

***Western India Regional Council
of
The Institute of Chartered
Accountants of India***

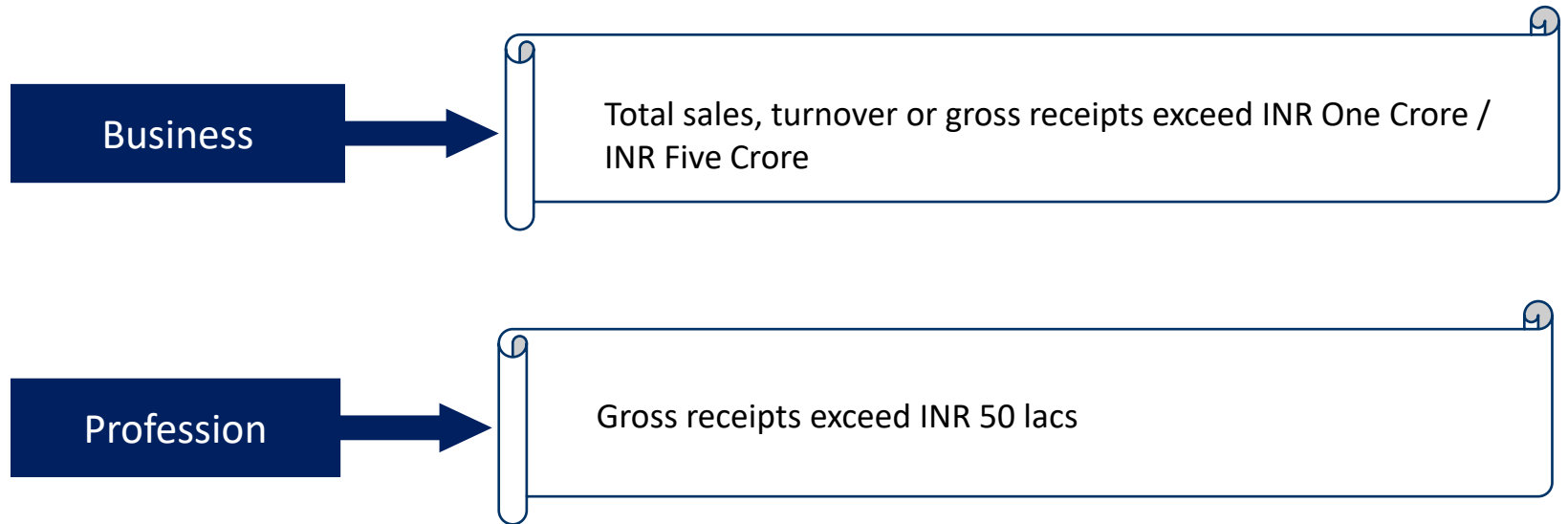
Seminar on Tax Audit

C.A. Malay Deliwala

14th September 2020

Basic Principles

Basic Principles...



Ghai Construction v. State of Maharashtra 184 Taxman 52 (Bom HC) – Tax audit is only in respect of business carried on by the assessee and not in respect of his income from other sources.

CIT v. Manmohan Das (59 ITR 699) – Whether a particular activity can be classified as business or profession will depend on facts of each case. Profession involves idea of an occupation requiring intellectual skill or manual skill as distinguished from an operation which is substantially production or sale

Finance Act 2020 Amendments

Insertion of Proviso

Provided that In case of person whose:

