

**INSTITUTE OF CHARTERED  
ACCOUNTANTS OF INDIA  
WIRC**

**ISSUES IN TAX AUDIT**

**05.09.2015**

**CA S. V. SHANBHAG**

# ISSUES IN TAX AUDIT

## PRIMARY ISSUES

- ✓ Code of Ethics of ICAI
- ✓ Eligibility for Appointment as Tax Auditor.
- ✓ Ceiling on Tax Audit

## Issues on Form 3CA and 3CB

## Consequences of contravention of sec 44AB

## Issues on Tax Audit provisions u/s 44AB

## Issues on revised Form 3CD

# ISSUES RELATING TO ICAI - CODE OF ETHICS:

## ➤ COMMUNICATION WITH PREVIOUS AUDITOR

- Communication with Previous Auditor by Registered A.D or in Person.
- No need to communicate with Statutory Auditor.

## ➤ INDEBTED FOR MORE THAN RS 10,000

*(NOTIFICATION NO 1-CA(7) 63/2002 DT 2.08.2002)*

## ➤ PROFESSIONAL REASONS FOR NOT ACCEPTING THE APPOINTMENT

- Non-Payment of Undisputed Audit Fees under Co's Act or other statutes except in case of sick units

## ISSUES RELATING TO ELIGIBILITY TO BE APPOINTED AS TAX AUDITOR:

- Internal Auditor (Proprietor/Partner).
- CA in full time or part time employment.
- Part time COP holder.
- 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.

# ISSUES RELATING TO CEILING ON TAX AUDIT

## Councils General Guidelines 2008:

- A CA not to **accept** more than 60 tax audit in a FY.
  - Date of Audit Report not relevant. Date of acceptance is relevant.
  - Bank Audit accepted in March '2013; Audit Report in Apr '2013.
- Limit reconed qua CA
  - Proprietor can perform 60 Audits.
  - Each partner of the Firm can perform 60 Audits.
  - Audits signed as Proprietor and also as partner not to exceeds 60 per member.
- **Enforcement of Limit be strengthened for quality control**

## FORM OF TAX AUDIT PARTICULARS TO BE FURNISHED BY MEMBERS/FIRM:

### ➤ Record of Tax Audit Assignments

1. Name of the Member accepting the assignment
2. Membership No.
3. Financial year of audit **acceptance**
4. Name and Registration No. of the firm/ firms of which the member is a proprietor or partner.

Name of the Auditee	A.Y of the Auditee	Date Of Appointment	Date of Acceptance	Name of the Firm on whose behalf the Member has accepted the assignment	Date of Communication with the Previous Auditor ( if applicable)

## ISSUES RELATING TO CEILING ON TAX AUDIT ... COUNCIL GUIDELINES

- Inclusions in limit of 60 Audits
  - ❖ Joint Audits.
  
- Exclusions in limit of 60 Audits
  - ❖ Audit of **HO & branch** treated as one audit.
  - ❖ Audit of **more than one branch** of a company be treated as one Audit.
  - ❖ Audits under Sec. 44 AD, 44AE .
  - ❖ Audits required under any **other statute** (e.g. MVAT Audit).
  
- Record of audits be maintained in prescribed format.

## CONSEQUENCES ON FAILURE TO SUBMIT TAX AUDIT REPORT:

- ❖ Penalty under Sec. 271B.
- ❖ Defective Return U/s 139(9).
- ❖ Return treated “Invalid Return” if defect not cured.
- ❖ Penalty u/s 271 F (Rs.5000).
- ❖ Best judgment assessment u/s 144.
- ❖ Special Audit u/s 142(2A) .
- ❖ Prosecution under 276CC (wilful default).
- ❖ Interest U/s 234A for delayed filing of Return.



