

Clauses of Tax Audit Report



- **BY CA MAHENDRA SANGHVI**

Few samples of observation which one can consider to clarify in Form

3CB are:

Sr No.	Qualification Type	Observation/Qualification
1.	Records produced for verification of payments through account payee cheque were not sufficient	Clause 21(d)- Section 40A(3) & 40A(3A):- It is not possible for us to verify whether the payments exceeding Rs.10,000/- have been made otherwise than by account payee cheque or bank draft, as the necessary evidence is not in the possession of the assessee.
2.	Proper Stock Records are not maintained by the assessee .	Day to day stock records are not maintained and in the absence of the same it is not possible to reconcile quantitatively the opening stock, purchases, sales and closing stock.
3.	Creditors under Micro, Small and Medium Enterprises Development Act, 2006 are not ascertainable	Clause 22:- Assessee is not aware of any Interest payable to concern which are registered under Micro, Small and Medium enterprises.
4.	Recorded necessary to verify personal nature of expenses are not maintained by the assessee	Clause 21(a)- Personal expenditure:-In the absence of specific details 10% of Telephone Expenses and 10% of Motor Car Expenses are treated as personal expenses.

Sr No.	Qualification Type	Observation/Qualification
5.	Others	<p>i. Clause 34(b): TDS - We have verified the compliance with the provisions of Chapter XVII-B regarding the deduction of tax at source regarding the payment thereof to the credit of the Central Government in accordance with the Auditing Standards generally accepted in India which include test check and concept of materiality. We have verified compliance with the provisions of Chapter XVII - B related to the proprietary concern only.</p>
		<p>ii. Physical copy of Form No. 3CB and Form no. 3CD contains certain explanatory and other notes to the various clauses which do not find place in the electronic Form no 3CD. In view of this, the electronic Form no. 3CD should be read together with all the notes appearing in the physical Form no. 3CD and in case of any conflict, the information and details provided in physical copy shall prevail.</p>
		<p>iii. Clause 31(b), (bb), (bd), (c), & (e)- Section 269SS, 269T and 269ST:- It is not possible to verify the taking or accepting loan or deposit or specified sum, or repayment of the same as specified in section 269SS and 269T or receipt/ payment in excess of limit specified in section 269ST, were made by account payee cheque drawn on a bank or account payee bank draft as the necessary evidence are not possession of the assessee.</p>
		<p>iv. We have verified the compliance to the provisions of section 139A(5)(c) in accordance with the Auditing Standards generally accepted in India which include test check and concept of materiality.</p>

Sr No.	Qualification Type	Observation/Qualification
		v. GST on closing stock is not included in valuation. Since the same is factored in the valuation prescribed u/s 145A, it is not mentioned under the clause No. 13 of form 3CD.
		vi. Section 145 A - Assessee is following exclusive method of accounting for purchase, sales and inventories. However, as per the Guidance Note on Tax Audit issued by the Institute of Chartered Accountants of India there is no impact on the profit of the assessee.

Tax Audit Clauses

5

➤ Clause 13

a. Method of Accounting employed in the previous year

Mercantile System or Cash System

b. Whether there has been any change in the method employed vis-a-vis the method employed in the immediately preceding previous year.

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

Tax Audit Clauses

6

- A change in an accounting policy will not amount to a change in the method of accounting and therefore need not be mentioned under this clause.
- A change in accounting policy can be made only if:
 - Adoption of different policy is required by the statute; or
 - The change would result in a more appropriate presentation of the financial statements;
- As per AS-1, a change in accounting policy and the impact of such change is to be disclosed in the financial statements.
- If it is not possible to quantify the effect of the change in the method of accounting, appropriate disclosure should be made.

Tax Audit Clauses

7

- 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).*
- e. If answer to (d) above is in the affirmative, give details of such adjustments:*
- f. Disclosure as per ICDS:*
 - **Vide notification no. 88/2016, dated 29.09.2016, the CBDT had amended Form No.3CD with effect from 01.04.2017 and substituted sub-clause(d) of clause 13 with new sub-clauses (d), (e), and (f) requiring reporting of the adjustments and disclosures mandated as per the notified ICDSs.**
 - **The amended clause (d) requires the Tax Auditor to report whether any adjustment is required to be made to the profits or loss for complying with the provisions of ICDSs notified u/s.145(2) and**

Tax Audit Clauses

8

- if answer is in affirmative, new clause (e) requires reporting of the standard wise adjustments made to the profit or loss for complying with the ICDSs notified u/s.145(2) showing clearly increase/decrease in profits as well as the net effect of such adjustments standard wise.
- *Clause 13(f) requires reporting of the standard wise disclosures as per the ICDSs.*

DEVELOPMENTS

- Circular no. 10/2017 dated 23.03.2017 was issued giving certain clarifications in respect of ICDS.
- Hon'ble Delhi High Court in case of Chamber of Tax Consultants vs. UOI (400 ITR 178) vide order dated 08.11.2017, quashed certain ICDS and certain portion of other ICDS and read down the powers of the Government u/s.145(2).
- Amendments brought out by Finance Act, 2018 w.r.e.f. AY 2017-18 to over rule the judgment of the Hon'ble Delhi High Court.

Tax Audit Clauses

9

➤ **General Finding of Court:**

The Central Government by way of a Notification cannot:

- 1. Override any judicial precedents of Supreme Court and High Court**
- 2. Cannot amend or alter any basic principles of computation of Income.**

Tax Audit Clauses

10

➤ ICDS 1 - Accounting Policies

- ICDS 1 does away with the concept of 'prudence; which is present in erstwhile AS1 notified u/s.145(2) of the Act. A negative provision has in fact been made in the ICDS by stating that prudence is not to be followed unless it is specified.
- Supreme Court and various High Courts have recognized the concept of 'prudence'.
- Infact, concept of prudence is embedded in section 37(1) of the Act which allows deduction in respect of expenses "laid out" or "expended" for the purpose of business. The concept of prudence is inherent.

Held: ICDS I which does away with the concept of 'prudence' is contrary to the Act and binding judicial precedents and is therefore, unsustainable in law.

Tax Audit Clauses

11

➤ Amendment brought in by Finance Act, 2018

- Sec 36(1) - The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28-
 - ❑ (xviii) marked to market loss or other expected loss as computed in accordance with the income computation and disclosure standards notified under sub section (2) of section 145.
 - ❑ 40A(13) No deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss, except as allowable under clause (xviii) of sub section 1 of section 36.