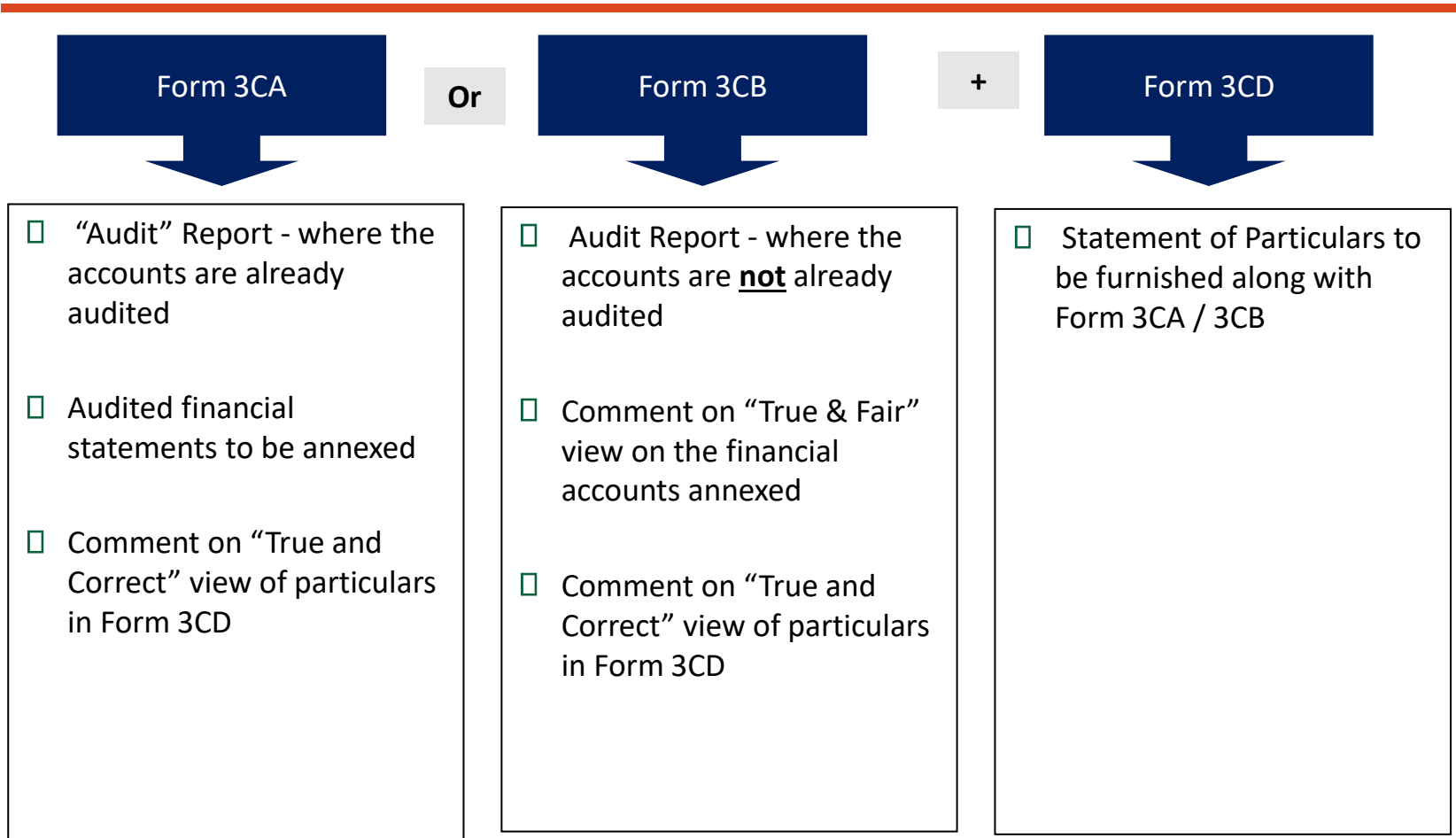
- aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed five per cent of the said amount; and
- aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed five per cent of the said payment,

this clause shall have effect as if for the words “one crore rupees”, the words “five crore rupees” had been substituted

Limit increased from INR 1 Cr to INR 5 Cr only if:

- ***Aggregate of all amounts received in cash do not exceed 5% of said amt and***
- ***Aggregate of all Payments made in cash do not exceed 5% of said payment***

Basic Principles...



Notes to Tax Audit Report – Possible?

Presumptive taxation - Glimpse

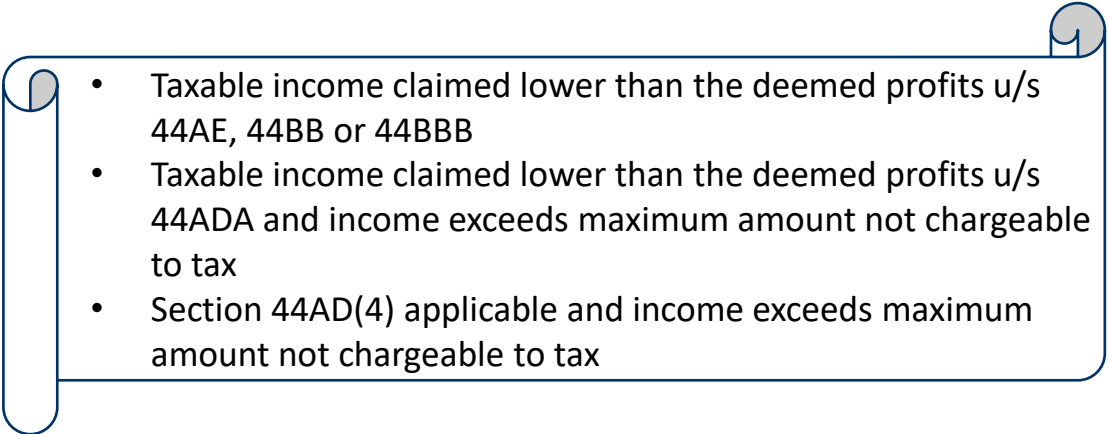
Tax Audit in Special cases

Presumptive taxation

- Sec 44BB - profits and gains in connection with the business of exploration of mineral oils
- Sec 44BBB - profits and gains of foreign companies engaged in civil construction, in certain turnkey power projects
- Sec 44AD – profit and gains of business on presumptive basis
- Sec 44ADA - profit and gains of profession on presumptive basis
- Sec 44AE - business of plying and hiring carriages

