

Legal and Practical Issues in Tax Audit Report September '19

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Tax Audit – Applicability of AS

- **Audit in case of non-corporate entities**

1. Entire audit to be conducted and 3CD details to be certified
2. True and Fair view of FS

- **Audit in case of Corporates**

1. Only details of Form 3CD to be certified
2. Reliance to be placed on the work of statutory auditors. SA 600 using the work of other professional.
3. Some additional verification to be made.*
4. Co-relation with the details in the Audit of companies.

- **Article clerk is most important part in the quality of audit conducted. ***

Signature of Assesse on Form 3CD

- Responsibility of preparation of accounts and form 3CD lies with the assessee.
- Para 13.4 of the guidance note states that the tax auditor is required to give his opinion whether the prescribed particulars furnished by the assessee in form 3CD are true and correct.
- Therefore signature of the assessee is to be taken on form 3CD though the form does not prescribe it.
- Documentation and Professional responsibility.

Applicability of Audit

Business other than 44AD	Business (S. 44AD opted for)	Profession (other than 44ADA)	Profession (S. 44ADA opted for)
If Turnover or gross receipts exceeds Rupees 1 Crore	If profit offered to tax is below 8 percent or 6 percent.	If Gross Receipts exceed INR 50 lakhs.	If profit offered to tax is below 50 percent.

1. In case of Business having Turnover between INR 1 crore to INR 2 crore Tax Audit applicable unless presumptive taxation opted for under section 44AD – CBDT Press Release dated 20 June 2016.
2. No Interest and Remuneration to partners permissible (absence of provisions similar to pre-amended section 44AD)
3. Restriction of 5 years (as provided in 44AD) (A Y 17-18 onwards)

Form 3CA , 3CB

- When to use for 3CA or 3CB:-Rule 6G provides that where audit is conducted under some other act form 3CA is to be used, or else form 3CB
- Giving Comments in para 3(a) of form 3CB
 - Effect thereof
 - Whether safeguards the auditor?
- Adding responsibility and scope Para in 3CB
 - Results in amending Form 3CB
 - Whether required?

Form 3CA , 3CB

- **Notes to normally specify**
 - Method of accounting followed –accrual or cash
 - Inventory valuation
 - Fixed Assets and Depreciation
 - Investments
 - Accounting of forex fluctuation
- **Items that may required qualification**
 - Mandatory AS not followed
 - Non provision of Income Tax
 - Employee benefits – especially retirement benefits
 - Confirmation of balances
 - Inventory valuation on estimated basis

Standard notes in form 3CB/3CA

Sr.No.	Qualification Type	Observation
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
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.

Sr.No.	Qualification Type	Observation
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.
5.	Others	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.
6.	Others	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.

Sr.No.	Qualification Type	Observation
7.	Records not available with regard to cheques taken or given by assessee as loans	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.
8.	Others	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.
9.	Clause 14	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.

Issues of Audit with ref. to 44AD

- Future & Option Trading – Loss,
 - Is the total turnover above Rs 1 crore?,
 - Is the total income above the taxable limit?
- Loss in partnership firm – Is audit required.
- Loss in Individual proprietor business, other income, is audit required.

Failure to get Tax Audit Done

Section 271B

- Penalty leviable at the rate of 0.5 percent of Turnover
- Maximum Penalty Rupees 1,50,000/-

Section 273B

- NO penalty if reasonable cause
- ✓ Few examples of Reasonable causes
 - ✓ Natural calamity
Fire, Theft, etc.
 - ✓ Non-availability of accounts due to seizure
Death or physical disability of partner in charge of accounts

Part A: Clauses 1 to 3 and 5 to 7

1. Name of Assessee

- In case of proprietor, name of business which is being audited – with name [say., XYZ Exports (Prop. ABC)]
- If audit of only branch carried out, then name of Branch

2. Address

- Normally of the registered office
- In case of a branch, division, etc. addresses thereof

Part A-clause 4

- Whether assessee liable to pay indirect tax like excise duty, service tax, Sales Tax, Goods and Service Tax, Customs Duty, GST etc.
- If yes, registration numbers to be provided GST:- Give all the numbers of GST registration if more than one held on a PAN NO.,
- Profession tax registration:-important to give the number as the term “etc.” used which leads us to believe other indirect taxes details need to be given.

Clause 9& 10 -I

- a. This clause applies only to firms and association of persons(P. Deed should be kept)
- b. If a partner is a partner in representative capacity then name of the beneficial partner should also be indicated
- c. Profit sharing ratio will also include loss sharing ratio
- d. If loss sharing ratio is different from the profit sharing ratio – both should be mentioned e.g. in a case where minor is admitted to the benefits of the partnership
- e. Change in remuneration paid to partners without change in profit sharing ratio would not require disclosure in tax audit report

Clause 9& 10 -II

- e. In case share of member of an AOP is indeterminate, the same should be stated.
- f. As per section 2(23) of the Income-tax Act, 1961 the term “Firm” shall have the meaning assigned to it in the Indian Partnership Act, 1932, and shall include a Limited Liability partnership firms defined in the Limited Liability Partnership Act, 2008.
- g. In clause 10 one needs to check the nature of business and if there is change or new business is started the same needs to be mentioned
(Copy of partnership deed and a MR on nature of business should be kept on record)

Clause 11- I

- The books of accounts prescribed , maintained and examined to be mentioned. The books maintained and examined should generally be same, unless the same are not provided in which case note or qualification may be warranted.(flood situation and books not available)
- Address where Books are maintained-very imp. For action u/s 133A (survey) and 132(search).
- Qualification day to day stock register is not maintained should be reconciled with GST law where stock book HSN wise is required.

Clause 11- II

- Rule 6F prescribes books of accounts for certain professions, (cash book, ledger, journals, bills)
- Doctors. Daily patients register in form 3C and the inventory on the first and last day in broad heads of medicine are to be maintained
- S. 2(12A)- books of accounts, S44AA & Rule 6F
- In case of a company assessee auditor should also verify as to whether any forms are filed under the Companies Act for maintenance of books of accounts at a place other than the registered office:
- In case of books maintained in computer the books generated are to be verified.(with printouts if available)

Clause 11- III

- As per section 2(12A) of the Income-tax Act, 1961, “books or books of account” include ledgers, day books, cash books account-books and other books, **whether kept in the written form or as print outs of data stored in a floppy, disc, tape or any other form of electromagnetic data storage device.**
- It may be noted that **section 4 of the Information Technology Act, 2000** states that “Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied if such information or matter is –
 - a. rendered or made available in an electronic form; and
 - b. accessible so as to be usable for a subsequent reference.”

Clause 12 Presumptive income in P & L account

- Reporting is for amounts included in P & L a/c
- Amount assessable under the presumptive section need not be given
- If 2 or more business exist and presumptive section applicable for some businesses, allocation of expenses may become necessary if common books are maintained
- Audit Process
 - ❖ To confirm whether any of the businesses fall under this category
 - ❖ If amount included in P & L a/c does not match the amount assessable under the presumptive section, note maybe added to that effect
 - ❖ Confirm whether common or separate books maintained for such businesses, Verify allocation if common books maintained

ICDS –Brief History

- Finance Act, 2014 amended section 145(2) of the Act to substitute “accounting standards” with “income computation and disclosure standards” (ICDS). Committee appointed to suggest ICDS.
- 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.

Applicability of ICDS

- **ICDS will apply to:**
 - An assessee
 - Following mercantile system of accounting
 - Computing taxable income under the following heads of income:
 - Profit and gains of business or profession
 - Income from other sources
- No Net worth or Turnover Criteria prescribed for applicability
- Not for the purpose of maintenance of books of account
- In case of conflict between ICDS and Act, the Act shall prevail

List of Notified ICDS

ICDS	Income Computation and Disclosure Standards	Equivalent AS
ICDS I	Accounting Policies	AS-1
ICDS II	Valuation of Inventories	AS-2
ICDS III	Construction contracts	AS-7
ICDS IV	Revenue Recognition	AS-9
ICDS V	Tangible Fixed Assets	AS-10
ICDS VI	Effects of Changes in Foreign Exchange Rates	AS-11
ICDS VII	Government Grants	AS-12
ICDS VIII	Securities	AS-13
ICDS IX	Borrowing Costs	AS-16
ICDS X	Provisions, Contingent Liabilities and Contingent Assets	AS-29

Disclosure in form 3CD 13(e)

Sr No.	ICDS	Increase in profit (Rs)	Decrease in profit (Rs)	Net Effect (Rs)
I	Accounting Policies			
II	Valuation of Inventories			
III	Construction Contracts			
IV	Revenue Recognition			
V	Tangible Fixed Assets			
VI	Changes in Foreign Exchange Rates			
VII	Government Grants			
VIII	Securities			
IX	Borrowing Costs			
X	Provisions, Contingent Liabilities and Contingent Assets			
XI.	Total			23

ICDS 1- Accounting Policies

- **ICDS recognizes three accounting concepts – going concern, consistency and accrual**
- **Materiality and prudence are absent as considerations for selection of accounting policies. A negative provision has in fact been made in the ICDS by stating that prudence is not to be followed unless it is specifically allowed.**
- **Accounting policy can be changed only if there is reasonable cause to do so**
- **Mark-to-market (MTM) or expected loss shall not be recognized unless provided by Act. ICDS I which does away with the concept of prudence is contrary to the Act and the supreme court decided judgments**

Amendment in Finance Act 2018

- **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.