Tax Audit Clauses

12

➤ ICDS 2 – Valuation of Inventories

- Delhi High Court has struck down that in case of dissolution of a Partnership Firm whether business is discontinued or not, the inventory on the date of dissolution shall be valued at the net realizable value.

Shakti Trading Co. 250 ITR 871(SC)

- Section 145A applies to service Industries also.
- Securities to be valued category wise - Bucket System
- Has to be valued at lower of Cost or Net Realizable value
- In case of not listed or not quoted with regularity it has to be valued at cost.

Tax Audit Clauses

13

➤ ICDS 3 - Construction Contracts

- Retention Money, Incidental income not be reduced from the borrowing cost and proportionate completion method for recognizing revenue from service contracts - Struck down by Delhi High Court.
- Section 43CB inserted to dilute the judgment

Tax Audit Clauses

14

➤ ICDS 4 - Revenue Recognition

- Time of accrual of Export incentives and proportionate completion method for recognizing revenue from service contracts is struck down by Delhi High Court.
- Interest to be taxed even in absence of reasonable certainty is held to be valid.
- Section 145B(2): Any claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realization is achieved.

Tax Audit Clauses

15

➤ ICDS 5 - Tangible Fixed Assets

- No specific finding of the Delhi High Court and no amendment.
- The treatment of expense incurred after the conduct of test runs and experimental production but before commencement of commercial production.

As clarified in Para 8 of ICDS-V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption shall be treated as capital expenditure - against the judgment of various Courts therefore, shall not have any impact.

Ref: National Thermal Power Corpn Ltd. Vs CIT 357 ITR 253 (Delhi HC)

Capital Bus Service(P) Ltd Vs. CIT 123 ITR 404 (Delhi HC)

Tax Audit Clauses

16

➤ ICDS 6 - Effects of Changes in Foreign Exchange Rates

- Entirely struck down by Delhi High Court
- New Section 43AA inserted
- Section 43AA - (1) Subject to the provisions of section 43A. Any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the Income computation and disclosure standards notified under sub section (2) of section 145.

Tax Audit Clauses

17

(2) For the purpose of sub-section (1), gain or loss arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions, including those relating to-

- i. monetary items and non-monetary items
 - ii. Translation of financial statements of foreign operations;
 - iii. Forward exchange contracts;
 - iv. Foreign currency translation reserves;
- Treatment of foreign exchange fluctuation in section 43A and section 43AA are contrary to each other.

Tax Audit Clauses

18

➤ ICDS 7 - Government Grants

- Delhi High Court held that the amount to be taxed in the year of receipt is contrary and in conflict with the accrual system of accounting
- Insertion of new section 145B(3) - The income referred to in sub-clause(xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income tax in any earlier previous year.

Tax Audit Clauses

19

➤ ICDS 8 - Securities

- Delhi High Court struck down the bucket system approach
- Section 145A is amended

➤ ICDS 9 - Borrowing Costs

- Delhi High Court struck down the para 5 dealing with borrowing costs that no incidental income can be reduced from borrowing cost
- Para 6 of ICDS: Formula prescribed for borrowing cost which can be attributable towards the qualifying asset to be capitalised. The formula does not deal with the aspect of sufficiency of own funds.
 - ❑ Reliance Utilities & Power Ltd 313 ITR 340 (Bombay HC)
 - ❑ DD Industries 231 Taxman 784 (Delhi HC)

Tax Audit Clauses

20

- To apply ICDS or Judgments?
- General borrowings para applies to all the borrowings other than the specific borrowings. Therefore, even a borrowing which is specifically for a purpose not being the specified purpose and has been utilised for the said purpose, still the interest amount would be liable to the included in the formula given?
- Practical difficulty for big companies with multiple borrowings and different blocks?

Tax Audit Clauses

21

➤ ICDS 10 – Provisions, Contingent Liabilities and Contingent Assets

- No finding by the Delhi High Court and no amendment in the same
- Warranty

In Rotork Control India(P) Ltd. vs. CIT 314 ITR 62 (SC), the court has held that provision for warranty claim is allowable as a deduction u/s.37(1) as the enterprise has a present obligation as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of.

Tax Audit Clauses

22

➤ Clause 13(f) - Disclosure as per ICDS

I. ICDS- I : Accounting Policies

- i.) All significant accounting policies
- ii.) Any change in accounting policy with the effect

II. ICDS- II: Valuation of Inventories

- i.) Cost formulae with the Accounting policy followed
- ii.) Total carrying amount and its classification

III. ICDS- III: Construction Contracts

- i.) Does not apply to real estate developers
- ii.) Percentage completion is mandatory. If work complete is more than 25%, we need to recognise revenue

Tax Audit Clauses

23

IV. ICDS- IV: Revenue Recognition

- i.) Sale made but not recognised due to uncertainty to give details of the same
- ii.) Amount of revenue from service transactions

V. ICDS- V: Tangible Fixed Assets

Details as per clause 18 of form 3CD relating to particulars of depreciation allowable as per IT Act for each asset or block of asset

- i.) Description of asset or block of asset
- ii.) Rate of Depreciation
- iii.) Actual Cost or Written down Value
- iv.) Additions or Deductions
- v.) Depreciation allowable
- vi.) Closing Written down value

Tax Audit Clauses

24

VI. ICDS- VI: Effects of Change in Foreign Exchange Rates

No Specific Disclosure required

VII. ICDS- VII: Government Grants

- i.) Nature and extent of grant **recognised** by way of deduction from Cost/WDV and **not recognised**
- ii.) **Recognised** as income and **not recognised** as income

VIII. ICDS- VIII: Securities

No Specific Disclosure Required

IX. ICDS- IX: Borrowing Costs

- i.) Policy adopted for borrowing cost
- ii.) Amount of Borrowing cost capitalised

Tax Audit Clauses

25

X. ICDS- X: Provisions, Contingent Liability & Contingent Asset

For each class of Provision

- i.) Brief Description
- ii.) Carrying amount at end & beginning
- iii.) Additional provision made
- iv.) Unused reversed
- v.) Expected Reimbursement