Special cases



- 
- Taxable income claimed lower than the deemed profits u/s 44AE, 44BB or 44BBB
 - Taxable income claimed lower than the deemed profits u/s 44ADA and income exceeds maximum amount not chargeable to tax
 - Section 44AD(4) applicable and income exceeds maximum amount not chargeable to tax

Presumptive taxation - Glimpse

Particulars	44AD	44ADA	44AE
Applicability	<ul style="list-style-type: none"> Individual, HUF or firm (not LLP) No deduction claimed u/s 10AA and Chapter VIA (Heading C) Turnover \leq 2 cr. 	<ul style="list-style-type: none"> Professional referred to in section 44AA Gross receipts \leq 50 lacs 	<ul style="list-style-type: none"> Plying, leasing or hiring of trucks, owning not more than 10 trucks at any time during the year
Deemed Income	<ul style="list-style-type: none"> 6% of the Turnover received by account payee cheque/ bank draft or ECS 8% of turnover not covered above 	50% of Gross Receipts	<p>For Heavy Goods Vehicle— Rs. 1,000/- per ton p.m. (Heavy Goods vehicle means goods carriage with gross vehicle weight exceeding 12000 kgs)</p> <p>For other goods vehicle – Rs. 7,500/- per month or amount actually earned w.e.higher</p>

Presumptive taxation - Glimpse

Particulars	44AD	44ADA	44AE
Business deduction	<ul style="list-style-type: none"> Deduction under section 30 to 38 deemed to have been allowed 		
Deduction under Chapter VI-A	<ul style="list-style-type: none"> Allowed (except for Chapter VI-A Heading C) 	<ul style="list-style-type: none"> Allowed 	<ul style="list-style-type: none"> Allowed
Books of accounts and Tax Audit	<ul style="list-style-type: none"> Not required Basic Records – cash book/ bank book – to ascertain the turnover, WDV of the assets 		
Maintenance of books and audit required in case of lower income declared	<ul style="list-style-type: none"> Required if, 44AD(4) applicable and Income exceeds maximum amount not chargeable to tax 	<ul style="list-style-type: none"> Required if income exceeds maximum amount not chargeable to tax 	Required

Section 44AD(4)

44AD “(4) Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section and he declares profit for any of the five assessment years relevant to the previous year succeeding such previous year not in accordance with the provisions of sub-section (1), he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of sub-section (1).

*(5) Notwithstanding anything contained in the foregoing provisions of this section, an eligible assessee to whom the **provisions of sub-section (4) are applicable and whose total income exceeds the maximum amount which is not chargeable to income-tax**, shall be required to keep and maintain such books of account and other documents as required under sub-section (2) of section 44AA and get them audited and furnish a report of such audit as required under section 44AB.”*

Section 44AD(4) (Applicable from AY 2017-18)

Situation	Audit Consequences	Other Consequences
Assessee not opted for presumptive income for AY 2018-19 and AY 2019-20 but has income exceeding basic exemption limit	<ul style="list-style-type: none">• Section 44AD(4) – Not applicable• Conditions for section 44AD(5) – not satisfied• No audit	Benefit of section 44AD in subsequent years available
Assessee opt for presumptive for AY 2018-19 and AY 2019-20	<ul style="list-style-type: none">• Not required	Compulsory to declare income u/s 44AD for 5 subsequent years
Assessee opt for presumptive for AY 2018-19 and not for AY 2019-20	<ul style="list-style-type: none">• Income exceeds maximum amount chargeable to tax• Then tax audit	No benefit for 5 years beginning from AY 2020-21

Applicability of AS

Applicability of Accounting Standards

- Section 133 of the Companies Act 2013 requires every company to comply with AS and IND AS, as the case may be.
- ICAI announced the scheme for applicability of AS to non-companies
- Classifies non-corporate entities into 3 Levels
- Level I- comply with all AS
- Level II and Level III –
 - No relaxation in respect of recognition and measurement principles
 - Exempted from AS which lay down disclosures requirement
- AS apply in respect of commercial, industrial or business activities
 - Not applicable – pure charitable activity
- Ensure compliance with mandatory AS to report on ***whether the accounts are “true and fair”***

In case AS issued, prescribed and made mandatory by the ICAI have not been followed by enterprise other than company – qualify tax audit report.