ICDS-2 Inventory Valuation

- 145A –amended retrospectively by finance Act 2018 from 1-4-2017.
“(i) the valuation of inventory shall be made at lower of actual cost or net realisable value computed in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145;”
- Stock valuation as prescribed by the ICDS is cost or market value which ever is lower.
- Auditor will also have to take in to consideration the landed cost, auditor should be careful to include all costs in valuation.
(British Paints India Ltd –SC-1991 AIR 1338)

ICDS-2 Inventory Valuation

- Supreme Court had 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 realisable value, Shakti trading co. 250 ITR 871(SC). However Clause 24 of ICDS-2 requires the inventory to be valued at Net realisable value. Does this mean that the SC ruling is not applicable?
- S 145A applies to service industries
- Securities to be valued category wise(at cost or market value which ever is lower),
- unlisted shares to be valued at cost.

Construction Contracts ICDS -3

The ICDS does not apply to builders.

- Percentage completion method to be followed (even for service contract)
- Retention money to be included in revenue and cannot be excluded.
- Incidental income like interest income cannot be deducted from borrowing cost.
- The estimated losses and expenses booked and allowed under AS 7 are specifically excluded (Para 20)

-AMENDMENT TO THE ACT

43CB. *(1) The profits and gains arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145*

Revenue Recognition-ICDS 4

- Scope of ICDS-IV is limited to sales of goods, rendering of services and use of resources by others yielding interest, royalties or dividends.(view that lease rentals are outside the purview of ICDS –IV)
- Interest to be taxed even in absence of reasonable certainty is held to be valid. (To be taxed on accrual basis)
- Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim for escalation of price and export incentives, revenue recognition in respect of such claim shall be postponed to the extent of uncertainty involved.
- Service contracts of more than 90 days ,to be recognized based on percentage completion method.

Amendment to the law for ICDS 4

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.*

(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.]

Fixed Assets and Exchange difference -ICDS

- ICDS for fixed asset is on the same lines as AS 10 and disclosures are on same lines as provided under form 3CD so reference may be made to clause 18.
- Spares for machinery where maintained and can be used only for a machine and use of which is uncertain to be capitalized

Issue:- Treatment of expenses incurred after the conduct of the test runs and experimental production. PARA 8 OF THE ICDS – V provides for capitalization of expenses till the commercial production which is contrary to National Thermal Power corp'n vs CIT 357 ITR 253(DEL HC)

ICDS 6 Foreign Exchange transactions

- ICDS for foreign exchange was entirely struck down by the Delhi HC
- New section 43AA introduced.
- The difference in the treatment of transactions entered for trading or speculation or that are entered into to hedge the foreign currency risk of a firm commitment or a highly probable forecast. Forward Contract profit / loss to be recognized only on the settlement of contract. (mark to mark contracts) *

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.*

ICDS – 6 law amended

43AA -(2) For the purposes 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*

Government Grants ICDS 7

- Grants to be recognized only when there is reasonable certainty of receipt or not later than actual receipt of grant.
- One needs to look at section 2(24)(xviii) as all grants are now taxable unless the same is related to a capital assets and reduced from the cost of capital asset.
- Amendment in section 145B(3)

ICDS on securities held as stock in trade

- The securities have to be recognized at cost or net realizable value whichever ever is lower.
- The market values has to be calculated based on category of securities as for example
 - Shares
 - Bonds
 - Mutual funds
- The unlisted securities are to be valued at at cost.
- Section 145A is amended.

ICDS -9 on borrowing cost

- The major issue is that the cost of borrowing till the asset is first put to use is to be capitalized. The definition of qualifying asset includes inventories that require a period of twelve months or more to bring them to a saleable condition.
- The ICDS provided for both the capitalization of specific borrowing like term loan for acquisition or generation of asset and general borrowing like cash credit on proportionate basis. (specific formula provided in para 6).
- Practical difficulty for big companies with multiple borrowings and different blocks and asset purchase dates.

Provisions, Contingent Liabilities and Contingent Assets

AS - 29	ICDS
❖ Provisions shall be recognised if it is <u>probable</u> that outflow of economic resources will be required.	❖ Provisions shall be recognised if it is <u>reasonably certain</u> that outflow of economic resources will be required.

Impact:

- ❖ The criterion for recognition of provisions on the basis of the test of ‘probable’ (i.e. more likely than not criterion) replaced with the requirement of ‘reasonably certain’.
- ❖ In the absence of definition and scope of ‘reasonably certain’ criterion, an ambiguity would arise on assessment of ‘reasonably certain’ criterion.
- ❖ In the Act, there is no specific provision for recognition of provisions. However, provisions are allowed based on accrued liabilities as per ordinary principles of commercial accounting.

Recognition of provisions

Impact:

- ❖ Provision for Warranty is allowed as an expenditure upholding the test of ‘probable’ warranty obligation in the following judgments. *
- Rotork Controls India P. Ltd. (2009) 314 ITR 62 (SC) (extract on next slide)
- Himalaya Machinery (P) Limited v DCIT 334 ITR 64
- CIT vs. Luk India P. Ltd. 52 DTR 117.
- Siemens Public communication Networks Limited v CIT
- CIT v Indian Transformer Limited. 270 ITR 259

Impact of ICDS

As in AS 29 there is no clarification in ICDS for allowing provisions on business experience , therefore Provisions made on obligations recognized out of customary business practices or voluntary obligations may not be allowed. (e.g. informal refunds policy to dissatisfied customers, employee welfare, etc.)

(The CBDT has clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS –X)

Disclosures required in clause 13(f)

Clause	Disclosure as per ICDS
I	ICDS I- Accounting Policies
II	ICDS II- Valuation of Inventories
III	ICDS III-Construction Contracts
IV	ICDS IV- Revenue Recognition
V	ICDS V-Tangible Fixed Assets
VII	ICDS VII-Government Grants
IX	ICDS IX- Borrowing Costs
X	ICDS X- Provisions, Contingent Liabilities and Contingent Assets

Disclosures -I

ICDS	Disclosure requirement
ICDS- 1	All significant accounting policies * Any change in accounting Policy with the effect
ICDS -2	The accounting policies adopted in measuring inventories including cost formulae used. (Method of valuation and the process followed should be disclosed e.g.. FIFO , Weighted Average, or Specific allocation.) IF standard costing method is followed : -details of such inventories and a confirmation of fact that standard cost approximates the actual cost. The carrying amount and its classification
ICDS -3	The amount of revenue recognized as revenue in the period and the method used to determine stage of completion. For contracts pending : - a) Amount of cost incurred and recognized profits (less loss up to the reporting date., b) Amount of advances received c) The amount of retentions.

Disclosures -II

ICDS	Disclosure requirements
ICDS -4	<ol style="list-style-type: none"> 1. Total sales not recognized due to lack of certainty of receipt and the nature of uncertainty 2. Amount of receipts of Service contracts recognized as revenue during the previous year 3. Service contracts in progress at the end of the year . A)Details of cost incurred and profits recognized for each project , B)Amount of advance received and C)Amount of retentions.
ICDS-5	Requirements are same as in clause 18 reference can be made to it
ICDS-6	No Specific requirements
ICDS-7	<ol style="list-style-type: none"> 1. Nature and extent of grants reduced from cost of assets during the previous year 2. Nature and extent of grants recognized as income 3. The nature and extent of govt. grants not recognized as income nor reduced from the cost of assets.

Disclosures-III

ICDS	Disclosure requirements
ICDS - 8	No specific disclosure requirements
ICDS -9	<ol style="list-style-type: none">1. The accounting policy adopted for borrowing cost2. The amount of borrowing costs capitalized during the previous year.
ICDS-10	<p>For each class of Provision</p> <ol style="list-style-type: none">1. Brief description2. Carrying amount at end & Beginning3. Additional provision made4. Unused reserves5. Expected Reimbursement.