Tax Audit Clauses

26

- *Clause 14(a): Method of valuation of closing stock employed in the previous year.*
 - AS 2 defines the term “inventories” to include finished goods, raw materials, work-in-progress, materials, maintenance supplies, consumables and loose tools. Therefore, method of valuation of items of inventories will have to be given under sub-clause(a).
- *Clause 14(b): In case of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss.*
 - The details of deviation from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss have to be stated under clause 14(b)

Tax Audit Clauses

27

- Clause 21(a): Please furnish the details of amounts debited to the profit and loss account, being in the nature of capital, personal, advertisement expenditure etc
 - Expenditure of Capital Nature
 - ✓ Different tests have been applied by the courts in different cases depending upon the facts and circumstances of each case and the case law on the subject.
 - ✓ The nature of receipt in the hands of the recipient is not a determining factor to decide the nature of payment in the hands of payer.
 - ✓ Capital expenditure of certain types e.g., on scientific research referred to in section 35, is deductible in computing the income.
 - ✓ Ordinarily the capital expenditure should not be debited to profit and loss account. The tax auditor needs to keep in mind that the accounting standards also apply in respect of financial statements audited under section 44AB of the Act. Therefore, besides disclosing the amount of such capital expenditure debited to profit and loss account under this clause, the tax auditor should give suitable disclosure/ qualifications in para 3(a) of Form No. 3CB, depending on the facts of the case.

Tax Audit Clauses

28

■ Expenditure of Personal Nature

- ✓ Refer section 143(1)(e) of the Companies Act 2013 which specifically requires the auditor to inquire whether personal expenses have been charged to revenue account.
- ✓ Format provided in the e-filing utility is as under:

SI. No.	Particulars	Amount
(1)	(2)	(3)

Suitable disclosure in para no.5 of form no.3CB should mention the facts and basis of arriving the amount of personal expenses.

Tax Audit Clauses

29

- *Advertisement expenditure in any souvenir, brochure, tract, pamphlet or the like, published by a political party*
 - ✓ Expenditure incurred by the assessee by way of advertisement given in the souvenir, brochure, tract, pamphlet or journal published by the trade union or the labour union formed by a political party is not required to be indicated against this clause.
 - ✓ The auditor needs keep in mind the provisions of section 80GGB and 80GGC which allow deduction in respect of contribution made by corporate and non-corporate assesseees respectively to political parties and electoral trust, as required to be reported by him in clause 33 of Form no.3CD.

Tax Audit Clauses

30

■ Expenditure incurred at clubs being entrance fees and subscriptions

- ✓ The payments may be for entrance fees as well as membership subscription and for catering and other services by the club, both in respect of directors and other employees in case of companies and for partners or proprietors in other cases. The fact whether such expenses are incurred in the course of business or whether they are of personal nature should be ascertained. If they are personal in nature, they are to be shown separately under Clause 21(a) referred to earlier.
- ✓ Details of payments made to clubs are also required by tax authorities for the purpose of determining whether any portion of club expenses could be treated as perquisite in the hands of the person concerned.

S.No.	Particulars	Amount
(1)	(2)	(3)

Tax Audit Clauses

31

- 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
 - ✓ This clause covers only penalty or fine for violation of law and not the payment for contractual breach or liquidator damages.
 - ✓ The tax auditor should keep in mind the difference between the amount prohibited by law and the amount paid which is compulsory in nature under the relevant statute.
 - ✓ Penalty or fine for violation of law is not admissible as expenditure. It is in this context the requirement stipulated by clause 21(a) is to be answered.
 - ✓ Wherever amount is found to be of a composite nature, that is partly of compensatory nature and partly of penal nature, the authority would have to bifurcate the two components and give deduction of that component which is compensatory in nature and refuse to give deduction of that component which is penal in nature.

As held in the case of: Swadeshi Cotton Mills 233 ITR 199 And

Malwa Vanaspati & Chemicals Co. 225 ITR 383(SC)

Tax Audit Clauses

32

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

▪ As payment to non-resident referred to in sub-clause (i)

- ✓ Where an actual remittance overseas has been made by the assessee during the relevant previous year without deducting any tax at source, the tax auditor may rely upon the legal opinion and/or certificates from chartered accountants based upon which remittances have been made without deduction of tax at source.
- ✓ Under clause 21(b)(i)(A), the auditor is required to report payments to non residents on which tax is required to be deducted but not deducted in respect of interest, royalty, fees for technical services and other such chargeable amount under the Income tax Act. The Auditor is required to give details under this clause for each individual payee as under:

Sr No.	Date of Payment	Amount of Payment	Nature of Payment	Name and address of the payee	PAN of the payee, if available
(1)	(2)	(3)	(4)	(5)	(6)

Tax Audit Clauses

33

- ✓ Similarly under clause 21(b)(i)(B), the auditor is required to report payments on which tax is deducted but is not deposited within the time prescribed during the previous year or in subsequent year. Such details are also required to be given for each individual payee prescribed under Section 40(a)(i) as under:

Sr. No.	Date of Payment	Amount of Payment	Nature of Payment	Name and address of the payment	PAN of the payee, if available	Amount of tax deducted
(1)	(2)	(3)	(4)	(5)	(6)	(7)

Tax Audit Clauses

34

- *As payment referred to in sub-clause (ia)*
 - ✓ Under sub-clause 21(b)(ii), any sum payable to a resident on which tax is deductible at source under chapter XVII-B and such tax has not been deducted or after deduction has not been paid on or before the due date specified in section 139(1).
- *As payment referred to in sub clause (ib)*
 - ✓ The said sub clause (ib) is relating to Equivilisation Levy under sub-clause 21(b)(iii). As per e-filing utility there is reporting under this clause but the same is not in form no.3CD prescribed under Income Tax Rules, 1962.
- *Fringe benefit tax under clause 21(b)(iv)*
- *Wealth Tax under clause 21(b)(v)*
- *Royalty, license fee, service fee etc. under clause 21(b)(vi)*

State Government undertaking to the State Government

Tax Audit Clauses

35

- Salary payable outside India/to a non resident without TDS etc. under clause 21(b)(vii)
- Payment to PF/other fund etc. under clause 21(b)(viii)
 - ✓ Section 40(a)(iv) provides that any payment to a provident or other fund established for the benefit of employees of the assessee shall be disallowed, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head “Salaries”.
- Tax paid by employer for perquisites under clause 21(b)(ix)
 - ✓ The Tax auditor is required to report the amount of tax paid by the employer on non-monetary perquisites which are exempt in the hands of employee as per section 10(10CC).