Accounting Standards – Criteria for classification of entities

Level I

- Whose equity or debt securities are listed or are in the process of listing – in India or outside India
- Bank, FI or entities carrying on insurance business
- Turnover (excluding Other income) > 50 cr. in immediately preceding accounting year
- Borrowings (including public deposits) > 10 cr. in immediately preceding accounting year
- Holding and subsidiary entities of any one of the above

Level II

- Turnover (excluding Other income) > 1 cr. in immediately preceding accounting year
- Borrowings (including public deposits) > 1 cr. in immediately preceding accounting year
- Holding and subsidiary entities of any one of the above

Level III

- Not covered under Level I and Level II

General Issues

General Issues...

Items to be included in turnover:

- Cash discount – it is a financing charge (otherwise than that allowed in cash memo/sales invoice)
- Sale of scrap
- Sale of by product
- Sales proceeds of shares, securities, debentures etc. held as stock-in-trade
- Special rebate which is in the nature of commission on sales

Items to be excluded from turnover:

- Ancillary charges-packing, freight, forwarding, interest etc.
- Sale proceeds of fixed asset
- Cash discount allowed in cash memo/sales invoice
- Trade discount
- Price adjustments
- VAT and other indirect taxes collected/ collectible

General Issues...

Items to be included in gross receipts:

- Receipt in kind
- Cash incentives / duty drawback
- Advances received from customers and forfeited
- Exchange differences on export sales
- Out of Pocket expenses charged to clients in the invoice
- Liquidated damages
- Interest / rental income – if business income

Items to be excluded from gross receipts:

- Sale proceeds of fixed assets/ assets held as investments
- Dividend on shares except for assessee dealing in shares
- Interest / Rental income unless assessable as business income
- Capital receipts
- Advance forfeited in respect of fixed assets
- Write back of amounts no longer payable to creditors
- Write back of provisions
- Share of profits of a partner from a partnership firm/ LLP

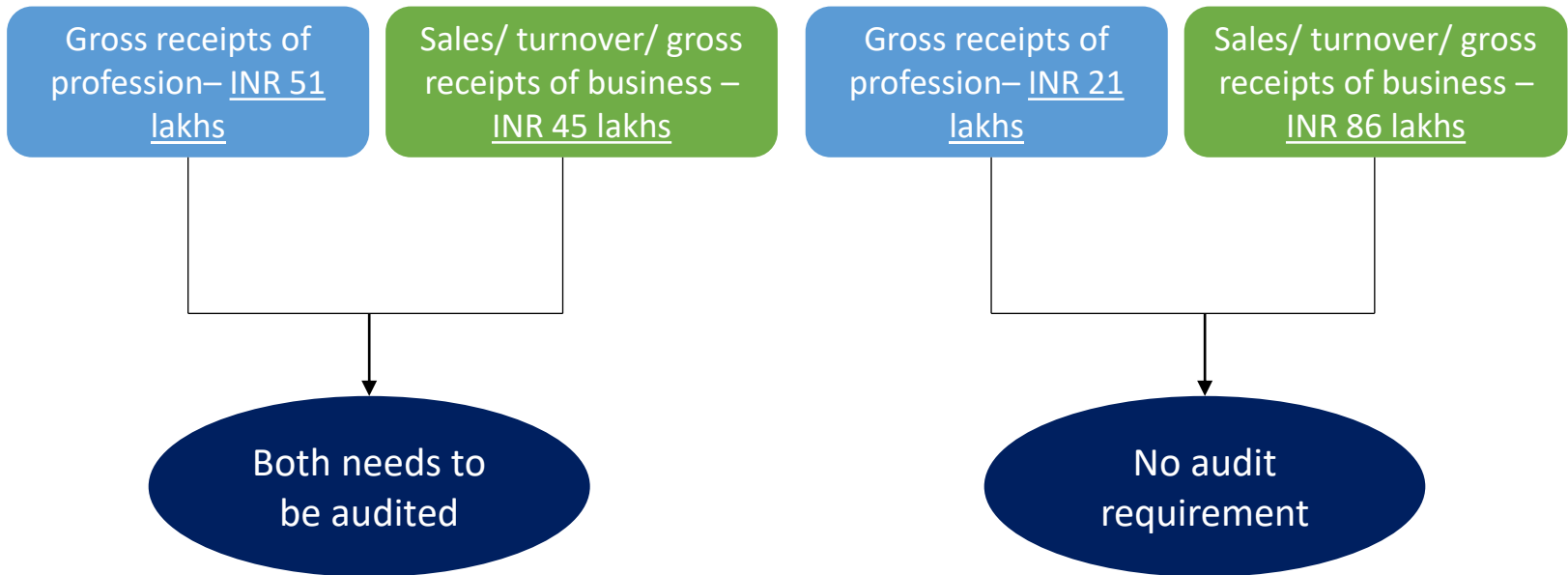
General Issues...

