

Tax Audit u/s 44AB of the IT Act

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OBJECTIVES OF TAX AUDIT

- ▶ One of the objectives of tax audit is to ascertain/derive the requirements of Form No. 3CD and report in Form Nos. 3CA/3CB.
- ▶ Apart from reporting requirements of Form Nos. 3CA/3CB, an audit for tax purposes would assure that the books of account and other records are properly maintained, that they reflect the true and correct particulars in Form No. 3CD.
- ▶ The intention behind the implementation of Tax Audit was to help the tax authorities in the process of assessments.
- ▶ A tax auditor is supposed to verify the details and replies to various clauses of 3CD to the best of his ability and knowledge and must be true and fair.
- ▶ But one thing is sure that the liability of the correctness of the information provided in 3CD or its annexures lies with the auditor, unless it is proved that the auditor has carried the assigned job with utmost caution and to the best of his ability.

Impact on Professionals for Incorrect Information

Penalty on professionals for furnishing incorrect information in statutory report or certificate, [Section 271J]

- ▶ This section is inserted from April 1st, 2017 but does not exclude the reports and certificates signed before such date.
- ▶ section 271J is “without prejudice to the provisions of the Act”. If the Chartered Accountant is liable to any other penalty or prosecution proceedings under the Act, he will continue to be liable under those provisions.
- ▶ A Chartered Accountant in practice who is being penalised by Income Tax Department u/s 271J can also be penalised by the Institute of Chartered Accountants of India for professional misconduct under the Chartered Accountants Act, 1949.

Guidance Note issued by ICAI

- ▶ The law has placed onerous responsibility of conducting tax audit u/s 44AB on chartered accountants in practice.
- ▶ For compiling particulars for tax audit, conduct of audit and issuing of audit report, inputs are required by auditors and the other stakeholders.
- ▶ In order to address this requirement, Direct Taxes Committee (DTC) of the ICAI, has issued Tax Audit Guidance Note.
- ▶ Guidance Note on Tax Audit u/s 44AB was revised by ICAI applicable for AY 2023-24.
- ▶ This Guidance Note is revised to facilitate compilation of particulars and conducting tax audit and issuing report for the Assessment Year 2023-24.

Major Changes in Revised Guidance Note

- ▶ Audit report/certificate not to be treated as invalid if UDIN not updated within 60 days.
- ▶ Revision of the tax audit report is mandatory in the circumstances mentioned in Rule 6G(3). (Sec 40 or Sec 43B).
- ▶ Adherence to relevant Auditing Standards and Guidance Notes for special purposes.
 - ▶ Para 13.1 of 2022 GN provided that the tax auditor “would also be well advised” to refer to the other Standards on Auditing (SAs) as may be relevant, issued by ICAI, as well as the “Guidance Note on Audit Reports and Certificates for Special Purposes”. The 2023 GN replaces the words “would also be well advised ” in Para 13.1 with the word “should”.
- ▶ Differences of opinion with regard to particulars furnished by assessee for Form 3CD to be reported by the tax auditor in Para 5 of Form No.3CB.
 - ▶ 2023 GN has amended para 18.6 of 2022 GN to provide that where the tax auditor has a difference of opinion with regard to the particulars furnished by the assessee, he shall report these differences of opinion in paragraph 5 of Form 3CB. Earlier it was to reported in the respective clauses.

Major Changes in Revised Guidance Note

- ▶ Income taxable under a specific section yet not credited to P&L to be reported against clause 16(a).
 - ▶ It is possible that an item of income may be taxable under a certain specific section yet not credited to a profit and loss account, e.g. benefit or perquisite arising from business or profession u/s 28(iv) tax on which is deducted u/s 194R. New Para 28.2 of GN 2023 clarifies that such income should be reported under clause 16(c).
- ▶ Govt grant in relation to a specific fixed asset and deducted from the gross value of that asset is not to be reported in clause 16(e) of Form No. 3CD.
 - ▶ In terms of the 2023 GN, such government grant deducted from fixed assets is not to be reported against clause 16(e) as capital receipt not credited to P&L.
- ▶ Tax auditor to use his professional expertise and judgement to determine whether receipt is taxable for reporting under sub-clauses (a) to (d) of clause 16 of Form No.3CD
 - ▶ Para 28.18 of GN 2023 requires the tax auditor to use his professional expertise and judgement to determine whether the receipt is taxable or not for reporting under sub-clauses (a) to (d) of clause 16 of Form No.3CD. Further, the tax auditor may report in the observation part of the audit report [Para 3 of Form No.3CA/Para 5 of Form No.3CB], disclosing the basis of the same.