Tax Audit Clauses

36

- Clause 21(c): Amounts debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;
 - ✓ The inadmissible amount under section 40(b)/40(ba) is required to be stated.
 - ✓ Applicable to firm/LLP/AOP/BOI.
 - ✓ 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.

Tax Audit Clauses

37

✓ Circular No.739 dated 25.03.1996

- No deduction under section 40(b)(v) will be admissible unless partnership deed either specifies amount of remuneration payable to each individual working partner or lays down manner of quantifying such remuneration.

✓ Reporting to be provided in the e-filing utility format as under :

Sr. No.	Nature of payments made to partner/member	Section 40(b)/40(ba)	Amount debited to profit and loss account	Amount admissible u/s. 40(b)/40(ba)	Amount inadmissible u/s.40(b)/40(ba) [difference between (d) and (e)]	Remarks, if any
(a)	(b)	(c)	(d)	(e)	(f)	(g)

Tax Audit Clauses

38

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

✓ (A): *On the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, please furnish the details:*

Sr. No.	Date of Payment	Nature of Payment	Amount	Name of the payee	PAN of the payee, if available
(1)	(2)	(3)	(4)	(5)	(6)

Tax Audit Clauses

39

- ✓ (B): *On the basis of the examination of books of account and other relevant documents/evidence, whether the payment referred to in section 40A(3A) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft If not, please furnish the details of amount deemed to be the profits and gains of business or profession under section 40A(3A);*

Sr. No.	Date of Payment	Nature of Payment	Amount	Name of the payee	PAN of the payee, if available
(1)	(2)	(3)	(4)	(5)	(6)

Tax Audit Clauses

40

- ✓ Section 40A(3): Where the assessee incurs any expenditure in respect of a payment or aggregate of payments made to a person in a day . In case of payment made for plying, hiring or leasing of good carriage, limit is Rs.35,000/- instead of Rs.20,000/-.
- ✓ Section 40A(3A): Where any allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during the pervious year the assessee makes payment in respect thereof.
- ✓ Cases and circumstances prescribed under Rule 6DD having regards to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors. Notification no. 97/2008 dated 10.10.2018 has amended Rule 6DD.

Tax Audit Clauses

41

- ✓ Reporting has been done on the basis of the certificate of the assessee, the fact shall be reported as an observation in clause (3) of form no.3CA and clause (5) of Form No.3CD as the case may be.

- ✓ **Illustration:**

Assessee makes cash payment of Rs.11,000/- to Mr.X for purchase of Stores on 01.05.2018. Payment is made for following purchases:

<u>Purchases On</u>	<u>Amount</u>	<u>Accounted in</u>
01.02.2018	6000	F.Y. 2017-18
01.05.2018	5000	F.Y.2018-19

What is the amount of disallowance? Whether reporting required?

Tax Audit Clauses

42

- Clause 21(e): provision for payment of gratuity not allowable under section 40A(7);
 - ✓ The deduction shall be allowed in relation to any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year.
- Clause 21(f): any sum paid by the assessee as an employer not allowable under section 40A(9);
 - ✓ Any payment made by an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860, or other institutions (other than contributions to recognised provident fund or approved superannuation fund or notified pension scheme or approved gratuity fund) is not allowable.

Tax Audit Clauses

43

- Clause 21(g): particulars of any liability of a contingent nature;
 - ✓ The tax auditor may look into particular items of contingent liabilities of the earlier year in order to determine whether or not any items has been charged to the profit and loss account of the current year and if so, whether the liability continues to be contingent in nature. Wherever necessary, a suitable note should be given by the tax auditor as to the non-availability of such particulars relating to the contingent liabilities.
 - ✓ Refer - AS 29 - “Provisions, Contingent Liabilities & Contingent Assets”.
 - ✓ ICDS - 10 : Relating to Provisions, Contingent Liabilities and Contingent Assets

Tax Audit Clauses

44

- **Clause 21(h): amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income;**
 - ✓ The expenditure which is relatable to the income which does not form part of the total income is not allowed as a deduction in terms of section 14A of the Act.
 - ✓ Eg: Income from agriculture, share of profit in a partnership firm, income from units, etc.
 - ✓ In case of an investment in a partnership firm, while the interest and the salary received by the partner are taxable, the share of profit is exempt. The provisions of section 14A will be applicable.
 - ✓ Sub-rule (1) of Rule 8D provides that having regard to the accounts of the assessee of a previous year, if the Assessing Officer is not satisfied with the correctness of the claim of expenditure made by the assessee or with the claim made by the assessee that no expenditure has been incurred, in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount of such inadmissible expenditure in accordance with the method of computation laid down in sub-rule (2) of Rule 8D.

Tax Audit Clauses

45

✓ **Rule 8D(2) w.e.f. 02.06.2016:**

The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:-

- (i) the amount of expenditure directly relating to income which does not form part of total income; and*
- (ii) an amount equal to one percent 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:*

Provided that the amount referred to in clause(i) and clause(ii) shall not exceed the total expenditure claimed by the assessee.

- ✓ An assessee may claim that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Act. Even in such a case the provisions of section 14A will apply. Accordingly, the tax auditor is required to verify such contention of the assessee.

Tax Audit Clauses

46

✓ *Relevant important judgments:*

- ❖ Maxopp Investment 402 ITR 640(SC)
- ❖ Godrej & Boyce vs. CIT 328 ITR 81 (Bom)
- ❖ CIT vs. IL&FS 399 ITR 483 (Del HC)
- ❖ M/s. V-Tex Wvg & Mfg Mills Ltd vs. DCIT (ITA No.6703/Mum/2016 dated 22.03.2018)(Mum ITAT)
- ❖ CIT vs. Holcim India P. Ltd (ITA No.486/2014 & ITA No.299/2014 dated 05.09.2014)(Del)

Tax Audit Clauses

47

- **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 referred to in section 28 of the Act.
 - ✓ The proviso, w.e.f. A.Y. 2004-05, provides that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalized in the books or account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was put to use, shall not be allowed as a deduction.
 - ✓ Refer AS 16 and ICDS IX “Borrowing Cost”.
 - ✓ **Relevant Important Judgments:**
 - ❖ CIT vs. Reliance Industries Ltd 410 ITR 466 (SC)
 - ❖ CIT vs. Reliance Utilities & Power Ltd 313 ITR 340 (Bom)
 - ❖ CIT vs. HDFC Bank Ltd 366 ITR 505 (Bom)