- Whether gross receipts /sales/turnover exceeds prescribed limits - to be determined in each financial year independent of the results obtained in preceding years
 - impact on withholding tax liability under Chapter XII for individuals and HUF
- Income of a person is below taxable limit
 - tax audit is applicable if threshold is exceeded
- Assessee carries on 2 or more business activities
 - the results of all business activities should be clubbed together
- Two partnership firms with common or same partners - independent assesses
- If Assessee opts to be assessed under respective sections on presumptive basis, the turnover thereof should be excluded

General Issues...

Where assessee carries on both business and profession

Para 5.20 of Guidance Note



General Issues...

- **Advance received for services to be rendered – to be included in gross receipts?**
 - ICAI's view: Such receipts are liabilities and not a part of gross receipts until services are rendered
 - However, ITAT (Lucknow) in case of *Gopal Krishan Builders [2004] 91 ITD 124* upheld a contrary view
 - Held that the scope of the word “gross receipts” is quite wide to include advances also
- **Share brokers/sub-brokers – How to compute 1 crore limit?**
 - Only brokerage income to be taken into account
- **Salaried person having income from investment in shares**
 - Investment, income/loss is assessable under the head “Capital Gains” and not to be included in turnover

General Issues...

- **Speculative Transactions / Derivative, Futures & Options**

- Contract is squared up by paying out differences (positive or negative)
- Contract Note issued for full value of asset purchased or sold
- Entries in books of accounts are only of the differences

- ICAI's view Speculative Transaction

- Aggregate of both differences to be treated as “turnover”

Particulars	profit / (loss)
Contract 1	70
Contract 2	(50)
Turnover	120

- Contrary view:

- *Growmore Exports Ltd. (Mumbai ITAT 78 ITD 95)*
- *Om Stock & Commodities (Mumbai ITAT 48 taxmann 186)*

“...No delivery has taken place. The account has been settled only by crediting the difference...No turnover was effected at all...” and hence assessee was not liable to get the accounts audited under section 44AB of the Act

General Issues...

- **Delivery based transactions**

- To determine if the transaction is in the course of business or as investment
- If business – included in turnover
- If investment – not included in turnover

Relevant Form 3CD - Clauses

Clause 11 – Books of Accounts

- Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed
 - List of books of account maintained and the address at which the books of accounts are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of accounts are not kept at one location, please furnish the addresses of locations along with the details of books of accounts maintained at each location.)
 - List of books of account and nature of relevant documents examined.
-
- Section 44AA read with Rule 6F
 - Prescribes books only for specified professional
 - For business and non-specified professionals – such books which enables AO to compute the total income
 - Clause 11(a) – affirmative only in case of professionals
 - Requirement of Books of accounts
 - Income exceeds Rs. 1,20,000 or sales, turnover or gross receipts exceeds Rs. 10,00,000 in any of the 3 preceding years.
 - Income lower than profits deemed under section 44AE, 44BB or 44BBB
 - Provisions of 44AD(4) are applicable and income exceeds minimum amount which is not chargeable to tax

Clause 12 – Presumptive Income

Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant section (44AD, 44ADA, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, Chapter XII-G, First Schedule or any other relevant section.)

- Reporting the amount credited to Profit & Loss Account satisfies the requirement of this clause
- Tax Auditor is not required to indicate whether such amount corresponds to amount assessable under the relevant section
- Guidance Note provides reporting requirement under different scenarios of Presumptive income
 - Covered in case study

Clause 13 – Method of Accounting

13 (a) Method of accounting employed in the previous year

(b) Whether there had been any change in the method of accounting employed vis-à-vis the method employed in the immediately preceding previous year.