## REASONABLE CAUSE FOR NOT FURNISHING AUDIT

### REPORT U/s 44AB:

(u/s 273B)

**No penalty for failure in case of ‘Reasonable Cause’**

- Resignation of Tax Auditor
- Death/Physical disability of ‘A’
- Genuine difficulties
  - Labour problem, Strike, Lock outs
  - Natural Calamity
  - Loss of accounts-Fire, Theft
- Seizure of books of account

### **Appeal:**

Penalty order of assessing officer is appealable u/s 246(1)(m) before CIT(A)

## ISSUE RELATING TO FORM 3CA & 3CB:

### ➤ Accounts **not** Audited under any other law.

- Entire audit to be conducted
- Audited Balance Sheet be annexed with Audit Report in **3CB/3CD.**

### ➤ Accounts Audited under any other law.

- Only particulars in Form **3CA/3CD** to be certified.
- Reliance to be placed on report of Statutory Auditor ( SA 600 - Using the work of another auditor).
- Co-relation of particulars given in Form 3CD with disclosures in Financial Statement (e.g. AS 18-Related Party Disclosure, CARO report, etc.)
- Auditor to note **conflicting AS**

# Accounting Standards in variance with ITA..

## ➤ Exchange Fluctuation:

- Exchange fluctuation be adjusted to cost of asset as per section 43A of ITA.
- This treatment is in variance with **AS 11 *The Effects of Changes in Foreign Exchange Rates.***

## ➤ Subsidy, Grant or reimbursement to asset deducted from cost of asset:

- Explanation 10 to Section 43(1) provides for such adjustment.
- **AS 12 *Accounting of Government Grants*** provides 2 methods
  - Reduce from cost of capital asset
  - Treat Grant as deferred revenue income over useful life of assets.

## Revised Tax Audit Report (w.e.f 2014-15)

- CBDT Notification dated 25.07.2014  
Substituted the Old Tax Audit Forms (3CA/3CB and 3CD) with New Forms.
- Certain new clauses, Substitution of some existing clauses, templates specified.
- Reporting on 41 Clauses in form 3CD

# HIGHLIGHTS OF CHANGES IN FORM 3CD

- ❖ Registrations under Indirect Taxes.
- ❖ Clause of sec.44AB is applicable for tax audit
- ❖ Locations/addresses of keeping books of accounts.
- ❖ 50C & 43CA : Reporting Market Value of Land/Building.
- ❖ 56(2)(vii a) : Shares of Pvt. co acquired without/ inadequate consideration.
- ❖ 56(2)(vii b) : Issue of shares at a premium.

# HIGHLIGHTS OF CHANGES IN FORM 3CD

- ❖ 40A(3) & 40A(3A) : Additional Reporting of Disallowance
- ❖ 269SS & 269T : Report based on auditees certificate abolished.
- ❖ Deductions claimed u/s 10A/10AA
- ❖ Details of Speculation Loss, c/f of spec. loss(73A) & Deemed spec. loss 73A .
- ❖ Amounts inadmissible u/s 40(a)
- ❖ Scope of Reporting on TDS provisions expanded

# NEW CLAUSES IN FORM 3CD

- ❖ Distributed Profits, Reductions there from and details of DDT paid.
- ❖ Cost/ Excise/ Service tax Audit:  
Report on disqualification/ disagreement on any matter/ item/Valuation/ Qty.
- ❖ Ratio Analysis for TWO Years.
- ❖ Demand or refund under any Tax law except IT/Wealth Tax

# KEY CHANGES IN TAX AUDIT REPORT

## Additional Reporting in form 3CA/ 3CB

Old Clause	New Clause
Particulars given in the said Form 3 CA/CB and the Annexure thereto are true and correct.	Particulars given in the said Form 3 CA/3CB and the Annexure thereto are true and correct, <b>subject to the following observations / Qualifications if any:</b>

### ISSUES

- ✓ The format of Audit Report is not in Sync with SA 700.
- ✓ Words used are “Subject to” and not “read with”.
- ✓ Example of Observations/ Qualification (**Exchange Fluctuations & Government Grants**)
- ✓ Form of Audit Report for LLP (3CA or 3CB ?)