Tax Audit Clauses

48

- Clause 27(a): Amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts;
 - ✓ Whether it applies to the GST regime (i.e. AY 2019-20 and onwards)?
 - ✓ Tax Auditor should check relevant statutory records maintained under GST law, i.e. **GST credit** ledger & Cash ledger
 - ✓ Accounting treatment in the Financials would depend on the method of accounting followed. Whether exclusive or inclusive?
 - ✓ At times GST credit availed may be lesser than the GST credit utilised during the year on account of opening balance in GST credit account or vice versa and therefore it would be advisable to report the opening and closing balance of GST credit also.
 - ✓ Reporting in the e-filing utility in the following format:

Tax Audit Clauses

49

- ✓ Reporting has to be done in the e-filing utility in the following format:

CENVAT/ITC	Amount	Treatment in Profit & Loss/ Accounts
Opening Balance		
Credit Aailed		
Credit Utilized		
Closing/ outstanding Balance		

Tax Audit Clauses

50

- Clause 27(b): Particulars of income or expenditure of prior period credited or debited to the profit and loss account;
 - ✓ Particulars of expenditure or income of any earlier year debited or credited to Profit & Loss account when mercantile system of accounting is followed needs to be reported.
 - ✓ There is a difference between expenditure of any earlier year debited to the profit and loss account and the expenditure relating to any earlier year, which has crystallized during the relevant year. Material adjustments necessitated by circumstances which though related to previous periods but determined in the current period, will not be considered as prior period items. In such cases, though the expenditure may relate to the earlier year, it can be considered as arising during the year on the basis that the liability materialised or crystallised during the year and such cases will not be reported under this clause. Similar consideration will apply in relation to income also.
 - ✓ Refer AS 5 “Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies”.

Tax Audit Clauses

51

- ✓ Reporting has to be done in the e-filing utility in the following format:

Sr No.	Type	Particulars	Amount	Prior Period to which it relates(Year in yyyy - yy format)
(1)	(2)	(3)	(4)	(5)

Tax Audit Clauses

52

- Clause 28: Whether during the previous year the assessee has received any property, being share of a company not being a company in which the public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2)(viii), if yes, please furnish the details of the same;

✓ Not Applicable w.e.f. A.Y. 2017-18

Tax Audit Clauses

53

- Clause 29: Whether during the previous year the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib), if yes, please furnish the details of the same;
 - ✓ Applicable to Corporate Assessee (in which public is not substantially interested)
 - ✓ Details of shares issued during the year with the value
 - ✓ Whether issued at Fair Market Value as per provisions of Rule 11UA(2)
 - ✓ Reporting has to be done in e-filing utility in the following format:

Sr No.	Name of the person from whom consideration received for issue of shares	PAN of the person, if available	No. of shares issued	Amount of Consideration received	Fair Market Value of the shares
(1)	(2)	(3)	(4)	(5)	(6)

Tax Audit Clauses

54

- Clause 29A (a): Whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub-section (2) of section 56? (Yes/No);

- inserted W.E.F 20.08.2018, wr.t. Notification No.33/2018 dated 20.07.2018

- Clause 29A (b): If yes, please furnish the following details:
 - ✓ Section 56(2)(ix) was inserted by the Finance (No 2) Act 2014, with effect from assessment year 2015-16. It provides for taxability as Income from Other Sources of any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if such sum is forfeited and the negotiations do not result in transfer of such capital asset.

Tax Audit Clauses

55

- ✓ Prior to such amendment, section 51 provided for deduction of such amount forfeited from the cost or written down value of the asset. Section 51 has now been amended to provide that any amount taxed under section 56(2)(ix) shall not be deducted from the cost or written down value.
- ✓ Only forfeiture of amounts received as advance towards transfer of a capital asset is required to be reported under this clause. Any advances received and forfeited towards sale of stock-in trade would be taxable under section 28(i), and would not be required to be reported since the amount would be credited to profit & loss account.
- ✓ The tax auditor should obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year. The advance might have been received during the previous year or earlier. For the purpose of this clause, the previous year in which forfeiture takes place is relevant.

Tax Audit Clauses

56

- Clause 29B (a): Whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (x) of sub-section (2) of section 56? (Yes/No);

inserted W.E.F 20.08.2018, wr.t. Notification No.33/2018 dated 20.07.2018

- ✓ Section 56(2)(x) effectively applies with effect from assessment year 2018-19.
- ✓ Under this section, the following amounts/ value of assets received by an assessee from any person or persons are chargeable to tax as Income from Other Sources:
 - (i) Any sum of money, received without consideration, if it exceeds Rs.50,000
 - (ii) A. Stamp duty value of any immovable property received without consideration, stamp duty value of which exceeds Rs. 50,000
B. Stamp duty value in excess of the consideration of any immovable property received, where the stamp value exceeds the consideration by more than Rs.50,000 **and the amount equal to five percent of the consideration**

Tax Audit Clauses

57

- (iii) A. Aggregate Fair market value of property, other than immovable property, without consideration, where the aggregate fair market value of such property exceeds Rs. 50,000
- B. Aggregate Fair market value of property, other than immovable property, in excess of the consideration, where the aggregate fair market value exceeds the consideration by more than Rs. 50,000 and the amount equal to five percent of the consideration

- ✓ Exemption for certain receipts
- ✓ In case of immovable property, provisions of section 50C regarding date of agreement and registration are different and stamp duty value disputed by the assessee are applicable
- ✓ In case of other assets, rule 11UA(1) read with rule 11U are to be followed for determination of the fair market value.