Major Changes in Revised Guidance Note

- ▶ Cross-referencing required of clauses 17 and 16(d) of Form No. 3CD. (43CA & 50C)
- ▶ Sums covered by Section 43B are allowed only on a payment basis, irrespective of assessee's method of accounting.
 - ▶ New Paras 46.8 to 46.11 and 46.13 clarify what amounts to "actual payment" for section 43B and clause 26 purposes
- ▶ Reporting of break-up of total expenditure of entities registered or not registered under GST under Clause 44.
 - ▶ Para 82.3 of 2023 GN clarifies as under:
 - ▶ (a) Headings of columns 3-6 and column 7 of Tabular format in clause 44 require reporting of "Expenditure in respect of entities registered under GST" and "Expenditure relating to entities not registered under GST", respectively.
 - ▶ (b) Thus, the expenses within the scope of GST i.e., which are tantamount to 'supply' in section 7 of the CGST Act, 2017, are only required to be reported in clause 44 in any of the columns from 3 to 7.
 - ▶ New Para 82.4 of 2023 GN requires the tax auditor to maintain a working paper of reconciliation of total expenditure as per P&L with the value of expenditure reported in clause 44.

Major Changes in Revised Guidance Note

- ▶ Determination of turnover in respect of derivatives, futures and options
 - ▶ The new guidance in Para 5.10(b) of the 2023 GN provides that the turnover or gross receipt in respect of transactions in derivatives, futures and options is to be determined as follows:
 - ▶ (a) The total of favourable and unfavourable differences shall be taken as turnover in case of squared-off transactions.
 - ▶ (b) In case of an open position at the end of the financial year (i.e., trades which are not squared off during the same financial year), the turnover from the said transaction should be considered in the financial year when the transaction has been actually squared off.
 - ▶ (c) In the case of delivery-based settlement in a derivatives transaction, the difference between the trade and settlement prices shall be considered as turnover.
 - ▶ Further, in the hands of the transferor of the underlying asset, the entire sale value shall also be considered as business turnover where the underlying asset is held as stock in trade.
 - ▶ (d) The premium received on the sale of options is also to be included in turnover. However, where the premium received is included for determining net profit for transactions, then such net profit should not be separately included.
 - ▶ (e) In respect of any reverse trades entered, the difference thereon should also form part of the turnover.

TAQRB set up by ICAI

- ▶ ICAI has constituted the Taxation Audits Quality Review Board (TAQRB) with a sole aim to review any report prescribed under the Income-tax Act, 1961 and Rules framed thereunder and any report prescribed under the Indirect Tax Laws including GST Law which are certified by a Chartered Accountant

with a view to determine, to the extent possible..
- ▶ compliance with the reporting requirements prescribed under the respective Acts and related Rules and pronouncements, guidance notes issued, if any, by ICAI in respect of the same.
- ▶ TAQRB, if it finds any error or mistake or limitation in tax audit report, may initiate appropriate action, including referring case for disciplinary proceedings.

Tax Audit Applicability

- ▶ A person carrying on business, if his total sales, turnover or gross receipts (as the case may be) in business for the year exceeds Rs. 1 crore
- ▶ This provision is not applicable to the person, who opts for presumptive taxation scheme under section 44AD and his total sales or turnover doesn't exceed Rs. 2 crores.
- ▶ Note: The threshold limit, for a person carrying on business, is increased from Rs. 1 Crore to Rs. 10 crores in case when cash receipt and payment made during the year do not exceed 5% of total receipt or payment, as the case may be. In other words, more than 95% of business transactions should be done through banking channels.

Tax Audit Applicability

- ▶ A person carrying on profession, if his gross receipts in profession for the year exceed Rs. 50 lakhs.
- ▶ An assessee who declares profit for any previous year in accordance with section 44AD and he declares profit in any one of the 5 assessment years relevant to the previous year succeeding such previous year, lower than the profit computed as per section 44AD and his income exceeds the amount which is not chargeable to tax.
- ▶ If an eligible assessee opts out of the presumptive taxation scheme, within the aforesaid period, he cannot choose to revert back to the presumptive taxation scheme for a period of five assessment years thereafter.