## Clause 8: Tax Audit Applicability u/s 44AB

Old Clause	New Clause	
NA	Relevant clause of sec 44AB under which the audit has been conducted.	
b) Profession	Gross Receipts exceeds Rs. 25 Lakhs.	
c) 44AE	Goods carriers <10 Nos. Minimum Presumptive Profits not offered.	@ 7500 p.m per vehicle
d) 44AD	Minimum Presumptive Profits not offered & <b>income exceeds non-taxable limits.</b>	@ 8%

# **CERTAIN ITEMS INCLUDED IN :**

- ❖ Sale of license.
- ❖ Duty Draw Back.
- ❖ Cash Assistance.
- ❖ Out of pocket expenses.
- ❖ Net Exchange Rate Difference.
- ❖ Advance received & forfeited from c9/15/2015ustomer.
- ❖ Sale of scrap & wastage.
- ❖ Travel Agent conducting package tours.
- ❖ Remuneration and interest of Working Partner.

## CERTAIN ITEMS **NOT** INCLUDED AS GROSS RECEIPTS:

- ❖ Sale proceeds of Investments.
- ❖ Share of profit of partner exempt u/s 10(2A)
- ❖ Write back of creditors
- ❖ Advances received by professionals (liable for service tax)

## ISSUES RELATING TO T/o:

- ❖ Brokerage income of MCX broker is 96 lakhs. Interest income is 8 lakhs.  
*(Pondichery Distilleries Ltd Vs ITO 1984, 8 ITD 39 Mad.)*
- ❖ If Purchases exceed Rs.1 Crores & Sales below Rs.1 Crores.  
*(CCIT v/s Vijay Maheshwari HUF 228 ITR 157 SC 1997)*
- ❖ In the case of Builders & Developers, *Whether Advance received from Customers is 'Gross Receipts' for Turnover purpose ?*  
*(DCIT vs Gopal Krushna Builders ITAT Lucknow) YES*  
*(Siroya developers vs DCIT 2011, ITAT Mumbai) NO*
- ❖ *Turnover of Speculative Transactions / Derivative Transactions*

## Clause – 11 : Books of Accounts

Old Clause : 9	New Clause
<p>Only list of books of account maintained.</p> <p><b><u>ISSUES</u></b></p> <p><b>1. What is meant by 'Books of Account' ? [ sec 2(12A)]</b> (Whether Printed books be insisted by Auditor)</p> <p><b>2. <u>Location of Books:</u></b></p>	<p>List of books maintained.</p> <p>Location (address) of books.</p> <p>Where books of accounts maintained at multiple locations, location wise list of books .</p> <p>Nature of relevant documents examined</p>

- Centralized accounting at HO.
- Books maintained both at HO and Branch, consolidated at HO
- Books maintained by an outsourced agency.
- Cloud server is maintained by the third party?

## Clause:12

### Presumptive Taxation u/s 44AD is not permitted:

#### ❑ Ineligible Assesse

- *Non-Residents*
- *Companies, LLPs, Trust etc. requiring maintenance of Books under respective statues.*
- *Claiming deductions u/s 10A, 10 AA, 10B, 10BA.*
- *Claiming deduction under chapter VIA-C (Deductions in respect of certain incomes).*

#### ❑ Ineligible Business

- *Carrying on any agency business.*
  - *Earning commission income.*
  - *Professionals specified u/s 44AA(1).*
- ❖ *Transporter having more than 10 goods carriers, T/o bellow Rs. 1 Crore, whether 44AD possible ?*

## Clause 13: Method of Accounting (Sec 145)

- Cash or Mercantile system of Accounting
- Central Government is may notify “**INCOME COMPUTATION & DISCLOSURE STANDARDS (ICDS)**”
- **Central Govt. has notified 10 ICDS applicable from A.Y 2016-17. (Notification No. S.O.892(E) dated 31.3.2015)**
- **AO is empowered to make a best judgement Assessment for not following ICDS{ sec 145(3)}**





## Clause : 17

### Section 50C : Sale of Land & Building bellow stamp Duty Value (Capital Asset)

#### ISSUES

- Increase in Market Value between ‘Agreement for Sale’ and ‘Registration of Property’. Not insulated in Sec. 50 C.
  
