

Tax audit under Section 44AB of the Income Tax Act, 1961



Articles Orientation Programme

The Chamber of Tax Consultants

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Coverage



- ❖ Purpose of Tax audit
- ❖ Approaching Tax Audit
- ❖ Overview of Section 44 AB and its applicability
- ❖ Audit report –applicability of Form 3CA / 3CB
- ❖ Statement of Particulars- Form 3CD

Coverage



- ❖ Difference between Statutory audit and Tax audit (Areas of divergence)
- ❖ Ethical requirements
- ❖ Documentation

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Purpose of Tax audit



- ❖ To enable Assessing officer compute the income and consequent tax liability of the assessee based on the information certified by the Tax auditor
- ❖ Standardised Format of information (Statement of particulars) to be certified by the Auditor
- ❖ Applies to business / professional income

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Overview of Section 44 AB



Business:

- ☞ Applies to every person carrying on business if total sales / turnover/ gross receipts exceed Rs. 1 crore;
- ☞ Applies to every person carrying on business as referred to in s 44AE, 44 BB, 44 BBB and income from said business is declared lower than that prescribed under these sections
- ☞ Applies to every person carrying on business as referred to in s 44AD and income from said business is declared lower than that prescribed under these sections
- ☞ Tax audit provisions (s 44AB) not applicable if a person declares profits and gains in accordance with s 44AD and his total sales/ turnover/ gross receipts do not exceed Rs. 2 crore

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Overview of Section 44 AB



Profession:

- ☞ Applies to every person carrying profession if gross receipts exceed Rs. 50 Lakhs (earlier limit was Rs. 25 Lakhs)
- ☞ Applies to every person carrying on profession and if the person claims his income lower than deemed profits and gains under s 44ADA

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Overview of Section 44AB



- ☞ The assessee to get his accounts audited by an accountants before the specified date and furnish the tax audit report (now e-filing of tax audit report mandatory)
- ☞ Applies to both residents and non-residents (NR)
- ☞ Not applicable to NR engaged in operations of ships
- ☞ Not applicable to NR engaged in operations of aircrafts

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Section 44AD



- ☞ S 44AD represents presumptive system of taxation
- ☞ Eligible assessee doing eligible business can opt to declare presumptive income @ 8% of the total sales / turnover / gross receipts (6% if amount received by way of account payee cheque/ account payee bank draft / electronically (NEFT/ RTGS etc.) before due date of filing of return.
- ☞ LLPs, Companies and NRs are not eligible assessee for the purpose of s 44AD

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Section 44AD



- ☞ Eligible business means any business except the business of plying, hiring or leasing goods carriages referred to in s 44AE and
- ☞ Whose total turnover / gross receipts does not exceed **Rs. 2 Crore (limit now increased w.e.f. A.Y. 2017-18, earlier limit was Rs. 1 Crore)**

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Profession



- ☞ Profession u/s 44AA(1):
- ☞ Accountancy
- ☞ Architectural
- ☞ Authorised representative
- ☞ Company Secretary
- ☞ Engineering
- ☞ Film Artists
- ☞ Interior Decoration
- ☞ Legal
- ☞ Medical
- ☞ Technical consultancy
- ☞ Information technology

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Tax audit applicability to Corporates / non-corporates



- ☞ Certification of Form 3CD Statement of particulars (applicable in case of all assesseees liable to Tax audit)
- ☞ Audit opinion- Form 3CA (for corporates following April-March financial year/ Statutory Audit mandated under governing law)
- ☞ Audit opinion-Form 3CB (for non-corporates and statutory audit not mandated under the governing law + Corporates following different financial year)

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Meaning of total sales / turnover / gross receipts



- ☞ The terms total sales / turnover /gross receipts not defined under the Income Tax Act
- ☞ Understand the meaning of these terms as per guidance given in the ICAI Guidance Note on Tax audit
- ☞ Exclusions / inclusions from Turnover / Gross receipts

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Inclusions in Turnover



- ❧ Sale of scrap/by product
- ❧ Sales proceeds of shares, securities, debentures, etc, held as stock-in-trade by the Assessee
- ❧ Commission on sales
- ❧ Sales Tax/Excise Duty if included in the Sale price as per the inclusive method of accounting followed by the Assessee