Tax Audit Applicability

- ▶ A person who is eligible to opt for the presumptive taxation scheme of section 44ADA, but claims the profits or gains for such profession to be lower than the profit and gains computed as per the presumptive taxation scheme and his income exceeds the amount which is not chargeable to tax.
- ▶ This provision does not apply to the person, who opts for presumptive taxation scheme under section 44AD/44ADA
- ▶ A person who is eligible to opt for the presumptive taxation scheme of sections 44AE but claims the profits or gains for such business to be lower than the profits and gains computed as per the presumptive taxation scheme of sections 44AE.
- ▶ A person who is eligible to opt for the taxation scheme prescribed under section 44BB or section 44BBB but he claims the profits or gains for such business to be lower than the profits and gains computed as per the taxation scheme of these sections.

Clause 3 of Form 3CB - DISCLOSURES

- ▶ Disclose whether all the information and explanations which, to the best of knowledge and belief necessary for the purposes of the audit has been obtained.
- ▶ Disclose whether proper books of account have been kept by the head office and branches of the assessee.
- ▶ Disclose whether statement of P&L and BS show True & Fair View.

Clause 5 of Form 3CB - QUALIFICATIONS

- ▶ Following areas should be covered in the clause 5 of Form 3CB.
 1. Extent of physical verification.
 2. Areas where sampling is used - vouching, verification etc
 3. Areas relied on confirmations from management - 40A(2)(b), Closing Stock etc.
 4. Areas practically not possible to report in Form 3CD - Clause 44 GST break up, Clause 35 Quantity particulars etc.
 5. Any specific matter like reason for reduction in turnover, GP etc.
 6. Any significant event like opening/closure of a branch, change in line of business etc.

Auditor should ensure that appropriate disclaimers and disclosures are made wherever necessary.

Clause 13(d) to (f) of Form 3CB - ICDS

- ▶ Check the applicability of ICDS.
- ▶ Check whether the statement of adjustments required to profit or loss as per P&L in the tabular format given has been obtained.
- ▶ For a particular ICDS, if no adjustment is required, whether the management representation in this regard has been obtained?
- ▶ Whether the accounting policies followed by the assessee have been tested to see any divergence vis-a-vis ICDS?
- ▶ Whether disclosures as required by ICDS have been given in tabular form?

Clause 14(a) - Method of valuation of inventory

- ▶ Whether the procedure followed by the assessee for the valuation of inventory of closing stock in respect of every item has been checked and verified (like raw material, WIP, finished goods, etc)?
- ▶ Whether there has been any change in the method of valuation from the method as prescribed under section 145A?
- ▶ Whether deviation, if any, from the method of valuation prescribed under section 145A has been ascertained and its impact on profit and loss has been reported?
- ▶ Whether adjustments under section 145A have been made in all cases where “inclusive method” is followed?

Clause 17 - 43CA/50C cases

- ▶ Check whether the assessee has transferred any land or building or both during the year under consideration?
- ▶ the copy of registered sale deed has been obtained?
- ▶ the consideration shown in the registered sale deed is in accordance with the provisions of section 43CA or 50C?

Clause 20 & Sec 36 - PF/ESI

- ▶ Obtain list of employees and see if rules and regulations of PF Act is complied?
- ▶ Obtain the PF/ESI challans and see if the employee contributions are deposited on respective due dates.
- ▶ In case of any non compliance, ensure that the employee portion is disallowed u/s 36 in the ITR.

Clause 21(a) & Sec 37 - Personal/capital expenditure

- ▶ Check whether all expenditure heads of Trading/Manufacturing, P&L or I&E account (including purchase account) have been examined to check any Personal expense has been charged/ debited to it? If yes, report accordingly.
- ▶ Check whether all expenditure heads of P&L or I&E account have been examined to verify if any expenditure by way of penalty or fine for violation of any law for the time being in force has been charged/debited to it? If yes, report accordingly.
- ▶ Check whether any capital expenditure debited to P&L Account.
- ▶ Check whether all the orders/notices received during the year under consideration under various laws like FEMA, GST, Custom and Excise etc. have been verified?
- ▶ Ensure that electronic cash ledger of GST Portal for payment of any fine or penalty has been verified.
- ▶ Ensure that TDS returns/ Traces portal/ Form No. 26AS for any fine/penalty have been verified