- Whether sale of TDR is required to be reported?
  - ✓ **Rule 34 of Development Control Regulation of Gr. Mumbai 1991**
  - ✓ **Inderlok Hotels Pvt Ltd Vs ITO ITAT mum ( Sec 50C not applicable to TDR in the case of a builder) - Favorable**
  - ✓ **Arif Akhtar Hussain Vs. ITO 2011 45 SOT 257 ITAT mum. – Against**

## Clause 21b : Disallowances u/s 40(a)

### □ Reporting TDS on payment to

#### ➤ Non Residents: Interest, Royalty and FTS.

TDS Paid before Due Date of filing Return – Expense Allowed

#### ➤ Resident: Tds deduction covers all expenses in Chapter XVII-B (23 heads)

Disallowance @ 30% w.e.f AY 15-16

TDS not deducted but Payee has paid Tax thereon (Certificate in Form 26A)

Assessee	TDS not Deducted	TDS deducted but not Paid
NON-RESIDENT u/s 40(a)(i)	Date of Payment	Date of Payment
	Amount of Payment	Amount of Payment
	Nature of Payment	Nature of Payment
RESIDENT u/s 40(a)(ia)	Name & Address of Payee	Name & Address of Payee
	S. V. SHANBHAG	TDS deducted but not paid

**Clause 21(d) : Disallowance/deemed income u/s 40A(3)**

Old Clause	New Clause
<p>Certificate to be obtained from the assessee regarding payments relating to expenditure covered u/s 40A(3)</p>	<p>On basis of examination of books of account and other relevant documents, whether expenditure covered u/s</p> <p>(A) 40A(3) - made by account payee cheque or bank draft.</p> <p>(B) 40A(3A) - <b>Deemed Income if payments not made by account payee cheques or bank draft against provision for Expenditure allowed in previous year.</b></p> <p>If not, details to be provided.</p>

## ISSUES- Reporting relating to income under Sec.40(A)(3)

- ❖ The responsibility shifted from assessee to the Auditor.
- ❖ Cash payment limit per day **Rs.20,000** (Rs.35,000 incase of Transporters)
- ❖ Exceptions under Rule 6DD:
  - ✓ Payment made on Bank Holiday or Banks on strike
  - ✓ Government Payments requiring payment in Legal tender
  - ✓ Payments to Employees at the time of Retrenchment , Death or Resignation (**Rs.50,000**)

# Clause-21(h):Expenses inadmissible u/s 14A...

- ❑ Can disallowance under Rule 8D exceed exempt income?

It cannot exceed the expenditure actually incurred

*Daga Global Chemicals Pvt Ltd v/s ACIT (ITAT Mum) 01.01.2015*  
*DCIT VS Punjab State Co-op Marketing Federation Ltd 2012 14 ITR(Trib)*  
*69(Chd)*

- ❑ Interest expenses incurred to earn exempt & taxable income - Pro-rata Disallowances.

*JD Mehta (2007) 104 ITD 527(mum)*  
*Sudhir Dattaram Patil VS DCIT (2005) 2SOT678 (mum)*

- ❑ Whether Interest on funds borrowed for business of trading in shares disallowable Rule 8D?

*Vivek Malhotra VS ACIT (ITA 6332 dt 11.1.2013)*

# Clause-22: INTEREST INADMISSIBLE U/s 23 of MSME Act, 2006

## Enterprise Engaged in Manufacture or Production

Investment in <b>Plant &amp; Machinery</b>	Nature of Enterprise
Up to Rs. 25 lakhs	Micro
25 lakhs – Rs. 5 crores	Small
Rs. 5 to 10 crores	Medium

## Enterprise Engaged in providing Services

Investment in <b>Equipments</b>	Nature of Enterprise
Up to Rs. 10 lakhs	Micro
10 lakhs – Rs. 2crores	Small
Rs. 2 to 5 crores	Medium

## Clause-22: Interest paid to MSME Disallowable

❑ How to verify interest if any paid to MSME disallowable u/s 23 of MSME Act ?