CL 14-Closing Stock Valuation

S.145A

- 145A :-(ii) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation;
- The AS 2 and the guidance note provide for net method to be followed.
- The Guidance note for accounting of MODVAT/ CENVAT, provides that the ultimate impact on profit is nil.

Closing Stock Valuation S.145A

- Clause 14(b)/ 26/ 27* requires specific disclosure as to whether the valuation as per S. 145A is followed. One needs to state “No” in clause 14(b) and state that the impact is nil.
- The Bombay High court in the case of CIT vs Diamond Dye Chem Ltd. ITA 146/2015(BOM) has held that the net method or gross method the impact on profit would be nil. A clear disclosure of reliance on a judgment would help.

Clause 15 – Sec. 45(2) Conversion capital asset to stock in Trade

- Reporting only if conversion has taken place during the year under audit ◦
 - Conversion as claimed by the assessee or even inferred on the basis of facts?
- No reporting of taxability due to such conversion
- Cost of Acquisition ◦
 - As per books of accounts
 - Depreciable Asset – Original cost and not WDV
 - Asset acquired prior to 1-4-2001- FMV as on 1-4-2001

Clause 16 – Items missing from P&L

A/c

- Five sub-clauses
 - a) Items falling in Section 28
 - b) Tax refunds admitted as due
 - c) Escalation claims accepted
 - d) Any other income
 - e) Capital receipt
- (b), (c) & (d) – overlapping with (a) – but to report under specific sub-clause
- Management Representation in writing may be obtained for reporting under all sub-clauses

Clause 16(a) – Section 28

- Business income in general and specific items listed in Section 28
- Common case
- Partner's remuneration and interest taxable u/s. 28(v)
- Incentives in kind taxable u/s. 28(iv)
- Foreign tour for achieving sales target, dealers given incentives e.g.. Gold coins, electronic goods(MR from assessee important)
- Sale of asset for which deduction was claimed u/s. 35AD
- Income reduced from the cost of asset / WIP

Clause 16(b) – Refunds

- Examine all relevant correspondence, records and evidence
- “admitted by the concerned authorities” would mean admitted within the relevant Previous year Admitted as due after Previous year need not be reported.
- **Export Incentives**
 - ICDS - : Export Incentive to be recognized where there is reasonable certainty of ultimate collection

Clause 16(c) – Escalation Claims

- “Accepted” – unconditional acceptance by the other party
- No reporting where –
 - Claims have been made but not accepted
 - Claims under negotiation
 - Claims which are sub-judice
- Assesse following cash system of accounting
 - Acceptance without actual receipt has no significance
 - To mention the fact that it is not received during Previous year

Clause 16(d) – Any other income

- Clause (a) vs. Clause (d)
- Any other item of income means other than those which fall u/s. 28?
- Even exempt income is required to be reported? - Share in profits of partnership firm
- Non-business income of proprietor – whether required to be reported?
 - Credited to Capital A/c
 - Not recorded in books related to proprietary concern

Clause 16(e) – Capital Receipt

- Capital receipts not included in the profit and loss needs to be included e.g..
 - Capital subsidy received in the form of government grants which are in the nature of promoters' contribution (This is no more possible as section 2(24)(xviii) which taxes all grants as revenue receipts other than the receipts where the same are reduced from asset purchased from the grant, supreme court judgment CIT vs Ponni Sugar and Chemicals 306 ITR 392 now not relevant)
 - Government grants related to specific fixed asset and reduced from its value
 - Compensation for surrender of rights ◦ Profit/loss on sale of fixed assets/investments to the extent not credited in the P & L A/c (loans, gifts and capital received need not be reported)

Clause 17- S 50C & 43CA

- Sale of land or building or both
 - If the value is lower than the stamp duty value or circle rate, the said transaction needs to be reported under this clause. (5% safety net provided)
 - Whether there is a dispute and an appeal if file with stamp duty authority or the assessee does not agree with the valuation is of no relevance for reporting.

Section 43CA or 50C – Clause 17

- Whether reporting is at all required for items covered by Section 50C
 - Scope shall be confined to Business Income
 - Clause 28 and 29 deals with Section 56(2)(viia) and 56(2)(viib)
- Clause 17 :
 - Details in respect of the land or building or both transferred during the year for a consideration less than value adopted or assessed or assessable by *authority of state government referred to in section 43CA or 50C*.
- Clause talks about authority referred to in section 50C and not the transactions referred to in section 50C.
- Ghai Constructions Vs. State of Maharashtra – Bom HC – Order Dt. 30-4-2007
 - Requirement of compulsory audit is only in respect of business carried on by the person and not in respect of his income from other sources.

Section 43CA – Issues

- Section 43CA – whether applies in the case of Percentage completion method
 - Section 43CA applies in the year of transfer
 - Whether transfer is complete on entering agreement or registration ?
- Whether section 43CA has to be considered for computing deduction u/s. 80-IBA
- Sub-section (3) of section 43CA : Whether payment by journal entries will get the benefit of valuation on date of agreement
 - Sub-section (4) : “Any mode other than Cash”

Section 50C – New Developments

- New provisos w.e.f. A.Y. 2017-18
 - Value as on date of agreement to be taken where there is difference in date of agreement and date of registration
 - Condition : consideration or part thereof has been received by A/c. payee cheque or Draft or ECS on or before the date of agreement
 - Difference between second proviso and 43CA(4) – A/c. payee cheque / Draft / ECS Vs. Other than cash
 - Provisos held to be retrospective – *Dharmshibhai Sonani Vs. DCIT 161 ITD 627 (Ahd.)*
- Amendment by FA 2018 – **w.e.f. A.Y. 2019-20 ***
 - If Stamp Valuation is not more than 105% of consideration, → no adjustment will be made for computation
 - If variation is beyond 5% - Stamp Duty value will be treated as Consideration – 5% is not a standard deduction

50C – Applicability and Non-Applicability

- Tenancy Right – Kishori Sharad Gaitonde – ITA No. 1561/M/09 Dated 27-11-09 – itatonline.org
- Leasehold Rights – Atul G. Puranik Vs. ITO 132 ITD 499 (Mum). / Greenfield Hotels & Estates P. Ltd. – ITA No. 735/2014 - Bom. HC – Order dated 24-10-16 – itatonline.org
- TDR / FSI – ITO Vs. Prem Ratan Gupta 31 CCH 384 (Mum.)
- Development Rights – Chiranjeev Lal Khanna Vs. ITO 132 ITD 474 (Mum) – Peculiar facts – May not apply to Co. Op. Societies

50C- Applicability ?

- Shares of the company holding immovable property – Irfan Abdul Kadar Fazlani Vs. ACIT 56 SOT 12 (Mum.)
- Impact of Section 50CA and Rule 11UA w.e.f. A.Y. 2018-19
- Depreciable Asset – ITO Vs. United Marine Academy 130 ITD 113 (Mum. SB) – Interplay between Section 50C and section 50-Against
- Slump Sale – Section 50B – Dy. CIT Vs. Summit Securities Ltd. 135 ITD 99 (Mu. SB) - Undertaking as a whole not Land or building or both

Clause 18-Depreciation

- Details of depreciation claimed for each block has to be provided in the format provided.
- **One has to be see that the GST claimed as input credit is not included in the asset value.**
- Tax auditor should examine allow ability of claim
 - a. classification of the asset;
 - b. classification thereof to a block;
 - c. the working of actual cost or written down value;
 - d. the date of acquisition and the date on which it is put to use;
 - e. the applicable rate of depreciation;
 - f. the additions / deductions and dates thereof; g. adjustments required – specified as well as on account of sale, etc.

Suggested note 18

- The opening written down value of each block of assets and classification of each asset as on April 1, 2018 is on the basis of the return of income filed for AY 2018-2019 and has been relied upon by the auditors. (new audit)
- Date put to use as regards additions to fixed assets, is as certified by the assessee.