Clause 21(b) & Sec 40a - amounts inadmissible

- ▶ Whether any payment of interest, royalty and fee for technical services or any other sum chargeable under Income Tax Act, 1961 (other than salary) is paid/ payable outside India to any person or to non-resident/ foreign company in India?
- ▶ If yes, whether TDS has been deducted on said payments as per chapter XVII-B of Income Tax Act, 1961?
- ▶ Whether TDS deducted has been paid on said payments as per chapter XVII-B of Income Tax Act, 1961?
- ▶ Whether Form no. 15CA/15CB filed during the year has been obtained?
- ▶ Whether TDS challans and TDS returns in form no. 26Q and form no. 27Q has been obtained?
- ▶ Whether TDS payable account has been verified from the books of account and reconciled with TDS challans and returns?

Clause 21(d) & Sec 40A(3) - cash payments

- ▶ Check whether there is any payment or aggregate payments for any expenditure to a person by mode otherwise than by account payee cheque or bank draft or through other such electronic mode in excess of Rs. 10,000 (or Rs. 35,000 in case of transportation), in a day?
- ▶ If yes, check whether such payments are falling under Rule 6DD?
- ▶ If such payments are not falling under rule 6DD, the same are not deductible and whether the same has been reported?
- ▶ Where the reporting has been done on the basis of the certificate of the assessee, whether the fact has been reported as an observation in Form No. 3CA and Form No.3CB, as the case may be?

Clause 23 & Sec 40A(2)(b) - Related parties

- ▶ Obtain list of related parties from the assessee.
- ▶ Report in Form 3CB that you have relied on the list given by the assessee.
- ▶ Report all related party transactions along with nature of payment.
- ▶ Scrutinize the expense ledger and see if the payment made to related parties are at arms length price.

Clause 26 & Sec 43B- Statutory Payments

- ▶ Analyze the payable schedule and see if the statutory payments are settled within the due date.
- ▶ Scrutinize the GST electronic ledger, ESI/PF challans etc for compliance.
- ▶ See if any bonus or leave salary to employees charged to P&L remains unpaid?
- ▶ Ensure that interest to banks and FIs pending as on BS date are paid within the due date. (especially in case of NPAs)

Clause 31& Sec 269SS, 269ST & 269T - Loan

- ▶ Check whether there is new acceptance/ repayment of any Loan/ deposit and transactions of specified sum during the year under consideration.
- ▶ Obtain the complete list of borrowings and repayments as envisaged under Sec.269SS and 269ST from the Assessee.
- ▶ Obtain Declaration from the Assessee in respect of sum exceeding the limit as specified in the above sections?
- ▶ Verify advance against property received or repaid during the year from the Fixed Assets or investments or stock in trade & Advance related ledgers?
- ▶ Check whether the assessee has received an amount of Rs. 2 Lakhs or more in aggregate from a person in a day or in respect of a single transaction or in regard to one event or occasion from a person in violation of the provisions of section 269ST?
- ▶ Check whether Loan confirmations from parties of Secured/ Unsecured loans, obtained or not?

Clause 34 of Form 3CD - TDS Summary

- ▶ Scrutinize the expenses and ensure that taxes are deducted as per the appropriate rates.
- ▶ Make a note of expenses that comes under the purview of TDS even if payments are below the threshold limit to deduct TDS.
- ▶ Report TDS section wise expenses in Clause 34.
- ▶ Obtain quarter wise details of filing of TDS returns.
- ▶ Report the date of filing and report whether the returns are accurate.

Clause 35 of Form 3CD - Quantitative particulars

- ▶ Check whether the stock register is obtained and verified.
- ▶ Check whether it is practically possible to report the items of stock in Form 3CD especially in cases where items dealt are voluminous.
- ▶ Report the difficulty/ inability to report under Clause 5 of Form 3CD.
- ▶ In case of manufacturing unit, obtain report from management regarding the loss of quantity on account of manufacture.
- ▶ Ensure that the losses are in line with the standards. Report any huge variation.

Clause 44 of Form 3CD - Breakup of GST

- ▶ Obtain expense wise party wise GST wise list from the client - mostly not available especially if accounts are maintained in tally.
- ▶ In case of non availability of breakup, ensure that the reason for non reporting is reported in Clause 5 of Form 3CD.
- ▶ Eg: “clause 44 of form 3CD which requires break of expenditure under GST is not filled up as the details to be reported in the specified format could not be extracted from the books of accounts maintained”



Thank you!