Tax Audit Clauses

58

- ✓ Wherever there is a dispute or doubt as to the valuation of an asset, it would be advisable for the tax auditor to request the assessee to obtain a valuation report from a registered valuer.
- ✓ The tax auditor is required to report the nature of income and the amount of income chargeable under this clause. In the nature of income, the details of the asset received and the date of receipt should be given. While stating the amount of income, a computation of how such income has been arrived at should be provided, giving the fair market value or stamp duty value of the asset and the amount of consideration

Tax Audit Clauses

59

- Clause 30: Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque. [Section 69D];
 - ✓ Section 56(2)(x) effectively applies with effect from assessment year 2018-19.
 - ✓ The tax auditor should obtain a complete list of borrowings and repayments of hundi loans otherwise than by account payee cheques and verify the same with the books of account.
 - ✓ Reporting has to be done in e-filing utility in the following format:

Sr. No.	Name of the concerned person	PAN, if available	Addresses	Amount borrowed	Date of borrowing	Amount due including interest	Amount repaid	Date of repayment

Tax Audit Clauses

60

- Clause 31(a): Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year;
 - ✓ Section 269SS prescribes the mode of taking or accepting certain loans, deposits and specified sum
 - ✓ Loan or deposit means loan or deposit of money
 - ✓ Whether Journal entries to be included?
 - Ref: CIT vs. Triumph International Finance 345 ITR 270 (Bom HC)
 - CIT vs. Noida Toll Bridge Co. Ltd 262 ITR 260 (Del HC)
 - CIT vs. World wide Township Projects Ltd ITA No.232/2014 (Del HC)
 - ✓ Security deposits against contracts etc. will be covered by the definition of 'deposit' and therefore, such information will have to be given.
 - ✓ The amount retained by the contractee against performance of contract will not be covered as loans/deposits for reporting as amount is not received.
 - ✓ Not applicable to loan or deposit taken or accepted from or by Government, Bank Company, Co-operative Bank or Corporation

Tax Audit Clauses

61

- Clause 31(b): Particulars of each specified sum in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year;
 - ✓ Specified sum means any sum of money receivable, whether as advance or otherwise, in relation to transfer of an immovable property, whether or not the transfer takes place.

Tax Audit Clauses

62

- Clause 31(ba), (bb), (bc) and (bd) -

Inserted W.E.F 20.08.2018, wr.t. Notification No.33/2018 dated 20.07.2018;

(ba): Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, during the previous year, where such receipt is otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account;

(bb): Particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, received by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year;

(bc): Particulars of each payment made in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion to a person, otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year;

(bd): Particulars of each payment in an amount exceeding the limit specified in section 269ST, in aggregate to a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion to a person, made by a cheque or bank draft, not being an account payee cheque or an account payee bank draft, during the previous year;

Tax Audit Clauses

63

- ✓ Section 269ST was introduced by the Finance Act, 2017 with effect from 1 April 2017. It provides that no person shall receive sum of Rs. 2 lakh or more a) in aggregate from a person in a day; or
b) in respect of a single transaction; or
c) in respect of transactions relating to one event or occasion from a person otherwise than by an account payee cheque or an account payee demand draft or by use of electronic clearing system through a bank account.
- ✓ Contravention of section 269ST attracts penalty under section 271DA.
- ✓ The note under sub-clauses 31(ba), (bb), (bc) and (bd) does not specifically refer to receipt by or payment to Government. Considering the provisions of the section, particulars of the payments made to the government need not be included under sub-clauses (bc) and (bd) and a suitable note may be given to the effect that details of payments made to Government have not been included in the particulars.

Tax Audit Clauses

64

- ✓ Section 269ST does not distinguish between receipt on capital account and revenue account. Once the receipt or the payment, as the case may be, exceeds the limit specified in section 269ST, the particulars of such transactions will have to be reported under these clauses.
- ✓ the tax auditor will have to exercise care and caution while arriving at the particulars of receipts or payments pertaining to a single transaction or relating to a single event or occasion. The tax auditor will need to link all receipts or payments, as the case may be, otherwise than by the modes specified in this section received/made in respect of a single transaction and verify if the aggregate amount exceeds the limits specified in section 269ST.
- ✓ To this the CBDT by Circular No. 22 of 2017 (F.No.370142/10/2017-TPL) dated 3rd July 2017 has clarified that 'in respect of receipt in the nature of repayment of loan by NBFCs or HFCs, the receipt of one instalment of loan repayment in respect of a loan shall constitute a 'single transaction' as specified in clause (b) of section 269ST of the Act and all the instalments paid for the loan shall not be aggregated for the purposes of determining applicability of the provisions of section 269ST.'

Tax Audit Clauses

65

- ✓ While section 269ST deals only with receipts exceeding Rs. 2 lakh or more otherwise than by the specified modes, sub-clauses 31(ba), (bb), (bc) and (bd) require details to be furnished of both of receipts and Payments also.
- ✓ Reporting in sub-clause (ba), (bb), (bc) and (bd) is different, but for e-filing utility following reporting is required:

Sr No.	Name of the Payer	Address of the payer	PAN, if available of the payer	Nature of Transaction	Amount of Receipt	Date of Receipt
(1)	(2)	(3)	(4)	(5)	(6)	(7)

Sr No.	Name of the Payee	Address of the payee	PAN, if available of the payee	Nature of Transaction	Amount of Payment	Date of Payment
(1)	(2)	(3)	(4)	(5)	(6)	(7)

Tax Audit Clauses

66

- Clause 31 (c), (d) and (e) substituted w.e.f. 19.07.2017

▪ Clause 31(c): Particulars of each repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T made during the previous year;

- ✓ Section 269T prescribes the mode of repayment of loan, deposit or specified advance
- ✓ Not applicable to loan or deposit taken or accepted from or by Government, Bank Company, Co-operative Bank or Corporation
- ✓ Loan or deposit means any loan or deposit of money which is repayable after notice or repayable after a period and, in the case of a person other than a company, includes loan or deposit of any nature;

Therefore, in case of a company loan or deposit repayable on demand will not be considered for the purpose of this section as loan or deposit. However, in the case of non-company assessee loan or deposit is defined to mean loan or deposit of any nature.

Tax Audit Clauses

67

- Clause 31(d): Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year ;
 - i.) name, address and Permanent Account Number (if available with the assessee) of the payer;
 - ii.) amount of repayment of loan or deposit or any specified advance received otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account during the previous year.
- ✓ Clause 31(c) is for repayment of loan/deposit/specified advance in contravention of section 269T
- ✓ What to report under this clause? Confusion.....
- ✓ Bad drafting of clause
- ✓ Errors rectified vide notification dated 20.07.2018.

Tax Audit Clauses

68

- ✓ **Clarification by ICAI:** Clause 31 of form 3CD has been substituted to include within its fold, reporting requirements taking into consideration the amendments effected in section 269SS and 269T, including within its scope payments relating to immovable property transactions. Further, the scope of reporting in relation to section 269T, relating to repayment of loan or deposit or specified advance, has been increased to also require **reporting by the recipient** of such loan or deposit or specified advance which has been repaid. So far, such reporting was required only by the payer.
- ✓ If loan/deposit/specified advance given is received back otherwise than by cheque or bank draft or ECS, the same is to be reported under this clause.