- Check interest paid or provide for if any.
- Identify MSME suppliers from 12 digit code (Enterprise Memorandum Code)
- Statutory Auditor's Report incase of Company on MSME payments.

❑ Whether disallowance is permissible without a corresponding provision under IT Act ?

- Sec.23 of MSME Act contains overriding provisions
- CBDT Instruction 12/2006/14.12.2006 mandates disallowance.

❑ Issue of “*True and Fair*” if interest provision is not made.

❑ Disallowance applicable to Micro and Small Enterprises only. (Medium Enterprise not covered)

# **Clause-26: Deductions only on actual Payment** **u/s 43B**

## **Payments covered :**

- ❖ Tax, Duty, Cess or fee.
- ❖ Employer's contribution to PF, SA fund or Gratuity Fund
  
- ❖ Bonus or Commission
- ❖ Interest on Loan from Public Financial Institution
  
- ❖ Interest on Scheduled Bank
- ❖ Leave Salary



# Issues

## ❖ Service Tax/Sales tax

➤ *CIT v/s Noble & Hewitt (I) Pvt. Ltd. (2008) 166 Taxman 48 (Delhi)*

Service Tax not routed through P/L account in an exclusive method, whether covered u/s 43B ?

➤ *CIT v/s Associated Pigments Ltd. 71 Taxman 244 (Cal) -*

“Where the Assessee has credited Sales Tax collection & debited Sales Tax payment in a separate Sales Tax account, the provisions of Sec. 43B are applicable.”

## ❖ *Interest on loan*

➤ *converted into loan. (Cir. 7/2006/17.7.2006)*

➤ *From Co-operative Bank*

❖ *Leave salary: Bharat earth Movers 245ITR428 (2000) SC  
Exide Industries Ltd v/s UOI (2007)292ITR 470  
Calcutta*



Clause 29:Share Premium received from Resident by Private Company in excess of FMV u/s 56(2)(viib)

**New Clause**

Transaction :

- Applies when assessee is a Private Company.
- Shares are issued in excess of FMV (Valuation Rule 11UA)
- Applies to shares issued to Resident only (NRI's not covered)
- Issue of shares above fair market value as covered u/s 56(2)(viib).
- Proviso to Sec.68 covers unexplained share premium in the hands of recipient Private Company (Double Taxation?)