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Exclusions from Turnover



- ❧ Sales Tax/Excise Duty if the Assessee follows exclusive method of accounting for taxes and such taxes are credited to a separate liability account.
- ❧ Sales proceeds of Fixed Assets.
- ❧ Sales proceeds of Investment property.
- ❧ Sales proceeds of shares, securities, debentures held as an Investment.
- ❧ Trade discounts allowed in the Invoice.
- ❧ Turnover discount even if allowed by way of separate credit note.
- ❧ Ancillary charges such as packing charges, freight etc. if, identified separately

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Applicability of tax audit in certain cases



- ☞ Applicability to stock brokers

- ☞ Calculation of limit in case of securities
 - Delivery based transactions
 - Speculative transactions
 - Derivatives, Futures and options

- ☞ Agricultural income

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Penalty for non-compliance



- ☞ S 271B -@ 0.5% of the total sales, turnover or gross receipts or Rs. 1.50 Lakhs, whichever is less

- ☞ Reasonable opportunity of being heard before levy of penalty

- ☞ No penalty if reasonable cause is demonstrated

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Steps for checking applicability of tax audit



- ☞ Check whether Assessee carrying on business or profession
- ☞ Check the respective limits under s 44AB and its applicability
- ☞ Check the applicability of presumptive provisions if turnover below threshold (44AD / 44ADA)
- ☞ If assessee opts for presumptive scheme no tax audit
- ☞ If assessee does not opt for presumptive scheme, then Tax audit applicable

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Tax Audit and Statutory Audit -Areas of Divergence



- ☞ Applicability
- ☞ Frequency
- ☞ Qualification / Disqualifications
- ☞ Appointment formalities
- ☞ Rotation

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Tax Audit and Statutory Audit -Areas of Divergence



- ☞ Scope and audit opinion
- ☞ Addressing of Audit opinion
- ☞ Format of audit opinion
- ☞ True and fair vs. True and Correct
- ☞ Ceiling on number of audits

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Ceiling, Ethical issues & ICAI Guidelines



- ☞ 60 Tax audits assignments
- ☞ Communications with the previous auditor
- ☞ Who can not conduct tax audit
- ☞ Appointment formalities
- ☞ Terms of engagement

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Form 3CA (Audit report)



1. *I / we report that the statutory audit of M/s. _____
 (Name and address of the assessee with Permanent Account Number) was
 conducted by *me / us / M/s. _____
 in
 pursuance of the provisions of the _____ Act,
 and *I/we annex hereto a copy of *my / our / their audit report dated
 _____ along with a copy of each of :-
- (a) the audited *profit and loss account / income and expenditure
 account **for the period beginning from -----to ending on**
 -----.
- (b) the audited balance sheet as at, _____; and
- (c) documents declared by the said Act to be part of, or annexed to, the
 *profit and loss account / income and expenditure account and balance
 sheet.

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Form 3CA (Audit report)



2. The statement of particulars required to be furnished under
 section 44AB is annexed herewith in Form No. 3CD
3. In *my / our opinion and to the best of *my / our information
 and according to examination of books of account including other
 relevant documents and explanations given to *me / us, the
 particulars given in the said Form No.3 CD are **true and correct**
subject to the following observations/qualifications, if any:
- a.
- b.
- c.

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Standard Qualifications



- ❧ Proper books of account, to enable reporting in Form No. 3CD, have not been maintained by the Assessee.
- ❧ All the information and explanations which to the best of my/our knowledge and belief were necessary for the purpose of my/our audit has not been provided by the assessee.
- ❧ Documents necessary to verify the reportable transaction were not made available
- ❧ Proper stock records are not maintained by the assessee.

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Standard Qualifications



- ❧ Records produced for verification of payments through account payee cheque not sufficient.
- ❧ Amount of expense related to exempt income under s 14A of the Income Tax Act, 1961 could not be ascertained
- ❧ Creditors under Micro, Small and Medium Enterprises Development Act, 2006 are not ascertainable.
- ❧ Prior period expenses are not ascertainable from books of account.
- ❧ Fair market value of shares under s 56(2)(vii-a)/(vii-b) is not ascertainable

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Standard Qualifications



- ❧ Valuation of closing stock is not possible.
- ❧ Yield/percentage of wastage is not ascertainable.
- ❧ Records necessary to verify personal nature of expenses not maintained by the assessee.
- ❧ TDS returns could not be verified with the books of account.

