether any such property has been transferred during the year.
- Alternatively, a list can be obtained of all properties held during the preceding two years for verification.
- Copy of Registered Sale Agreement should be obtained for verification of sale value and stamp duty value.
- Suitable working to be prepared for verifying the 110%/ 120% of the value and the difference thereof.
- If the property is not registered, reliance on “experts” like lawyer or solicitor representation needs to be made for valuation of property. Compliance with SA 620 – Using the Work of an Auditor’s Expert to be kept in mind.

Clause 18 – Depreciation Admissible as per Income Tax Act

Sr.No.	Description / Block of assets	Rate of depreciation	WDV as at 1 April 2021	Adjustment made to the written down value under section 115BAC/115BAD	Adjusted written down value	Addition more than 180 days	Addition less than 180 days	Gross additions	Deductions	Total	Depreciation allowable	WDV as at 31 March 2022

Block of Asset concept and rate of depreciation is as per Appendix 1 of Income Tax Rules.

Audit Procedures:

- Obtain depreciation schedule prepared by the client in the above format.
- Verify the following:

a) classification of asset
b) opening balances from previous year's tax audit form filed
c) addition and deductions from the audited Fixed asset Register / Fixed Asset Schedule in the Financials
d) segregation of addition between more than and less than 180 days

- Obtain sample invoices of additions and deletions during the year for verification of accuracy.
- For additional depreciation being claimed, check whether relevant conditions have been specified have been fulfilled.

Clause 19 – Amounts admissible under section 32AC to 35E

Amounts debited to profit and loss account and admissible under sections 32AC, 33AB, 33ABA, 35, 35ABB, 35AC, 35AD, 35CCA, 35CCB, 35CCC, 35CCD, 35D, 35DD, 35DDA, 35E.

A table showing the amount debited and deduction allowable under each section separately.

Audit Procedures:

- Ensure all conditions for availing the deduction have been fulfilled or not in the respective sections.

- The amounts not debited to P&L Account but admissible under any section also to be checked.

[Example : Section 33AB and Section 33ABA –Depositing amounts in designated accounts]

- If a separate audit report for claiming such deductions have been obtained by the assessee, document the same for giving reference to that report.

Clause 20 – Employee Related Deductions

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

b) Details of contributions received from employees for various funds as referred to in section 36(1)(va):

Serial Number	Nature of Fund	Sum received from employees	Due date for payment	The actual amount paid	The actual date of payment to the concerned authorities

- If bonus or commission is in the nature of profit or dividend - not allowable as a deduction.
- **Section 36(1)(va)**: any sum received by the assessee from any of his employees to which the provisions of section 2(24)(x) apply is credited to the account of the employees and paid to relevant statutory fund on or before the due date.
- **Section 2(24)(x):** any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or ESI Fund or any other Fund for employees' welfare.

Clause 20 – Employee Related Deductions

Audit Procedures:

- Verify employment/ contract details to be checked on sample basis to determine the nature of payments.
- A list of various contributions recovered from the employees to be obtained along with the date on which it is deposited.
- Due date for all such contributions to be verified (including extensions granted, if any) and mentioned suitably.
- A working to be prepared mentioning delay in payment, if any by verifying the respective challans.
- In view of the voluminous nature of the information, test checks and compliance tests can be carried out to satisfy that the system of recovery and remittance is proper.

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21 (a): the details of amounts debited to the profit and loss account, being in the nature of Capital, personal, advertisement expenditure etc.

Nature	Sr. No.	Particulars	Amount in Rs.
Capital Expenditure			
Personal Expenditure			
Advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like published by a political party			
Expenditure incurred at clubs being entrance fees and subscriptions.			
Expenditure incurred at clubs being cost for club services and facilities used.			
Expenditure by way of penalty or fine for violation of any law for the time being force			
Expenditure by way of any other penalty or fine not covered above			
Expenditure incurred for any purpose which is an offence or which is prohibited by law			

Audit Procedures:

- Obtain and scrutinize ledger dumps of all expenses for identifying expenditure of such nature. E.g. Advertisement expenses, Membership Subscription, Late payment fees, Penalty, Interest on delayed payment etc.
- Scrutinize specific ledgers such as foreign travel, staff welfare expenses along with directors/ related parties ledgers.