Depreciation on Assets not in Name of Company / Partnership

- Car Registered in Partner's / Director's name – Reflected in Firm / Company's Balance Sheet
 - CIT Vs. Aravali Finlease Ltd. 341 ITR 282 (Guj)
 - Edwise Consultants P. Ltd. Vs. DCIT 44 ITR 236 /45 CCH 392 (Mum. Trib.)
- Depreciation on vehicles for personal use
 - Microsoft Corporation India P. Ltd. Vs. Addl CIT 37 ITR 290 (Del. Trib.) – No Personal use in the case of companies
 - Difference in section 32 and section 37(1) –Asset given on rent?
 - **However, there is the issue of perquisite value not added to the Director and short deduction of TDS on salary. ITR 6 Revised to include details of car.**

Depreciation Clause 18 Issues

- **Functional Test for deciding whether plant or building**
 - ACIT Vs. Victory Aqua Farm Ltd. 379 ITR 335 (SC) –Ponds for breeding prawns
 - CIT Vs. Anand Theatres 244 ITR 192 (SC)-Cinema theatres not plant
 - CIT Vs. Dhampur Sugar Mills Ltd. 375 ITR 296 (All) – Tubewell held to be plant
 - CIT Vs. Express Resorts & Hotels Ltd. 230 Taxman 424(Guj) – Electrical Installations and Sanitary Fittings in hotel treated as plant
- **Depreciation on Individual assets which are not used but forming part of block of asset ***
 - CIT Vs. G. R. Shipping Ltd. – ITA No. 598 of 2009 (Bom HC)
 - CIT Vs. Sonic Hiochem Extraction P. Ltd. 94CCH 99 (Bom.)
 - DCIT Vs. Boskalis Dredging India P. Ltd. 53 SOT 17 (Mum.)

Depreciation Clause 18 Issues

- Depreciation on Intangibles
 - **Goodwill** – CIT Vs. Smifs Securities Ltd. 348 ITR 302(SC)
 - **Stock Exchange Card** – Techno Shares & Stocks Ltd. Vs. CIT 327 ITR 323 (SC)
 - **SEBI Registration Fees** – DIT Vs. HSBC Asset Management India Pvt. Ltd. 228 Taxman 365 (Bom.)
 - **One time Licence Fees** – ACIT Vs. GKN Sinter Metal P. Ltd. 153 ITD 311 (Pune)
 - **Compensation paid to retiring partner is goodwill and eligible for depreciation** – Pr. CIT Vs. Swastik Industries 240 Taxman 510 (Guj)
 - **Excess amount paid over Net asset value for acquiring business is goodwill** – Triune Energy Services P. Ltd. Vs. Dy. CIT 129 DTR 422 (Del. HC)
 - **Non Compete Fees**
 - Medicorp Technologies India Ltd. – (2009) 30 SOT 506 (Mad)
 - Srivastan Surveyors P. Ltd – (2009) 318 ITR 283 (Chennai Trib.)
 - ACIT Vs. Real Image Tech P. Ltd. 120 TTJ 983 (Chennai Trib).

Clause 19 – Special Deductions

- Auditor to ensure the eligibility for deduction and compliance of the concerned conditions
- Amount not debited to P & L A/c but admissible as deduction should also be stated.-35D
- The reliance on any specific judgment should be mentioned.
- Audit report to be taken in case of certain deductions, reference to be made to the said report. Copy of the said report to be kept.

Clause 20(a) – Section 36(1)(ii)

- **Transactions covered –**
 - Payment / Payable to employees
 - Who are also partners / shareholders
 - As bonus / commission for services rendered
 - Otherwise payable as profits or dividend

Where the bonus is paid in normal course of business, there is no need to disclose the same over hear, only if the said amount is payable as profits or dividend then the same is to be disclosed. (other view possible)

Controls & Switchgear Contractors Ltd. (Del) W.P. 2845/2014

-Guarantee commission paid to directors held to be allowable **Dalal Broacha Stock Broking Pvt Ltd vs. ACIT (Mum SB)-ITA NO 5792 / mum/2009** -No evidence to show that the directors had rendered any extra services for payment of huge commission in addition to services rendered as an employee for which salary was paid

Clause 20(b) – Section 36(1)(va)

- Reporting is required irrespective of deductibility, auditor is not to sit in judgment.
- Grace period should be considered for the purpose of reporting due date
 - 5 days grace period for making remittances to EPFO by employers has been withdrawn effective February 2016
- Bombay High court has held that if the employee contribution is paid before the due date of filing return then the deduction is to be allowed.
 - Bom HC - CIT vs. Ghatge Patil Transports Ltd.
 - SC has dismissed Revenue's SLP in the case of Pr. CIT v. Rajasthan State Beverages Corpn. Ltd. 84 taxmann.com 185

Clause 21(a)-Details of expenses

- Expenses in the nature of
 - capital,
 - personal,
 - advertisement(political party),
 - club membership and expenses,
 - expenses by way of penalty for violation of law,
 - Expenses in the nature of fine or penalty (eg late fees for TDS or GST is it a fine?) and
 - Expenses incurred for any purpose being an offence or prohibited by law-BMC fines,

Auditor only to give information and not decide about allow ability. (The auditor is required to maintain information in the format provided under the guidance note in para 30 issued by ICAI)

Clause 21(a)-Expense details

- Where estimation of personal expenses is made there not being a log book then a general note in form 3CB may be made
- Trade union magazines are not Political parties though they may have patronage.
- Club expenses listed should be checked for being personal and therefore need to include as salary.(Director's wife Gym fees) This could have TDS implications.
- Penalties which are for trade condition violations need not be mentioned here e.g.. LDC, Demurrage, fees/fines charged by SEBI to broker,

Clause – 21 Capital or Revenue Expenses

- Few Relevant Tests – Para 30.2 of GN of ICAI
 - Creation of New Asset or Enduring Benefit
 - Fixed Capital or Fixed Asset Vs. Working Capital or Current Asset
 - Whether it relates to basic framework of business
 - Acquisition of an Intangible Asset

Capital or Revenue -Principles

- Royalty paid to Foreign Collaborator for technical know how fees
 - No business in existence – Capital Expenditure - Honda Sael Cars India Ltd. Vs. CIT (2017) 99 CCH 39 (SC)
 - Subsequent years – business in existence – Royalty paid for improvement in the business – Revenue Expense – CIT Vs. Hero Honda Motors Ltd. 372 ITR 481 (Del.)
- Expense incurred for carrying on existing business in a more efficient manner incidentally resulting in enhancement of capacity - Revenue in nature – No enduring benefit or creation of income generating apparatus – *CIT Vs. Television Eighteen India Ltd. 364 ITR 605 (Del.)*
- **Expenses on upgradation of application software ***
 - Revenue Exps. : *ACIT Vs. Sanghvi Savla Stock Brokers Ltd. 152 ITD 820 (Mum.)*

Capital or Revenue – Principles

- Construction Expenditure incurred on an abandoned project is allowable as revenue expenditure – No asset is created – *Binani Cement Ltd. Vs. ACIT 380 ITR 116 (Cal.)*
- Fees paid for technical collaboration agreement which had to be terminated – Capital in nature – *Oriental Seritech Ltd. Vs. CIT 149 ITD 350 (Mum.)*
- Assessee engaged in production of audio cassettes and CDs – payment made for purchase of copyrights of sound tracks of films – Revenue Expenditure – *ITO Vs. Five Star Audio 143 ITD 288 (Chennai)*.
- DCIT Vs. Gujarat Narmada Valley Fertilizers Co. Ltd. 215 Taxman 72 (Guj)
- **Loan taken for the purpose of business – Expenditure incurred on restructuring of such loan is revenue in nature**
- **Premium on Redemption of Debentures which were issued for working capital requirements – Revenue Expenditure**

Capital or Revenue – Principles

- Cyanamid Agro Ltd. Vs. ACIT 148 ITD 606 (Mum.)
 - Payment made for avoiding competition over a reasonable long period of time – Capital in nature
 - If the period is uncertain and competition can again start any time – Revenue Expenditure
- Rent Income assessed as Business Income* – Payment of compensation to existing tenant to obtain vacant possession of building so as to earn higher rent – Revenue Expenditure – *Shyam Burlap Co. Ltd. Vs. CIT 380 ITR 151 (Cal.)*
- Expenses on Medical treatment of Eyes in the case of an advocate – Personal in nature – *Dhimant Hiralal Thakkar Vs. CIT 380 ITR 275 (Bom.)*
- Expenses to perfect the title of the land is capital expenditure – No Depreciation is allowable since do not pertain to Building – *Sandvik Asia Ltd. Vs. DCIT 378 ITR 114 (Bom.)*

Expln to 37(1)