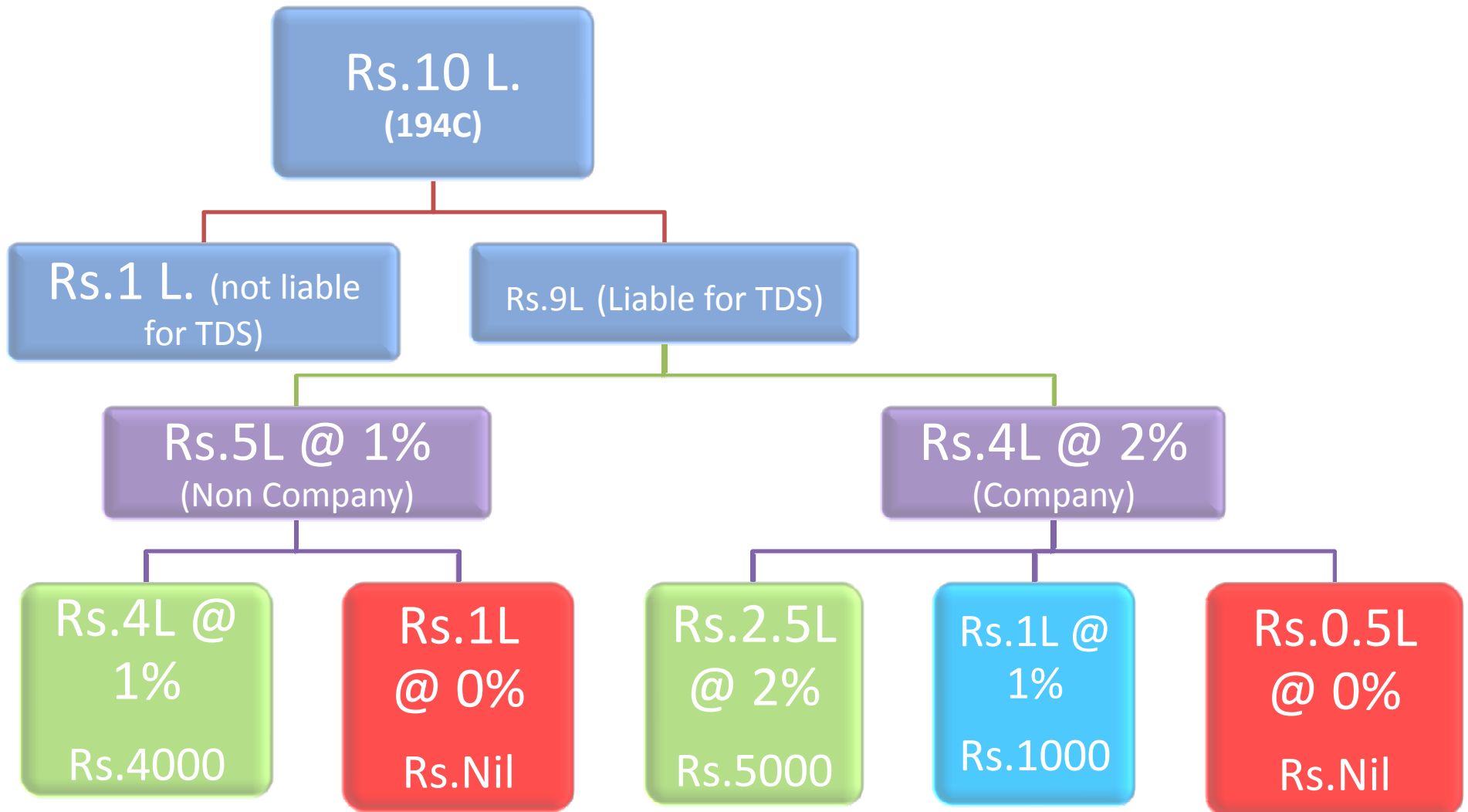
## Clause 31(c) : Loans Accepted & Loans Repaid

Old clause	New Clause
<p data-bbox="142 488 640 1000">Certificate to be obtained from assessee -Loans/ deposits accepted/ given or repaid by account payee cheques.</p> <p data-bbox="142 1057 296 1114"><u>ISSUE</u></p> <ul data-bbox="142 1130 1822 1414" style="list-style-type: none"><li>➤ Books/Bank Statement do not provide sufficient evidence.</li><li>➤ A bank certificate or cheque copy has to be obtained.</li><li>➤ Transactions by RTGS, NEFT, Debit card and Credit card are not covered .</li></ul>	<p data-bbox="745 488 1163 545"><u>Sec 269SS/269T</u></p> <p data-bbox="745 561 1902 846">Books of accounts to be examined by the tax auditor whether loan/deposit accepted or repaid by account payee cheques or account payee bank draft.</p> <p data-bbox="919 1438 1178 1471">S. V. SHANBHAG</p>

## Clause 32(c) : Loss from Speculative transactions

Old	New Clause : Clause
NA	<p><b><u>Speculative Transaction u/s 73:</u></b></p> <ul style="list-style-type: none"> <li>▪ Defined u/s 43(5)</li> <li>▪ Certain Derivative transactions are not covered (Reco. Stock Ex. - NSE, BSE, MCX, NCDEX, United Stock Ex. of India.)</li> <li>▪ Loss Can be carried forward <b><u>for maximum 4 years.</u></b></li> </ul> <p><b><u>Explanation u/s 73 Clause 32(e)</u></b></p> <p>Applicable to company buying and selling shares.</p> <p><u>Exceptions :</u></p> <ul style="list-style-type: none"> <li>▪ Co. - Interest on securities, Capital gains, Income from house Property, Income from Other Sources.</li> <li>▪ Banking Co.</li> <li>▪ <i>Companies engaged in principle business of trading in shares</i></li> </ul>