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

(d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2)

(e) If answer to (d) above is in the affirmative, give details of such adjustments

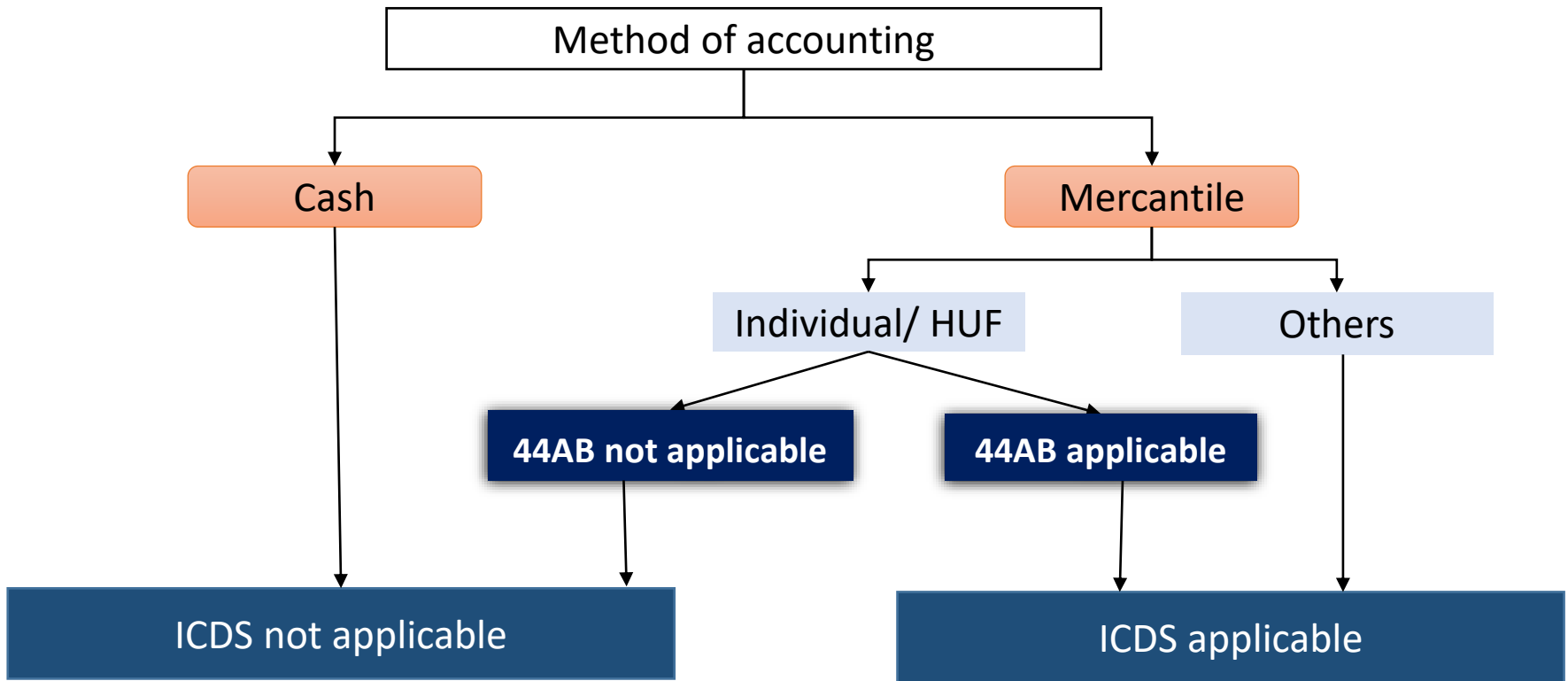
(f) Disclosure as per ICDS

Clause 13(a), (b) and (c)

- Method of accounting permissible - Cash or Accrual
 - Companies – compulsory accrual (Companies Act)
 - Separate method for different heads of income - Possible
- Not possible to quantify the effect - appropriate disclosure should be made
- Change in accounting policy cannot be treated as change in method of accounting – need not mention under clause 13(b)
 - E.g. Method of valuation of stock

Clause 13 – Method of Accounting

Clause 13(d), (e) and (f) – Deals with ICDS



Only for computing income under PGBP and IFOS

Clause 13 – Method of Accounting

- Disclosure required by ICDS (FAQ No. 25)
 - Net effect on the income due to application of ICDS to be disclosed in the Return of income;
 - Disclosures under ICDS to be made in the tax audit report in Form 3CD;
 - No separate disclosure requirements for persons who are not liable to tax audit
- ICDS applicable to taxpayers covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc.? – Even though tax audit is not required – ICDS FAQ 3 – Shall be applicable for determination of Turnover / Gross receipts

ICDS – Brief Background



Writ petition filed challenging the vires of ICDS before the Delhi HC



Delhi HC held certain provisions of ICDS to be ultra vires vide order dated 8 November 2017



The Finance Act, 2018 carried out certain retrospective amendments effective from AY 2017-18 nullifying certain aspects of the Delhi HC decision.