- Penalty or fine for violation of any law for the time being in force
 - Penalty paid for delay in supply of material – Whether allowable
 - Penalty for procedural lapses in compliance of Rules & Regulations of associations etc.
 - LKP Securities 36 CCH 93 (Mum)
 - Dy. CIT Vs. Kisan Ratilal Choksey Shares & Securities Pvt. Ltd. 41 (ITR Trib) 114 (Mum.)
- **Prakash Cotton Mills P. Ltd. Vs. CIT 201 ITR 684 (SC) ***
 - AO Should examine the scheme of the relevant statute to decide the nature of the particular levy to decide whether it is compensatory in nature or penal in nature – Nomenclature is not relevant while deciding the issue. In case of composite payment – amount is to be bifurcated appropriately
- Penal Interest Vs. Compensatory Interest under various laws like Sales Tax, Excise, Service Tax etc
- Penalties for Late filing of VAT Returns / Late filing Fees for Service Tax

Expln to 37(1)

- CIT Vs. Ahmedabad Cotton Mfg. Co. Ltd. 205 ITR 163 (SC)
 - Penalty for infraction of law is not permissible but payment in obedience of law as a measure of business expediency can not be subject to disallowance. Payment made towards exercise of option given by the scheme is not to be disallowed.
- Expense for any purpose which is an offence or which is prohibited by law
 - Compounding Fees / Consent Fees for settling Dispute – *ITO Vs. Reliance Share & Stock Brokers P. Ltd. 67 SOT 73 (Mum.)*
 - Advocate Fees – *T & T Motors Vs. Addl CIT 154 ITD 306 (Del.) – against –Driver Bail fees of advocate*
 - Ransom Money 340 ITR 99 (MP) K.M.Jain Tobacco Products(P) Ltd

Expln. to Sec. 37 (1)

- Compromise payment made to landlord to protect the Leasehold right – not an offence – allowable – *CIT Vs. Sports Field Amusement 231 Taxman 252 (Bom.)*
- Assesse guaranteed payment by third party – Third party failed – Decree executed against assessee – Payment made to avoid defamation of name – Held allowable – *CIT Vs. Hitachi Koki India Ltd. 230 Taxman 643 (Karn.)*
- Additional Filing Fees paid to ROC – Compensatory in nature – Allowable – *Cummins Turbo Technologies Ltd. Vs. DCIT 169 TTJ 358 (Pune)*

Clause 21(b) –Disallowance under 40(a)

- In clause (i) details of payment to non resident where TDS is deductible but has not been deducted, or
- Where tax is deducted but not paid to the government before due date provided under S200(1).
- Is the auditor required to disclose all cases where tds is not deducted due to the fact that the tax was not payable as per law?

The auditor is required to consider each payment to see if tax was deductible and report if the same is not deducted or if deducted and not paid. (Disallowance is 100%)

Clause 21(b)-40(a)(ia)

- In case of domestic payments, the auditor is required to report all cases where
 - TDS was deductible but is not deducted, or
 - deducted and not paid before due date of filling return.
- The concept of test check, is it valid?
- Whether all the transactions to be reported or only those on which tds is deducted?
 - Where TDS is not deducted (due to the fact that there is form 15G or 15H or where NIL TDS deduction certificate is issued or payment is below the limit prescribed) is it required to disclosed in the table?

Common errors

- The section 194A –TDS on interest, allows exemption for scheduled banks and cooperative banks.
- Loans from NBFC, Interest and loan processing fees?
- The payment of PMC paid to portfolio manager*. Applicable only in certain cases

40(a)(i) – 40(a)(ia)

- Can Auditor rely on Certificates issued u/s. 195 or he should examine all the documents / treaties etc. (AS 600)
- Section 40(a)(i) – Whether deduction is required to be made when the relevant income is not taxable in India due to DTAA
 - GE India Technology Centre Pvt. Ltd. Vs. 327 ITR 456 (SC)
- Deduction of TDS at lesser rate – Whether disallowance to be made u/s. 40(a)(ia)
 - DCIT Vs. Chandabhoy and Jassobhoy 49 SOT 448 (Mum.)
 - DCIT Vs. S. K. Tekriwal 48 SOT 515 (Cal.) – confirmed in CIT Vs. S. K. Tekriwal 361 ITR 432 (Cal.)
 - Contra View – CIT Vs. PVS Memorial Hospital Ltd. 380 ITR 284 (Ker)

40(a)(i) – 40(a)(ia)

- No TDS on Reimbursement of Expenses – *CIT Vs. DLF Commercial Project Corporation 379 ITR 538 (Del.)* ; *Hightension Switchgears P. Ltd. Vs. CIT 385 ITR 575 (Cal.)*
- Tax Deducted and Paid but no TDS Return filed – whether disallowance is to be made
- Form 15G / 15H not filed with Department – Whether Disallowance to be made
- No Disallowance where the expenditure is capitalised in the books of accounts – *CIT Vs. Mark Auto Industries Ltd. 358 ITR 43 (P & H)*
- No Liability to deduct tax on transport charges where primary contract is for supply and Transport is incidental – *CIT Vs. Krishak Bharati Co. Op. Ltd. 349 ITR 68 (Guj)*

40(a)(i) – 40(a)(ia)

- No TDS on Overseas Commission to Foreign Agent
 - Circular No. 23 of 1969
 - Circular No. 7 Dated 22-10-2009
 - CIT Vs. Toshoku Ltd. 125 ITR 525 (SC)
 - CIT Vs. Gujarat Reclaim & Rubber Products Ltd. – ITA No. 2116 of 2013 – Order dated 8-12-2015 / 94 CCH 148 (Bom.)
 - Sesa Resources Ltd. Vs. DCIT 287 CTR 89 (Bom.)
- Second proviso to Section 40(a)(ia) – If tax paid by the recipient – No disallowance to be made Form 26A
- Amount of Disallowance – Restricted to 30% w.e.f. A.Y. 2015-16
 - Deduction allowed in subsequent year on payment basis – w.e.f. 2015-16 also restricted to 30%
 - Disallowance in earlier year @ 100% and deduction now @ 30%

Payment in Cash 40A(3)/(3A)

- Payment above Rs 10000 to be identified and reported. One needs to consider the exceptions in Rule 6DD
 - Issue of salary paid to employees
 - Issue of payment to contractors.
 - A Daga Royal Arts vs ITO (ITAT Jaipur)

No disallowance can be made for cash payments if the transaction is genuine and the identity of the payee is known.

- Auditor cannot argue test check done. May lead to disciplinary action.

Section 40A(3)

- Rule 6DD – Exceptions to be taken care of
- Genuine Payments made in excess of the prescribed limit may still not be disallowed if they are made to meet the business exigencies and the payee can be identified
 - Honey Enterprises Vs. CIT 381 ITR 258 (Del.)
 - Anupam Tele Services Vs. ITO 366 ITR 122 (Guj)
 - Harshila Choradia Vs. ITO 298 ITR 349 (Raj.) – Rule 6DD has to be liberally construed.

Disallowance 40A(9)

S. 40A(9): The provision is not meant to hit genuine expenditure by an employer for the welfare and the benefit of the employees. Even contributions to unapproved and unrecognized funds have to be allowed as a deduction if they are genuine in nature

- PCIT vs State Bank of India(Bombay High Court)
- CIT vs Bharat petroleum Corporation LTD 252 ITR 43(BOM)
- CIT vs Indian petrochemicals Corporation LTD 261 taxman 251(BOM)

Section 14A-clause 21(h)

- Rule 8D -1% of average monthly investments
- Disallowance only if exempt income earned.
- Whether shares were held as stock in trade
- Separate books maintained.

Issue :- a)112A provides for taxation of LTCG above Rs 100,000/- do we take it as exempt while calculating disallowance?

- B)Dividend also taxable above Rs 10,00,000/- do we include it calculation of disallowance?