# Clause 34(a) : EXAMPLE ON TDS FROM CONTRACTOR



**Clause 34(a) : TDS COMPLIANCES**

TAN	Sec	Nature of Payment	Total Amt Paid	Amt on which TDS required to be deducted	
(1)	(2)	(3)	(4)	(5)	
*****	194C	Contractual	10,00,000	9,00,000	
Amt on which TDS was deducted at specified rate out of (5)		Amt of Tax deducted out of (6)	Amt on which TDS deducted at less than specified rate	Amt of tax deducted on (8)	Amt of TDS deducted and <b>not</b> deposited
* <b>Out of Rs.10000, Rs.8000 was deposited in time and Balance Rs.2000 deposited Late</b>					
(6)	(7)	(8)	(9)	(10)	
6,50,000	9,000	2,50,000	1,000	2,000*	

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## Clause 34(b) : TDS/TCS RETURN COMPLIANCES

- Where assessee has furnished the TDS/TCS Return within the prescribed time, If not, furnish the following details:

TAN	Type of Form	Due date of furnishing	Date of furnishing, if furnished	Whether TDS/TCS Return contains information about <u>all transactions</u> which are required to be reported.

certain transactions are not reported?

- Verify acknowledgement of returns filed & report discrepancies if any.
- Whether details of missing transactions be quantified?



**CLAUSE 34(C) : INTEREST PAYABLE FOR DELAY**

Where assessee liable to pay interest u/s 201(1A) or 206C(7) ? If yes, furnish following:

TAN	Amount of interest under section 201(1A)/206C(7) is payable	Amount paid out of column (2) along with date of payment
	<p><b><u>201(1A):</u></b> Provides for payment of interest at the specified rate incase</p>	<p>the specified rate incase</p>

- Tax not Deducted
- Tax deducted but not paid

**206C(7):** Provides for payment of interest at specified rate incase

- TCS not collected
- TCS collected not deposited

**Audit Checks:** Verify interest payable from

- Part E of form 26AS
- Books of Accounts

**Interest under TRACES disputed:** Calculate Interest u/s 201(1A) & 206C(7) and mention it under clause 34(C) .Mention fact of error in interest in F.CA /3CB

**Clause 36(c) : Details of Tax on Distributed Profits of a domestic Comapny**

- Total amount of distributed profits
  - ✓ Dividend received from Indian subsidiary Co (on which DDT paid).
  - ✓ Dividend received from a foreign subsidiary Co (on which tax is payable @ 15%)u/s 115BBD.
  - ✓ Dividend paid to any person on behalf of New Pension System Trust .
- Total tax Paid
- Date of Payment

**Clause : 37, 38, 39**

Old Clause	New Clause
<p>Enclose Report of:</p> <p>a. Cost Audit</p> <p>b. Central Excise</p> <p>ISSUES</p> <p>1. The period covered by Cost/ Excise/Service Tax Audit?</p> <p>2. Disqualifications / Observations in <b>Cost Audit Report</b> –</p>	<p>Whether <b>any</b> of the following <b>audit was carried out</b>, if yes, give details if any disqualification or disagreement on any matter/item/quantity as may be reported/identified by the auditor:</p> <p>a. Cost Audit</p> <p>b. Excise Audit</p> <p>c. Service Tax Audit</p>

- a) Matters appearing clearly wrong in principle or apparently unjustifiable.
- b) Cases where company funds have been used in negligent or inefficient manner.

## KEY CHANGES IN TAX AUDIT REPORT

### Clause : 41

Old Clause	New Clause
NA	Details of details of demand raised or refund issued during the previous year under any tax laws other than Income Tax along with relevant proceedings.
<b><u>Suggested Format of Details:</u></b>	

S.No	Name of applicable Act	Demand/ Refund Order no.	Date of Demand raised /Refund Granted	Amt.	Adj of Refund against Demand	Remarks
1	2	3	4	5	6	7
			S. V. SHANBHAG			

**Thank you**

# Questions ?