ICDS I – Accounting policies

Concept of Prudence

- AS 1 – non recognition of anticipated profits and recognition of anticipated losses
- ICDS - expected losses or mark to market losses shall not be recognized unless permitted by any other ICDS

Year	Loss	Income	Computation	
			Income-tax	Books
1	Expected - 5,000	Actual – 1000	1000	(4000)
2	Actual - 5000	Actual - 1000	(4000)	1000

ICDS I – Accounting policies

Disclosures

- Significant accounting policies including any change in it which has material effect in current and likely to have effect in future years.
- The amount by which an item is affected by change shall also be disclosed.
- Disclosure or change in policy cannot remedy wrong or inappropriate item of income.
- If fundamental accounting assumptions of going concern, consistency and accrual are not followed the fact needs to be disclosed else not.

ICDS III - Construction Contracts

Disclosures

- The amount of contract revenue recognized as revenue in the period
- The methods used to determine the stage of completion of contracts in progress

For contracts in progress -

- the amount of costs incurred and recognized profits less recognized losses upto the reporting date
- the amount of advances received
- the amount of retentions

ICDS for real estate developer has not yet been notified

ICDS VI – Effect of changes in foreign exchange rates

Exchange difference on monetary item relating to capital asset

- AS - recognition in P&L or capitalize as per Para 46/46A
- ICDS – recognition in P&L subject to section 43A
 - Section 43AA provides gain or loss arising on account of effects of changes in foreign exchange rates to be treated as income or loss as per ICDS
 - In respect of monetary items, exchange difference **shall be recognised** as income or as expense
 - In respect of non-monetary items, exchange difference **shall not be recognised** as income or as expense

ICDS VIII – Securities

Valuation at the end of the year

- AS - Individual Scrip wise Valuation
- ICDS - Category wise Valuation
 - Classification into four categories namely,
 - (a) shares;
 - (b) debt securities;
 - (c) convertible securities; and
 - (d) any other securities not covered above.
- Introduction of Section 145A

ICDS VIII – Securities

Illustration for valuation at the end of the year

Shares	Cost	NRV	Valuation as per AS 13	Valuation as per ICDS
A Ltd	100	40	40	
X Ltd	200	140	140	
B Ltd	300	150	150	
C Ltd	100	500	100	
	700	830	430	700

ICDS IX – Borrowing Cost

Qualifying asset

- AS – Land is not a qualifying asset
- ICDS - Land is qualifying asset
 - Capitalisation of interest attributable to acquisition
 - Depreciation not allowed
 - Impact on Capital gains at the time of sale

Commencement of capitalisation

- AS – three conditions viz. incurrence of capex, incurrence of borrowing costs and preparatory activities are in progress
- ICDS –
 - specific borrowings - Date on which funds were borrowed
 - General borrowings – Date on which funds were utilized.

Suspension of Capitalisation

- AS – when active development of the asset is interrupted
- ICDS - No specific provision

ICDS IX – Borrowing Cost

Capitalisation method – specific borrowing

- AS - Actual borrowing costs **less** any income from temporary investment of those borrowing
- ICDS – actual borrowing cost to be capitalized
 - income from temporary investment taxable as IFOS
 - **Contrary ruling**
 - Tuticorin Alkali Chemicals [1997] (227 ITR 172) (SC) - interest income earned from temporary deployments of funds has to be offered to tax immediately
 - Karnal Co-operative Sugar Mills Ltd [2001] 118 Taxman 489 (SC) – interest income is a capital receipt which would go to reduce the cost of asset

Disclosures

- Accounting policy adopted for borrowing cost and
 - The amount of borrowing cost capitalized during the previous year
-

Clause 16 – Amounts not credited to the profit and loss account

Amounts not credited to the profit and loss account, being, -

- a) The items falling within in the scope of section 28;
- b) The proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax or Goods & Services Tax, where such credits, drawbacks or refund are admitted as due by the authorities concerned;
- c) Escalation claims accepted during the previous year;
- d) any other item of income;
- e) Capital receipt, if any.