Section 14A – Rule 8D

- Rule 8D - Significance of the phrase “having regard to accounts of the assessee”
- Conclusive finding necessary
 - Godrej & Boyce Mfg. Co. Ltd. Vs. DCIT (2010) 328 ITR 81 (Bom.)
 - Maxopp Investment Ltd. Vs. CIT (2011) 347 ITR 272 (Del) – recently approved by SC
 - CIT Vs. I. P. Support Service India P. Ltd. – 94 CCH 37 (2015) (Del)
- No Disallowance in absence of exempt income :
 - CIT Vs. Delite Enterprises – ITA No. 110 of 2009 (Bom) – itatonline.org
 - CIT Vs. Shivam Motors Pvt. Ltd. – (2015) 230 Taxman 63 (All)
 - CIT Vs. Corrttech Energy Pvt. Ltd. 223 Taxman 130 (Guj)
 - Cheminvest Ltd. Vs. CIT (2015) 378 ITR 33(Delhi)(HC) – SB decision overruled

Section 14A – Rule 8D

- Meager Dividend Income
 - DCM Ltd. Vs. DCIT (Del. Trib) – ITA No. 4467/Del/2012 Dated 1-9-15 - following HC decision in Cheminvest
- Disallowance cannot be in excess of expenditure incurred
 - ACIT Vs. Iqbal M. Chagla – 67 SOT 123 (Mum)(URO)
 - Gillete Group India P. Ltd. 22 taxmann.com 61
 - Haresh S. Jhaveri – ITA No. 8518/Mum/2010

14A in MAT Scenario

- 115JB is a self contained code – Book Profit as per Explanation
- Clause (f) – Expenses in connection with incomes exempt u/s. 10, 11 and 12
- Expense to be added back “if debited to P & L A/c.” – Only Actual Expenses – No scope for Rule 8D
- **Decisions**
 - Essar Teleholdings Ltd. Vs. DCIT – ITA No. 3850/M/2010 (Mum.)
 - Quippo Telecom Infrastructure Ltd. Vs. ACIT – ITA No. 4931/Del/2010 (Del.)
 - Everest Kanto Cylinders Ltd. Vs. ACIT 167 TTJ 204 (Mum.)
- Clause (f) will not be applicable in case of no exempt income earned during the year - Minda Sai Ltd. Vs. ITO 114 DTR 50 (Del. Trib)

S 14A:-Subsidiaries / Strategic Investments / Stock in Trade

- Purpose of Investment
- Recently Settled : Maxopp Investment Ltd. Vs. CIT SC - itatonline.org – Dt. 12-2-18
 - Purpose is not relevant
 - Applies to both Stock in Trade and Investments
 - However only proportionate disallowance to be made
 - AO has to record finding how the disallowance made by assessee is incorrect

Interest Disallowance - Mixed Funds

- Common Funds – Sufficient funds available for making Tax Free Investment
 - Woolcombers of India Ltd v. CIT 134 ITR 219 (Cal) / East India Pharmaceutical Works Ltd v. CIT 224 ITR 627(SC)
 - CIT Vs. Reliance Utility and Power Ltd. 313 ITR 340 (Bom) - section 36(1)(iii)
- CIT V. HDFC Bank Ltd. 366 ITR 505 (Bom.) – section 14A – applying ratio of Reliance Utility
- Similar view : CIT Vs. UTI Bank Ltd. 215 Taxman 8 (Guj) / CIT Vs. Torrent Power Ltd. 363 ITR 474 (Guj)

Profit from Partnership Firm

Vishnu Anand Mahajan Vs. ACIT 137 ITD 189 (Ahd. SB)

- Funds are borrowed and Introduced as Capital in Firm
- Also other expenses are incurred by partner – Motor Car Expenses – Car Depreciation etc.
- Partner earns Remuneration + Interest + Share of Profit from Firm
- Section 14A applies to Interest and Other Expenses
- Disallowance to be made by apportionment
- Section 14A do not apply to depreciation

(Other judgments to be considered on the topic–Dharam Singh Popat ITA 7534 /M/2004 & Delite Enterprises ITA 110 of 2009)

Clause 22 – Interest under MSME Act

- Whether the auditee is a “buyer”?
 - Bought any goods or received any services from a “supplier” for consideration
 - Supplier is a small or micro industry
 - The payment is delayed beyond agreed period, (period cannot be beyond 45 days) in any case payment has to be made within 45 days
 - If terms are not agreed then has to be paid within 15 days.
- Interest payable as per S 16 of MSME Act
- Interest not deductible as per S23 MSME ACT

Clause 23 Particulars of payments made to persons specified under section 40A (2)(b).

- **Audit Procedure**
- Obtain a list of 40A(2)(b) transactions from the client and compare it with Related Party Transactions reported and obtained under AS 18 or Ind AS 24. The transactions in the list should match.
- A list of these transactions are to be disclosed in this clause.
- Note: This clause is for merely for disclosure and specifically for **Payments**.
- **Take a list from the assessee, one will have to consider the prior years details to see that something apparent is not missed out.**
- **(Any amount missed in this list and later identified by the AO in scrutiny will surely lead to addition on the allegation that the same is not disclosed.)**

Clause 24 : Amounts deemed to be profits and gains under section 32AC/32AD/33AB/33ABA /33AC

- his clause requires reporting of amounts deemed to be profits and gains under each of these five sections. The sections referred to in clause 24 deal with the following -
 - **Section Deduction for**
 - **32AC - Investment in new plant and machinery**
 - Applies in cases where the new plant and machinery which was acquired and deduction was claimed in the notified years, was sold within the lock- in period of 5 years **except** in connection with the amalgamation or demerger.
 - **32AD Investment in new plant and machinery in notified backward areas in certain States (Andhra Pradesh, Bihar, Telangana and West Bengal)**
 - Applies in cases where the new plant and machinery which was acquired and deduction was claimed in the notified years, was sold within the lock- in period of 5 years **except** in connection with the amalgamation or demerger or re-organization.

- **33AB Tea development account; coffee development account**
- **and rubber development account**
- Applies when any amount standing to the credit of the assessee in the special account or the Deposit Account is withdrawn except for the purposes specified in the scheme or, as the case may be, in the deposit scheme or
- any specified business asset acquired out of such funds is sold within the lock-in period of 8 years. Amount claimed earlier will be considered as income in the previous year.
-
- **33ABA Site Restoration Fund**
- Applies when any amount standing to the credit of the assessee in the special account or the Deposit Account is withdrawn except for the purposes specified in the scheme or, as the case may be, in the deposit scheme or
- any specified business asset acquired out of such funds is sold within the lock-in period of 8 years. Amount claimed earlier will be considered as income in the previous year.
- **33AC Reserves for shipping business**
- Applies when the amount credited to the reserve account under sub-section (1) shall be utilized by the assessee before the expiry of a period of eight years from the end of the previous year in which the amount was credited.
- Or if the ship which was purchased within 8 years from the amount credited in the reserves and is sold within 3 years from the end of the year of purchase.

Section 41 – Clause 25

- Liability which is time barred but not written back in the accounts
 - CIT Vs. Vardhman Overseas Ltd. 343 ITR 408 (Del)
 - CIT Vs. Bhogilal Ramjibhai Atara 88 CCH 49 (Guj)
 - Contra view : ITO Vs. Shailesh D. Shah – Mum ITAT – itatonline.org – doubting genuineness
- Refund of excise duty / sales tax etc. where the department is in appeal at higher forums – whether section 41 gets attracted ? *
 - CIT Vs. Hindustan Housing and Land Development Trust Ltd. 161 ITR 524 (SC) – Regarding compensation for land acquisition not taxable if there is an appeal pending

Clause 26 -43B

- The details are required to be provided in two parts,
 1. Part A-The liability which existed on the beginning of the year, disallowed for non payment in the last year. Will be allowed in current year if paid, also details are to be provided if not paid by the end of the financial year.
 2. Part B-Incurred during the year and paid before the due date of filling the return, or not paid by that date.

Clause 26 – Section 43B

- Section 43B is a disallowance section – Taxes paid in advance though not due as per law not allowable as deduction on payment basis
 - Gopikrishna Granites India Ltd v. DCIT (251 ITR 337)(AP)-Not allowed.
 - Hindustan Lever limited v. V.K. Pandey, JCIT, (251 ITR 209) (Bom)-Fav
 - **CIT Vs. Modipon Ltd. (SC) – itatonline.org - Advance deposit of central excise duty in the Personal Ledger Account (PLA) constitutes actual payment of duty within the meaning of s. 43B and the assessee is entitled to the benefit of deduction of the said amount**
 - **107 Taxmann.com 177 Glaxo Smithkline Consumer Healthcare Ltd. (2019)**
- Both Employer and Employee Contribution is allowable as deduction in the year of actual payment if not allowed earlier – *CIT Vs. Ghatge Patil Transports Ltd. 368 ITR 749 (Bom.)*
- Circular No. WSU/9(1) 2013/ Settlement – Dt. 8-1-16 – Availability of 5 days of grace has been discontinued
- **(g) any sum payable by the assessee to the Indian Railways for the use of railway assets**

Clause 27-CENVAT Credit Details

- The form refers in rules to CENVAT credit which is no more available. Thus a view that this clause is redundant
- The utility however has been changed to include input tax credit, this without changing the rule. Can utility override the rule?
- However, the auditor may fill up input tax credit (GST) as per books in this clause. Alternative view is that this clause is NA. like clause 28 which is not deleted.

Clause 29-56(2)(ix) /(x)

- **29A-Forfeiture of advances / deposits not covered**
- Provide details regarding the advance or deposit forfeited and earned.
- Provide the nature of income and amount of transactions not resulting in transfer of asset. Taxable under IFOS.
- It is not possible to find this out unless the assessee discloses the same, adequate MR may be obtained.