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Standard Qualifications



- ❧ Reports of audits carried by Excise/Service Tax Department were not made available.
- ❧ GP ratio is not ascertainable from the financial statements prepared by the assessee.
- ❧ Information regarding demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth Tax Act was not made available.
- ❧ Others

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Form 3CB (Audit Report)



- ☞ 1. *I / we have examined the balance sheet **as on**, _____, and the *profit and loss account / income and expenditure account **for the period beginning from** ----- **-----to ending on** -----, attached herewith, of
- (Name), _____ (Address),
 _____ (Permanent Account Number).
- ☞ 2. *I / we certify that the balance sheet and the *profit and loss / income and expenditure account are in agreement with the books of account maintained at the head office at _____ and ** _____ branches.

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Form 3CB (Audit Report)



- 3.(a) *I / we report the following observations / comments / discrepancies / inconsistencies; if any:
- _____
- (b) Subject to above, -
- (A) *I / we have obtained all the information and explanations which, to the best of *my / our knowledge and belief, were necessary for the purpose of the audit.
- (B) In *my / our opinion, proper books of account have been kept by the head office and branches of the assessee so far as appears from *my / our examination of the books.

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Form 3CB (Audit Report)



*(C) In *my / our opinion and to the best of *my / our information and according to the explanations given to *me / us, the said accounts, read with notes thereon, if any, give a true and fair view :-*

(i) in the case of the balance sheet, of the state of the affairs of the assessee as at 31st March; and

*(ii) in the case of the *profit and loss account / income and expenditure account of the *profit / loss or *surplus / deficit of the assessee for the year ended on that date.*

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Form 3CB (Audit Report)



4. *The statement of particulars required to be furnished under section 44AB is annexed herewith in Form No.3CD.*

5. *In *my/our opinion and to the best of *my / our information and according to explanations given to *me / us, the particulars given in the said Form No.3 CD are true and correct **subject to following observations/qualifications, if any:***

- a,*
- b.*
- c.*

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Form 3CD



- ☞ Statement of Particulars
- ☞ In two parts- Part A & Part B
- ☞ Part A- Basic Information
- ☞ Part B- Other information

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Clause 1-6



- ☞ Clause 1-6 Basic information about the assessee
 - Clause 4- Registration nos. in respect of indirect taxes
 - Clause 8- Indicate relevant clause of s 44AB under which the Tax audit has been conducted

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Clause 9 /10/11



- ☞ Clause 9- In case of Firm or Association of Persons, indicate names of partners and their profit sharing ratios and particulars of change, if any, in the partners /members or profit sharing ratios, if any
- ☞ Clause 10- Nature of business / profession and particulars of change, if any
- ☞ Clause 11- Books of account prescribed / maintained Books of account and **nature of documents** examined

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Clause 12 /13



- ☞ Clause 12- Whether profit and loss account includes any profits and gains assessable on presumptive basis, if yes indicate the amount and the relevant section
- ☞ Clause 13- Method of accounting employed
-if there is a change, then impact on the Profit and Loss

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Clause 13



- ☞ Notification dated 29th September 2016 amended Clause 13
- ☞ "(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:

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Clause 14 / 15



- ☞ Clause 14- Method of valuation of closing stock

In case of deviation from method of valuation prescribed under s 145 A, then impact on profit and loss

- ☞ Clause 15- Particulars of the capital asset converted into stock in trade
 - Description of capital asset
 - Date of acquisition
 - Cost of acquisition
 - Amount at which the asset is converted into stock-in trade

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ICDS



- ☞ Notification dated 29th September 2016 notifying 10 ICDS
- ☞ CBDT issued FAQs on ICDS vide Circular 10/2017 23rd March 2017
- ☞ Implications of ICDS

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Clause 16/17



- ☞ Clause 16- Amount not credited to profit and loss account (duty drawback, refund of duty, service tax refunds etc. admitted as due by the concerned authorities)
- ☞ Clause 17- Transfer of Asset u/s 43CA & 50C (applicable to land or building)
 - 43CA applies to business assets (held as stock in trade)
 - 50C applies to capital assets
- ☞ Transfer at a consideration less than the stamp duty valuation (give details in prescribed format)

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Clause 18



☞ Clause 18- Depreciation

- Description of block of asset
- Rate of depreciation
- Actual cost or W.D.V. as the case may be
- Additions / deductions during the year with dates
- Details of adjustments on account of CENVAT, change in forex rates, subsidy /grant
- Depreciation allowable
- W.D.V. at the end of the year

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Clause 19 / 20



☞ Clause 19-Amounts admissible u/s 32AC / 33AB/33ABA/ 35 etc.