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21(b): Amounts inadmissible under section 40(a):

(i) as payment to non-resident referred to in sub-clause (i) – Payment to Non-Residents → TDS not deducted/ paid

(ii) as payment referred to in sub-clause (ia) – Payment to Residents → TDS not deducted/ paid

(iii) Under sub-clause (ic) [wherever applicable] – Fringe benefit tax payment (N/A)

(iv) Under sub-clause (iia) – Wealth Tax payment (N/A)

(v) Under sub-clause (iib) – payment of royalty, license fees, service fees

(vi) Under sub-clause (iii) – payment chargeable under "Salaries" → TDS not deducted/ paid

(vii) Under sub-clause (iv) - payment to a provident or other fund established for the benefit of employees

(viii) Under sub-clause (v) - payment by an employer referred to in clause (10CC) of section 10

Audit Procedures:

- This clause requires reporting in furtherance to Clause 34(a) i.e. all procedures to be carried out similar to clause 34(a). Major reporting here is (i) TDS not deducted – 100%/30% amount disallowed or (ii) TDS deducted but not paid before due date u/s 139(1) – 100%/ 30% amount disallowed.
- Foreign payments to be verified specifically for reporting.
- Reporting Format → Reporting Formats

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21(c): Amount debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof.

- Applicable to Firms, AOP and BOI.
- Limits being prescribed for allowance of expenditure upto a certain limit.
- Salary, bonus, commission or remuneration or interest are not admissible, unless the following conditions are satisfied:

a) Remuneration is paid to working partner(s)
b) Remuneration or interest is authorised by the partnership deed and is in accordance with the partnership deed.
c) Remuneration or interest does not pertain to a period prior to the date of partnership deed.

Book Profit	Amount deductible as remuneration under section 40(b)
If book profit is negative	Rs. 1,50,000
If book profit is positive- On first Rs. 3 lakh of book profit On the balance of book profit	Rs. 1,50,000 or 90% of book profit whichever is more 60% of book profit

- Reporting Format → Reporting Formats

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21(d): Disallowance/deemed income under section 40A(3)

- Any payment made to person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeding rupees ten thousand, no deduction would be allowed in respect of such expenditure.
- In case of payment made for plying, hiring or leasing of goods carriage, limit is Rs.35,000 instead of Rs.10,000.

Audit Procedures:

- Obtain the cash and bank ledger from the accounting system for verification of payments made in excess of Rs. 10,000 or Rs. 35,000.
- Exemptions granted under Rule 6DD clauses to be referred in order to report correctly.
- Tools available for checking this clause in case of voluminous transactions.
- Certificate to be obtained where verification of payment made through account payee cheque, electronic mode etc. where checking data is practically not possible.

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21(e): provision for payment of gratuity not allowable under section 40A(7)

Any provision made by the assessee for the payment of gratuity to his employees towards an approved gratuity fund.

Audit Procedures:

- Obtain order of approval of Gratuity Trust by CIT for verifying effective date of the fund.
- Verify the provision made is as per the terms of the Trust Deed.

Clause 21(f): any sum paid by the assessee as an employer not allowable under section 40A(9)

Any sum paid by the employer towards setting up or formation of or as a contribution to any:
(i) Fund (ii) Trust (iii) Company (iv) AOP (v) BOI (vi) Society except approved Gratuity, PF or Superannuation Fund.

Clause 21(g): particulars of any liability of a contingent nature

Any liability of a contingent nature debited to the P&L.

Audit Procedures:

- Obtain and scrutinize outstanding liabilities, provisions, misc. expenses etc. for expenses related to disputed claims.
- Disclosure in financials pertaining to Contingent liabilities to be referred for changes, if any.
- Enquire about the changes made to contingent liabilities disclosure from the previous year.

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21(h): Amount of deduction inadmissible in terms of section 14A

a) Section 14A(1): No deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income.

b) Section 14A(2): Determination of expenditure incurred in relation to exempt income by the Assessing Officer.

c) Section 14A(3): Determination of expenditure incurred in relation to exempt income by the Assessing Officer when assessee claims that no expenditure has been incurred.

Audit Procedures:

- Determine whether any income earned by the assessee during the PY is exempt from tax (such as interest on tax-free bonds, share of profit from partnership firm, etc.)
- Determine expenses incurred by the assessee towards earning such exempt income.
- If expenses cannot be ascertained based on the above, determine disallowance as per formula prescribed under Rule 8D i.e.
  a) the amount of expenditure directly relating to income which does not form part of total income; and
  b) an amount equal to one per cent of the annual average of the monthly averages of the opening and closing balances of the value of investment, income from which does not or shall not form part of total income:

Clause 21 – Admissibility and Inadmissibility of certain expenses

Clause 21(i): amount inadmissible under the proviso to section 36(1)(iii)

- The provisions of section 36(1)(iii) provide that the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession would be allowed as a deduction in computing the income.
- When the capital is borrowed for acquisition of a capital asset, then interest liability pertaining to the period till the date such asset is put to use shall not be allowed as deduction.

<u>Audit Procedures:</u>

- Obtain a list of all such capital assets which are financed through a borrowing specifically.
- Verify whether the interest on such borrowing is being capitalized with the asset.
- Verify whether the asset has been put-to-use as on the reporting date.
- Appropriate documents to be obtained for ensuring correctness of reporting.