Tax Audit Clauses

69

- Clause 31(e): Particulars of repayment of loan or deposit or any specified advance in an amount exceeding the limit specified in section 269T received by a cheque or bank draft which is not an account payee cheque or account payee bank draft during the previous year;
 - ✓ This sub-clause is an extension of clause 31(d) and required reporting only in case when the above mentioned payment is received by cheque or draft which is not account payee.

Tax Audit Clauses

70

- Clause 32(a): Details of brought forward loss or depreciation allowance, in the following manner, to the extent available;
 - ✓ The amount of brought forward loss or depreciation allowance is required to be quantified as per return and assessment orders.
 - ✓ At times while the particular claim for loss/allowance pertains to a particular assessment year as per the return of income, the same may relate to another assessment year as per the assessment order the particulars have to be restated with reference to the assessment year to which they relate as per the assessment order.
 - ✓ Provisions contained in sections 32 and 70 to 79 of the Income-tax Act with regard to loss/depreciation under different heads. In the remarks column information about the pending assessment or appellate proceedings or about delay in filing loss returns should be given. For giving the above information, the auditors should study the assessment records i.e. income-tax returns filed, assessment orders, appellate orders and rectification/ revisional orders for the earlier years and ascertain if the figures given in the above clause are correct

Tax Audit Clauses

71

- Clause 32(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 section 79;
 - ✓ In the case of a company, not being a company in which the public are substantially interested, where a change in shareholding has taken place in a previous year, then no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of that previous year and on the last day of the previous year in which the loss was incurred, the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

Tax Audit Clauses

72

- Clause 32(c): Whether the assessee has incurred any speculation loss referred to in section 73 during the previous year, If yes, please furnish the details of the same;
 - ✓ Section 73 of the Act provides for the treatment of losses in speculation business. Section 73(1) provides that any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business.

Tax Audit Clauses

73

- Clause 32(d): whether the assessee has incurred any loss referred to in section 73A in respect of any specified business during the previous year, if yes, please furnish details of the same;
 - ✓ Section 73A provides for provisions relating to carry forward and set off of losses by specified business. It provides that any loss, computed in respect of any specified business referred to in section 35AD shall not be set off except against profits and gains, if any, of any other specified business.

Tax Audit Clauses

74

- Clause 32(e): In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in explanation to section 73, if yes, please furnish the details of speculation loss if any incurred during the previous year;
- ✓ Explanation to Section 73 provides that where any part of the business of a company trading in shares, be deemed to be carrying on a speculation business.

Tax Audit Clauses

75

- *Clause 33: Section-wise details of deductions, if any admissible under Chapter VIA or Chapter III (Section 10A, Section 10AA);*
 - ✓ Deductions admissible under Chapter VIA, section 10A and section 10AA will have to be with reference to the items appearing in the books of accounts audited by the tax auditor.
 - ✓ In the case of a sole proprietor being an individual or HUF it may so happen that the tax auditor is auditing the accounts of the business/profession and the sole proprietor is having other activities and other sources of income in respect of which tax audit is not mandatory. In such cases the particulars of deductions admissible under Chapter VIA will have to be given with reference to the items appearing in the books of accounts of the business/profession which is subject to audit under section 44AB.
 - ✓ there are certain sections under Chapter VIA like section 80-IA, 80-IB, 80-JJA etc. where separate audit report or certificate is required to be issued. Under the said sections, a non-corporate assessee who has income from industrial undertaking covered under the above sections has also to obtain audit report with reference to the accounts of these undertakings. While giving information with regard to the deduction allowable under these sections the tax auditor should refer to separate audit reports/certificates obtained by the assessee.

Tax Audit Clauses

76

- Clause 34(a): Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes please furnish;
 - ✓ While reporting under this clause the tax auditor may exercise his judgement in the light of the applicable laws, various pronouncements and report accordingly about the applicability of the provisions of Chapter XVII-B or XVII-BB. The tax auditor may rely upon the judicial pronouncements while taking any particular view. While answering the issue of applicability of the provisions of Chapter XVII-B and/or XVII-BB, a number of debatable issues may arise before the assessee as well as the tax auditor.
 - ✓ The auditor should obtain a copy of the TDS/TCS returns filed by the assessee. In view of the voluminous nature of the transactions, the tax auditor can apply test checks and compliance tests on the transactions reported in the TDS return by the assessee for verifying the information required to be provided under this clause.
 - ✓ Auditor should maintain working paper giving reconciliation of amount as per books of accounts and amount on which is TDS/TCS is required to be deducted/collected.

Tax Audit Clauses

77

- ✓ In column(6) the payer deducts/recipient collects tax at source at a rate lower than the specified rate on the basis of certificate issued under section 195 or 197, the lower rate or nil rate, as the case may be will be considered as the specified rate for the purpose of reporting under this clause. In the case of payment to non-residents the applicable rate of tax deduction at source is to be read along with the Double Taxation Avoidance Agreement.
- ✓ Column (10) requires the auditor to furnish the details of the amount of tax deducted or collected but not deposited to the credit of the Central Government. As such the tax auditor should verify the cases where the tax has been deducted at source but not paid to the credit of the Central Government till the date of the audit. It may be noted that tax deducted but deposited late will not be required to be reported in this clause.

Tax Audit Clauses

78

- Clause 34(b): whether the assessee is required to furnish the statement of tax deducted or tax collected. If yes, please furnish the details;
 - ✓ The tax auditor is required to furnish a list of details/transactions which are not reported in the statement of tax deducted at source and statement of tax collected at source.
 - ✓ The tax auditor will have to identify the transactions in respect of which tax was required to be deducted at source or collected at source and verify whether these transactions have been appropriately reported in the relevant form of the statement of tax deducted at source or tax collected at source. Wherever there is failure to report the transaction in the statement of tax collected or deducted at source the tax auditor will have to report the same.

Tax Audit Clauses

79

- Clause 34(c): whether the assessee is liable to pay interest under section 201(1A) or section 206C(7). If yes, please furnish;
 - ✓ To furnish detailed information in case the assessee is liable to pay interest under section 201(1A) or section 206C(7) of the Act. Section 201(1A) provides for payment of interest at a specified rate in case the tax has not been deducted wholly or partly or after deducting has not been paid to the credit of Central Government as required by the Act.