☞ Clause 20-Bonus / Commission to employees and Employees contribution to Provident and other funds

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Clause 21



☞ Clause 21-Amounts debited to Profit and loss account

- Capital expenditure/ Personal expenditure / Advertisement expenditure / Club expenditure /Penalty or fine for violation of law
- Amounts inadmissible under s 40(a)(i) / (ia)
- Interest, salary, bonus, commission, remuneration inadmissible u/s 40(b) / 40(ba)
- Disallowance u/s 40A(3) / (3A)

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Clause 21



- Provision for gratuity u/s 40A(7)
- Sum not allowable u/s 40A(9)
- Particulars of any liability of contingent nature
- Amount of deduction inadmissible u/s 14A
- Amount inadmissible under proviso to section 36(1)(iii)

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Clause 22 /23/24



- ☞ Clause 22-Interest inadmissible u/s 23 of MSMED Act, 2006
- ☞ Clause 23-Payments to persons specified u/s 40A(2)(b)-Related parties
- ☞ Clause 24-Deemed profits / gains u/s32AC/ 33AB/33ABA/33AC

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Clause 25 /26



- ☞ Clause 25-Deemed profits / gains u/s 41
- ☞ Clause 26-Taxes /duties and other sums covered under s 43B
 - ☞ -Tax/ duty/ cess etc.
 - ☞ Employer contribution to P.F. / E.S.I.C. /Superannuation / Gratuity fund
 - ☞ Bonus / commission to employees
 - ☞ Interest on loan from Financial institutions / Banks
 - ☞ Sum payable to employees in respect of leave entitlement

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Clause 27 /28



- ☞ Clause 27- CENVAT credit availed of /utilised during the year and its treatment in Profit and Loss
- ☞ Particulars of income or expenditure of prior period credited or debited to Profit and Loss Account
- ☞ Clause 28- Acquisition of shares covered u/s 56(2)(viiia)
 - *Refers to shares of private limited / closed held companies*
 - *Shares received without consideration / for inadequate consideration*
 - *Equity / Preference shares both included*
 - *Valuation as per methodology prescribed under Rule 11UA(1)*

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Clause 29



- ☞ Clause 29-Consideration for issue of shares covered u/s 56(2)(viib)
 - *Applies to fresh issue of shares*
 - *Applies to private limited companies / closely held companies issuing shares*
 - *Receipt of consideration exceeding FMV of the shares issued*
 - *Valuation methodology prescribed under Rule 11UA(2)*

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Clause 30/31/32



- ☞ Clause 30-Amount borrowed / repaid on Hundi
- ☞ Clause 31-Acceptance / repayment of loan / deposit u/s 269SS / 269 T
- ☞ Clause 32-Unabsorbed losses/ depreciation and speculation loss

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Clause 33 /34 /35 /36



- ☞ Clause 33-Deductions admissible under chapter VIA / Chapter III
- ☞ Clause 34- Compliance with TDS / TCS provisions
- ☞ Clause 35-Quantitative details for Trading / Manufacturing concerns
- ☞ Clause 36- Tax on Distributed profits u/s 115-O (grossing up)

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Clause 37 /38/39/40 /41



- ❧ Clause 37- Cost Audit
- ❧ Clause 38- Central Excise Audit
- ❧ Clause 39- Service Tax audit
- ❧ Clause 40- Accounting ratios and Business parameters
- ❧ Clause 41- Particulars of demand raised / refund issued under other laws

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Documentation



- ❧ Register for Tax audits
- ❧ Checklist for 3CD and relevant documentation
- ❧ Separate Management Representation letter
- ❧ Preserve audit working papers
- ❧ Important for Peer review as the Tax audit is an attest function

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