Clause 22 – Amount of Interest inadmissible under section 23 of MSMED Act, 2006

Definition of Micro, Small and Medium Enterprises as per the Act.

	Micro	Small	Medium
Invst in PPE	< 1Crore	< 10 Crore	< 50 Crore
Annual T/o	< 5 Crore	< 50 Crore	< 250 Crore

Section 16 of the MSMED Act provides for the date from which and the rate at which the interest is payable.

Section 15 of the MSMED Act, requires the buyer to make payment on or before the date agreed upon in writing (not exceeding 45 days) or where there is no agreement in this behalf, before the appointed day.

Section 22 of the MSMED Act provides for relevant disclosure in its annual accounts.

Clause 22 – Amount of Interest inadmissible under section 23 of MSMED Act, 2006

Audit Procedures:

- Obtain list of entities which are MSME Registered. (Responsibility of assessee to maintain relevant records)
- Verify on test check basis any interest that is payable/ paid from BOAs in terms of section 16 of the MSMED Act.
- Ensure that the disclosure requirement as per section 22 of the MSMED Act has been disclosed in the Financials.
- On verification:

a) If interest paid/ payable is NIL → then Nil amount to be reported.

b) If interest paid but not disclosed → then appropriate amount to report

c) If interest liable to be paid but not provided → no reporting but question on true and fair view of financials.

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

Definition of Related Parties as per IT Act.

Sr. no	Where the assessee is	Persons referred in clause (b)
(i)	Individual	any relative of the assessee
(ii)	Company, firm, AOP or HUF	any director (Co.), partner (Firm), member (AOP/HUF), or any relative of such director, partner or member
(iii)	Carrying on business/ profession	any individual who has a substantial interest in business/ profession of the assessee or any relative of such individual
(iv)	Carrying on business/ profession	a Company, Firm, AOP or HUF having a substantial interest in the business/profession of the assessee
		any director, partner or member of such Company, Firm, AOP or HUF
		any relative of such director, partner or member or any other company carrying on business or profession in which the first mentioned company has substantial interest.
(v)	Carrying on business/ profession	a company, Firm, AOP or HUF of which a director, partner or member has a substantial interest in the business/ profession of the assessee.
		any director/ partner / member of such Company, Firm, AOP or HUF or any relative of such director, partner or member.

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

Audit Procedures:

- Obtain a management certified Related Party List as per the definition of IT Act.
- Verify the details received with other data of the assessee (example: List of members, directors, form of declaration of director interest etc.)
- Obtain ledgers of the specified persons as per the list to verify ***payments*** paid to them.
- Enquiries to be made by reviewing related party transactions as disclosed in financial statements.
- Reporting format:

Name of the Related Party	PAN of Related Persons	Relation	Date of Payment	Amount of payment

Clause 24 – Amounts deemed to be profits and gains

32 AC	33 AB	33 ABA	33 AC
Investment in new plant or machinery	Tea development account, coffee development account and rubber development account.	Site Restoration fund	Reserves for shipping business

- Link to Clause 19 of Form 3CD – deductions allowed under the relevant sections
- Only eligible assessee can claim the benefit of above sections basis conditions specified. (Refer CA Final Direct tax Module 1 Chapter 6 for details)
- Any breach in the specified conditions will result in the amount to be treated as deemed profit to be reported under this clause.
- Reporting Format:

Section	Description	Amount	Remarks

Remarks column to mention the transaction resulting into such income.

Clause 25 – Amount of profit chargeable to tax under section 41

Section 41(1): Recovery against any Allowance or Deduction Allowed earlier

Section 41(2): Balancing Charge on Assets of an undertaking engaged in Generation or Generation and Distribution of Power

Section 41(3): Profit on Sale of Capital Assets used for Scientific Research

Section 41(4): Recovery out of Bad Debts Allowed as a Deduction

Section 41(4A): Amount withdrawn from Special Reserve Created and Maintained by certain Financial Institutions

Section 41(5): Adjustment of Loss

<u>Audit Procedures:</u>

- Obtain list of all amount's chargeable u/s 41
- Examine the records of the assessee to ensure the details obtained are correct.
- Ensure the said items should not be taxed twice.
- Reporting format:

Sr. no	Name of Person	Amount of Income	Section	Transaction Description	Computation, if any

Few Questions??

- In case of LLP should reporting for Tax Audit be in Form 3CA or 3CB?

- Should Turnover be inclusive of GST for:
  - Presumptive tax calculation
  - Determining the cut-off limit for Tax Audit

- Where the assessee has more than one business and maintains single books of accounts for all businesses which includes income from presumptive business?

- S.145A prescribes inclusive method of valuation – whereas AS-2 prescribes exclusive method of inventory valuation. Will there be any difference in the Valuation of inventory because of this and consequentially on the Taxable income / profit?

Thank You