Tax Audit Clauses

80

- Clause 35(a) and (b): In the case of a trading concern, give quantitative details of principal items of goods traded; In the case of a manufacturing concern, give quantitative details of the principal items of raw material, finished products and by-products;
 - ✓ This clause requires that quantitative details of “principal items” of raw materials and finished goods should be given. Therefore, information about petty items need not be given. What would constitute principal items will depend on the facts of each case. Normally, items which constitute more than 10% of the aggregate value of purchases, consumption or turnover may be classified as principal items.

Tax Audit Clauses

81

- Clause 36: In the case of a domestic company, details of tax on distributed profits under section 115O to be given;
 - ✓ Section 115-O provides for a tax , on the amount of dividend declared, distributed or paid by such company whether such dividend is out of current profit or accumulated profits. To report on dividend distributed during the financial year and the amount of tax @ 18% plus surcharge at the applicable rate along with the cess thereon has to be reported against this clause.
 - ✓ Dividend as per section 2(22)(e) is also covered w.e.f. 01.04.2018.
In that case tax @30% is to be paid instead of 18%.

Tax Audit Clauses

82

- Clause 36A: Whether the assessee has received any amount in the nature of dividend as referred to in sub-clause (e) of clause (22) of section 2? (Yes/No); If yes, please furnish the following details;
 - ✓ Inserted w.e.f. 20.08.2018
 - ✓ Section 2(22)(e) deems certain payments to be dividend
 - ✓ Main conditions attracting the provision are as under:
 - (i) Payment should be by a company in which public are not substantially interested
i. e. Say closely held company;
 - (ii) Payment should be by way of advance or loan or the payment should be on behalf, or for the individual benefit, of the shareholder;
 - (iii) The shareholder must be a person who is the beneficial owner of shares holding not less than 10% of the voting power. It may be noted that for considering the 10% of the voting power what is relevant is the shareholding of the assessee alone and shareholding of his relatives is not required to be considered;

Tax Audit Clauses

83

- (iv) Payment by way of advance or loan should be to the shareholder or any concern in which the shareholder is a member or a partner and in which he has substantial interest;
- (v) The company making the payment should have accumulated profits. The amount of dividend is restricted to the extent to which the company possesses accumulated profits.
- ✓ The tax auditor should obtain a certificate from the assessee giving particulars of any loans or advances received by any concern in which he has substantial interest from any closely held company in which he is beneficial owner of shares carrying not less than 10% voting power.
 - ✓ The tax auditor should also verify Form 26AS in the case of the assessee to know if the closely held company has deducted tax at source from any payment made by it to the assessee or the concern under section 194. This will indicate the view taken by the closely held company making the payment. The tax auditor may consider the same before coming to a conclusion.
 - ✓ an amount chargeable to tax as dividend under section 2(22)(e) has been always subject matter of litigation before various judicial forums.

Tax Audit Clauses

84

- i.** Whether registered shareholder only to be considered and not a beneficial owner?

 - CIT vs. C.P.Sarathy Mudaliar 83 ITR 170 (SC)
 - Rameshwarilal Sanwarmal vs. CIT 122 ITR 1 (SC)
 - Gopal and Sons (HUF) vs. CIT 391 ITR 1 (SC)
 - National Travel Services vs. CIT 401 ITR 154 (SC)
- ii.** Dividend does not include any advance or loan or trade advance made to a shareholder in the ordinary course of its business. Circular No.19/2017 dated 12.06.2017

 - CIT vs. Parle Plastics Ltd 332 ITR 63 (Bom)
 - CIT vs. Jayant H Modi 232 Taxman 337 (Bom)
 - CIT vs. Shree Balaji Glass Mfg 386 ITR 128 (Cal)
- iii.** Determination of accumulated Profits

Tax Audit Clauses

85

- Clause 37: Whether any cost audit was carried out, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the cost auditor;
 - ✓ The tax auditor is not required to make any detailed study of cost audit report, he has to take note of the the details of disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/identified by the cost auditor. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out. The said fact should be disclosed.
 - ✓ Information is required to be given only in respect of such cost audit report the time period of which falls within the relevant previous year. In effect the information is required to be given in respect of that cost audit report which is received upto the date of tax audit report.

Tax Audit Clauses

86

- Clause 38: Whether any audit was conducted under the Central Excise Act, 1944, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the auditor;
 - ✓ Since the information required to be given of such excise audit report will fall prior to financial year 2018-19, this clause will be redundant

- Clause 39: Whether any audit was conducted under section 72A of the Finance Act,1994 in relation to valuation of taxable services, Finance Act,1994 in relation to valuation of taxable services, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the auditor;
 - ✓ Since the information required to be given of such service tax audit report will fall prior to financial year 2018-19, this clause will be redundant

Tax Audit Clauses

87

- Clause 40: Details regarding turnover, gross profit, etc., for the previous year and preceding previous year;
 - ✓ Ratios have to be given for the business as a whole and need not be given product wise. Further, the ratio mentioned in (5) need not be given for trading concern or service provider and in (4) need not be given for service provider.
 - ✓ All the ratios mentioned in this clause are to be calculated in terms of value only.
 - ✓ Net profit in (3) is net profit before tax.
 - ✓ For (4), only stock-in-trade is to be considered, which does not include stores and spares, packing materials, loose tools. Also, stock of raw materials and work-in-progress should not be included as the objective here is to compute the stock turnover ratio.
 - ✓ Preceding previous year figures to be taken from last year's audit report. In case, preceding previous year was not subject to audit then to calculate the figures or make appropriate disclosure.

Tax Audit Clauses

88

- Clause 41: Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth tax Act, 1957 alongwith details of relevant proceedings;
 - ✓ Normally, the Indirect tax laws such as GST, Central Excise Duty, Service Tax, Customs Duty, Value Added Tax, CST, Professional Tax, entry tax, Octroi duty etc would be covered as other tax laws. Hence, the cess or duty like Marketing Cess, Cess on Royalty, etc. would not be covered as other tax laws.
 - ✓ Refund received directly in bank account and no details available with the assessee.
 - ✓ Reporting has to be done in e-filing utility in the following format:

Sr No.	Financial year to which demand / refund relates to	Name of the other tax law	Type(Demand raised/Refund received)	Date of demand raised/refund received	Amount	Remarks

THANK YOU