Clause 29-56(2)(x)

- **29B-Whether any amount is to be included as income chargeable under the head 'Income from other sources' as referred to in section 56(2)(x)?**

Check Receipt of money

- Whether money received is without consideration and exceeding Rs. 50,000

Receipt of Immovable Property

- Whether received without considerations or consideration less than FMV.
- Check if difference between consideration and FMV is in excess of 50,000 or 5% of consideration.

Note: FMV should be lesser of Stamp Duty Value or Valuation by DVO.

Clause 29-56(2)(x)

Receipt of Movable Property

- Whether received without considerations or consideration less than FMV.
- Check if difference between consideration and FMV is in excess of 50,000
- It is difficult ascertain a receipt under this clause. The auditor would to have to take an MR and rely on the same. A very Honorious responsibility set on the auditor.

Sec. 56(2)(x) – Statutory Amendments

- Section 56(2)(x) : Merger of Erstwhile Section 56(2)(vii) and 56(2)(viia) w.e.f. 1-4-17
- 56(2)(vii)
 - Applicable to Individual / HUF
 - For Money / Immovable Property / Other Property for no consideration or inadequate consideration
- 56(2)(viia)
 - Applicable to Firm / Company(public are not interested)
 - For shares of a Company(public are not interested) for no consideration or inadequate consideration
- 56(2)(x) - Applies to All assesses for Money / Immovable Property / Other Property

Sec. 56(2)(x) - Issues

- Whether fresh issue of shares is covered
 - Khoday Distilleries Ltd. Vs. CIT 307 ITR 312 (SC) – Allotment of shares is appropriation out of unappropriated share capital – Does not amount to transfer
- Whether Bonus shares received will be covered
 - CIT Vs. Dalmia Investment Co. Ltd. 52 ITR 567 (SC) – Bonus shares are without payment but not without consideration
- Whether Right Shares subscribed at less than FMV will be covered
 - Proportionate allotment
 - Disproportionate allotment
 - Sudhir Menon HUF Vs. ACIT 148 ITD 260 (Mum.)

Sec. 56(2)(x) – Rule 11UA Issues

- FMV of unquoted equity shares to be made as per formulae in Rule 11UA(1)(c)(b) - Rule amended w.e.f. 1-4-2018 i.e. A.Y. 2018-19
- Value as per amended Rule = $(A+B+C+D-L) \times (PV) / (PE)$
- If company A's shares are to be valued and Company A holds shares of company B, C & D then the FMV of all these has to be found for valuing shares of A
 - One needs to compute value of each step down companies in the process.
 - Difficulties in cases where shares of many companies are owned by the company whose shares are to be valued.
 - Difficulties in getting the data for the step down companies which are not group companies.
 - No threshold provided – Even if one share of an unlisted company is owned – calculation is necessary

269ST Receipt of Cash > 2 Lakhs

- Section 269ST

- Receipt of an amount of Rs. 2 Lakhs or more prohibited Otherwise than
 - Account Payee cheque / draft / Electronic clearing system
- In aggregate from a person in a day
 - Different bills totalling to Rs. 2 Lakhs or more
- In respect of a single transaction
 - A bill more than 2 Lakhs – payment on each day less than 2 Lakhs in cash
- In respect of transaction relating to one event / occasion from a person
 - *Same person receiving more than Rs. 2 Lakhs by cash in respect of a single event.*
 - *Type of product or services may be same or different.*

Restriction on Cash Transactions

- Excluded-
 - Receipts by Government,
 - Receipts by any banking company, post office savings bank or co-operative bank
 - Transactions of the nature referred to in Sec. 269SS
 - Any other person or class of persons to be notified – Notification No. 57 Dt. 3-7-2017 (Mainly banking Industry)
- Relaxation
 - For NBFC and Housing Finance Companies – Each Instalment is a transaction – Circular No. 22 Dt. 3-7-17
- Section 271DA
 - Penalty equal to amount of receipt
 - No penalty if proved that there are good and sufficient reasons for contravention - Proviso to 271DA – also section 273B
 - Penalty to be levied by Jt. Commissioner

Issues in 269SS/269ST/269T

- Transactions by Journal Entries
 - CIT Vs. Triumph International Finance Ltd. ITA No. 5745 of 2010 (Bom. HC)
 - CIT Vs. Noida Toll Bridge Co. Ltd. (2003) 262 ITR 260 (Del.)
 - CIT Vs. Bombay Conductors & Electricals Ltd. (2008) 301 ITR 328 (Guj)
 - **Recently SLP admitted by SC in case of Shakti Foundation 107 Taxmann.com 460 . Though it had rejected an SLP in Adinath Builders earlier. 102 Taxmann.com 57**
- Cash Withdrawn from Bank ? – CBDT Press Release Dt. 5-4-17
- Partnership and Partners
 - Cash withdrawn from partnership firm for Drawings or otherwise
 - Cash brought in by partners as capital
 - Cash taken for Expense purposes – Balance to be replenished.

Clause 31-S 269SS/ 269T/ 269ST

269SS-Receipt (Cl.a & b)

(a)Receipt of
loans

(b)Receipt of
specified sum

269ST (Cl.ba to bd)

Cl. ba &bb
Receipt(Above
Rs 2 Lakhs)

Cl. bc & bd
Payment(Above
Rs 2 Lakhs)

269T- Repayment (Cl.c)

Repayment of
Loan
Details

269T- Receipt Cl. d & e

Receipt of
Loan
given
earlier in
cash or
otherwise
then
account
payee
cheque

Recent Amendment in form 3CD for 269SS/269ST/269T

- New reporting requirement: Consequent to substitution of section 269SS by the Finance Act 2015 including within its scope specified sum receivable in relation to transfer of an immovable property, sub-clause (b) of new clause 31 requires reporting of particulars of each specified sum in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year.

Recent Amendment in form 3CD for 269SS/269ST/269T

- New reporting requirement – The reporting requirement in respect of section 269T was earlier required only in case of the person making the repayment of loan or deposit or any specified advance. Under the new clause 31, reporting is also to be done by the recipient. The recipient has to furnish the name, address and PAN (if available with him) of the payer and the amount of loan or deposit or any specified advance received
- (1) under sub-clause (d), in case the repayment is received otherwise than by a cheque or bank draft or ECS
- (2) under sub-clause (e), in case repayment is received by a cheque or bank draft, which is not an account payee cheque or account payee bank draft.

Clause 32(a) Brought forward losses

- Clause 32(a):Details of brought forward loss or depreciation allowance, in the following manner, to the extent available;
 1. The amount of brought forward loss or depreciation allowance is required to be quantified as per return and assessment orders.
 2. At times when 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.
 3. Provisions contained in section 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/provisional orders for the earlier years and ascertain if the figures given in the above clauses are correct

Clause 32(b)-S 79

- Clause 32(b):whether the change in the shareholders 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 case a company, not being a company in which the public is 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 in which the loss was incurred, the shares of the company carrying not less than 51% of the voting power was beneficially held by the same person.

Clause 32 – Explanation to Sec. 73

- Explanation applies where any part of business of company includes buying and selling of shares of company
- Exceptions carved out
- Amendment – Company whose principle business is trading in shares also covered in exception w.e.f. A.Y. 2015-16
- What about set off of the losses of past in similar transaction – whether speculative or non speculative ?
 - Fiduciary Share & Stock P. Ltd. Vs. ACIT 159 ITD 554 (Mum.)

Clause 32 – Section 79

- Past losses are not allowed to be set off in a case where the change in shareholding results in diversion of voting power to the extent of more than 51%
- CIT Vs. Amco Power Systems Ltd. 379 ITR 375 (Kar).
 - What is relevant is voting power and not shareholding pattern
 - Change of shareholding between the existing shareholders will not have any impact

Clause 34(a)-Details of tds deducted.

- The clause requires the auditor to reconcile the tds deducted under the various section under chapter XVIIIB with the heads of income under the profit and loss account.
- Ideally a reconciliation needs to be prepared and kept on record.
- Any amount specified under column 8,9 & 10 would lead to action by the department.
- One will have to give the total amount paid under a section in column 4. (would include payments where forms are received and lower deduction/nil deduction certificate received)

Clause 34(b) – Amendment

- Information required about the statement of TDS / TCS like Type of Form, Due Date of Furnishing, Actual Date of Furnishing etc.
 - **Amendment** : Information will be required to be given once the assessee is required to furnish the statements of TDS / TCS
- Earlier Tax Auditor was only required to state whether all the transactions which are required to be reported are reported or not in the TDS statement - Yes or No

Clause 34(b) – Amendment

- Now the Tax Auditor will also need to prepare a comprehensive list of all the transactions which were **required to be reported but not actually reported.**
- **What about the concept of Test Check ??**
- Whether all the transactions have to be reported here or only the transactions in which TDS is deducted ?
 - No Deduction due to certificates / Forms
 - No Deduction due to threshold limit not exceeded

Clause 34(c) – Interest Payable

- Section 201(1A) – Interest Calculations for delay in payment of TDS
 - 1% p.m or part of a month from date on which deductible to date of deduction
 - 1.5% p.m. or part of a month from date of deduction to date of payment
- Part of a month – Month whether calendar month or period of 30 days :
 - CIT Vs. Arvind Mills Ltd. 204 Taxman 38 (Guj) – Sec. 244A
 - Oil & Natural Gas Commission Vs. ACIT 62 taxman.com 133 (Ahd.)
 - Navayuga Quazigund Expressway (P.) Ltd. Vs. DCIT 64 taxman.com 212 (Hyd.)

Is the interest paid for tds default allowable as business exp?

Clause 36 – Deemed Dividend

- I. Section 115O 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 at the rate of 18% plus surcharge at the applicable rate along with the cess thereon has to be reported against this clause
- II. Dividend as per section 2(22)(e) is also covered i.e. 01/04/2018

In that case tax is at the rate of 30% is to be paid instead of 18%

Clause 36A – Deemed Dividend

- New clause 36A requires information to be given for Amount of Deemed Dividend as per sec. 2(22)(e) and date of receipt
- Subject of Deemed Dividend is prone to tremendous litigation
- Practical Difficulties
 - How to find out accumulated profit of the payer company
 - Possession of Accumulated Profits on the date of transaction
 - Accumulated profits which can be distributed and which cannot be distributed – Bifurcation to be made

Clause 36A – Issues

- Who is to be taxed – Registered share holder or beneficial share holder
 - ACIT Vs. Bhaumik Colour Pvt. Ltd. 118 ITD 1(Mum. SB)
 - CIT Vs. Universal Medicare Pvt. Ltd. 324 ITR 263 (Bom.)
 - CIT Vs. Ankitech Pvt. Ltd. 340 ITR 14 (Del.)
 - CIT Vs. National Travel Services 347 ITR 305 (Del.)
 - National Travel Services Vs. CIT 401 ITR 154 (SC) – Issue referred to a larger bench
 - Gopal and Sons HUF Vs. CIT 145 DTR 289 (SC) – Loan given to HUF treated as deemed dividend

Clause 36A – Deemed Dividend

- Loans Vs. Deposits
 - Inter corporate deposits are not loans – not subject to 2(22)(e) – Bombay Oil Industries Ltd. Vs. DCIT 28 SOT 383 (Mum.)
- Advances made in the ordinary course of business for business exigencies
 - CIT Vs. Ambassador Travels P. Ltd. (Del.)
 - CIT Vs. Creative Dyeing & Printing P. Ltd. 318 ITR 476 (Del.)
 - Sri Satchidanand S. Pandit V. ITO 19 SOT 213 (Mum.)
 - NH Securities Ltd. V. DCIT 11 SOT 302 (Mum.)
- Transactions in the nature of Current Account
 - ITO Vs. Gayatri Chakraborty 45 ITR 197 (Kol.)(Trib.) – affirmed by Kol HC in CIT Vs. Gayatri Chakraborty 94 taxmann.com 244 (Kol.)
 - CIT Vs. India Fruits Ltd. 274 CTR 67 (AP)
 - **CBDT Circular No. 19/2017 Dt. 12-6-2017**

Clause 36A – Deemed Dividend

- Inclusions and Exclusions
 - Accumulated Profits shall be commercial profits and not assessed income – CIT Vs. P. K. Badiani 105 ITR 642 (SC)
 - Capital Profits not to be included – Tea Estate India Pvt. Ltd. Vs. CIT 103 ITR 785 (SC)
 - Profit earned u/s. 41(2) is not part of Accumulated Profit – CIT Vs. Urmila Ramesh 230 ITR 422 (SC)
 - Revaluation Reserve – Book entry – May not be included
 - Development Rebate Reserve and Investment Allowance Reserves – to be included
 - Share Premium and Share forfeiture – Capital Reserves – Dy. CIT Vs. Maipro India Ltd. 116 TTJ 791 (Del.) / Jaikishan Dadlani Vs. ITO 4 SOT 138 (Mum.)
 - Amount treated as Deemed Dividend in past is to be excluded for determining Accumulated Profits CIT Vs. G. Narsimhan 118 ITR 60 (Mad.)

Clause 36A – Deemed Dividend

- Exception – Substantial part of Company's Assets and Income must be from money lending business
 - ❖ Substantial does not mean More than 50% - If it is not trivial then exception applies – CIT Vs. Parle Plastics Ltd. 332 ITR 63 (Bom.)
- Deemed Dividend u/s. 2(22)(e) brought within the purview of 115O with effect from A.Y. 2019-20 – Will it not be appropriate to call for these details from the auditor of payer companies.

Clause 42- Form 61/61A/ 61B

- Form No. 61 – Particulars of Declaration received in Form No. 60
- Form No. 61A – Statement of SFT u/s. 285BA(1)
- Form No. 61B – Statement of Reportable Account u/s. 285BA(1)
- Information to be given
 - ITDREN
 - Type of Form
 - Due Date of Furnishing Return
 - Date of Furnishing
 - Whether the form contains information about all transactions – If not give details for transactions which are not reported.

Clauses 30A and 30B

- Clause 30A – Information about primary adjustment and consequential secondary adjustment – Repatriation of amount of primary adjustment to India – Interest on amount not repatriated etc.
 - Time limit available for repatriation is 90 days from the due date of Return
 - Primary adjustment made by will be known only at the stage of assessment – How to report at audit stage ? Whether to report for the earlier year's adjustment made ?
- Clause 30B – Sec. 94B - Thin Capitalization – Interest to be restricted to 30% of EBITDA
 - Similar information in Form 3CEB – Duplication of work

Clause 30C – GAAR-DEFERRED

- Whether the assessee has entered into Impermissible Avoidance Arrangement as per section 96 – If yes give Nature of IAA and Amount of Tax Benefit to **ALL PARTIES** to Agreement
 - Labeling an arrangement as Impermissible is perception of AO and not assessee
 - Does an Auditor have power of AO to make detailed investigation to find such IAA
 - Reference to Pr. CIT and also GAAR panel is required
 - How the benefit to other parties will be determined
 - Auditor whether a watchdog or a blood hound ?

Clause 43 – CBC Reporting

- International groups required to furnish country by country report – Section 286(2)
- Clause 43 – If Sec. 286 applicable – give details
 - Whether report furnished by assessee or parent entity or alternate reporting entity
 - Name of Parent entity
 - Name of alternate reporting entity (if applicable)
 - Date of furnishing report
- Time limit available u/s. 286 is 12 months from end of accounting year – Report may not have been filed though applicable

Clause 33 – Chapter VI A

- Section 80-IB – “Derived from Vs. Attributable to”
- Liberty India Vs. CIT 317 ITR 218 (SC) – DEPB License not entitled to deduction u/s. 80-IB
- CIT Vs. Meghalaya Steels Ltd. 383 ITR 217 (SC) – Transport subsidies / Power Subsidies / Interest Subsidy
- Excise Duty Refund
 - CIT Vs. Dharmpal Premchand Ltd. 317 ITR 353 (Del.)– Pre Liberty India
 - CIT Vs. Meghalaya Steels Ltd. 332 ITR 91 (Gau.) – Post Liberty India
- Exchange Rate Difference – *CIT Vs. Rachna Udhyog* 230 CTR 72 (Bom.)
- VAT Incentive - M/s. Diamond Tools Industries Vs. JCIT – ITA No. 136/Mum/2009 – Order dated 14-12-2011
- First Degree nexus necessary for claiming deduction

Date of Audit Report

- Language of Section 44AB
- Audit Report to be obtained before the due date and Return to be filed on or before due date
- If Audit Report Dated – 30th September – whether 44AB violated ?
 - Chandra Kumar Seth Vs. ITO 62 ITD 106 (All.)
 - Chopra Properties Vs. ACIT ITA No. 6199/Del/2015 – itatonline.org

Broad Message.

CA – **C**onsistent **A**chiever

Change is the only constant.

Learn , Unlearn and Relearn



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