- Sub clauses (a), (d) & (e) to be reported on the basis of entries in the books of account and records made available
- Sub clauses (b) and (c) require information in respect of items which may also be covered under sub-clause (a)
- Those items which are reported in clauses 16(b) and (c) need not be reported in clause 16 (a).
- Management Representation in writing may be obtained for reporting under all sub-clauses

Clause 16 – Amounts not credited to the profit and loss account

Clause 16(a)

- Business income in general and specific items listed in section 28
 - Partner's remuneration and interest taxable u/s. 28(v)
 - Incentives in kind taxable u/s.28(iv) – Loan waiver
 - FMV of inventory converted into capital assets

Clause 16(b)

- 'admitted by the concerned authorities' would mean 'admitted by the authorities within the relevant previous year'
- Credits/claims admitted as due after the relevant previous year need not be reported here
- Such amount is reported but netted against the relevant expenditure - bring out such fact clearly

Clause 16 – Amounts not credited to the profit and loss account

Clause 16(c)

- accepted – signified unconditional acceptance during the relevant previous year constitute accepted claims
- No reporting where-
 - Claims have been merely made
 - Claims under negotiation
 - Claims which are sub-judice [CIT v. Hindustan Housing & Land Development Trust Ltd. [1986] 161 ITR 524 (SC)]
- Assessee following cash system of accounting
 - Acceptance without actual receipt has no significance
 - Mention the fact that it is not received during PY

Clause 16(d)

- Scrutinize all the items including casual and nonrecurring items appearing in the books of account
- Income (e.g. income referred to in section 41(1) or section 43CA) which is not credited to profit and loss account

Clause 16 – Amounts not credited to the profit and loss account

Clause 16(e)

- Illustrative list
 - Capital subsidy received in the form of Government grants which are in the nature of promoters' contribution
 - Government grant related to specific fixed asset and deduction from its value
 - Compensation for surrendering certain rights.
 - Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.
- No reporting for loans and borrowings

Clause 17 – Transfer of Land / Building

Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, please furnish:

Details of property	Consideration received or accrued	Value adopted or assessed or assessable
<ul style="list-style-type: none">• Section 43CA – Transfer of asset (other than a capital asset) being land or building or both• Section 50C – Transfer of capital asset being land or building or both• No distinction between depreciable asset and non-depreciable asset• Exempted transfers u/s 47?<ul style="list-style-type: none">• Transfers exempt u/s 47 should ideally be reported under Clause 17 – Enables Department to verify conditions for exemption• Date or agreement or date of registration – which value to be adopted?• Date of agreement may be considered only if part amount of consideration has been received before the date of agreement• Date of agreement – Agriculture land ; Date of Registration NA land – Which value to be reported?		

Clause 17 – Transfer of Land / Building

- **Definition of Transfer**
 - “Transfer” defined u/s 2(47) – applies to capital asset
 - Definition should not apply to transfer of stock in trade
 - Transfer of stock in trade may have to be construed in context of Transfer of Property Act
- **Stamp duty value disputed?**
 - Suitable note to be incorporated in the clause
- **Land and building shall also cover ‘any right in land or building’**

Clause 21 – Disallowance under section 14A

21(h) Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income

- Primarily responsibility of the auditee to furnish the details of amount of deduction inadmissible
 - Rule 8D is not mandatory
- Auditor to verify
 - If in agreement–
 - Report the amount
 - If not in agreement–
 - Qualified opinion–effect of difference is not so material
 - Adverse opinion–it is material and pervasive
 - Disclaimer of opinion–basis of disallowance has not been provided

Clause 23 – Related Party transactions

Particulars of payments made to a person specified under section 40A(2)(b)

- Name of Related Person
- PAN of Related Person
- Relation
- Nature of transaction
- Payment Made (Amount)

Procedure:

- Obtain full list of specified persons
 - Information supplied may be relied upon
 - Disclosure under AS-18 should be verified
- Obtain details of expenditure/payments made
- Scrutinise all items of expenditure/payments made
 - may be necessary to restrict the scrutiny only to such payments in excess of certain monetary limits depending upon the size of the concern and the volume of business

Clause 23 – Related Party transactions

Key considerations

- Reporting of only payments
 - Not required to exercise judgement regarding adequacy and reasonableness
 - Disallowance to be decided by AO
- No reporting of income
- Not applicable to discount allowed on sales to sister concerns – United Exports v. CIT 330 ITR 549 (Del)
 - actual payment must be made
 - expenditure incurred

Clause 29 – Section 56(2)(viib)

Whether during the previous year the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib), if yes, please furnish the details of the same.

- **Applicability**
 - Closely held companies
 - Issued of shares at premium to a resident
- Fair market value as per Rule 11UA
 - Book value approach
 - Assessee may opt for Fair value as per DCF method
- For determination of fair market value as per DCF method –valuation report of merchant banker must be obtained

Clause 29B – Section 56(2)(x)

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

(b) If yes, please furnish the following details:

(i) Nature of income :

(ii) Amount

Key Considerations

- Applicable in case of issue of shares?
 - Sudhir Menon HUF vs ACIT [2014] 148 ITD 260 - 56(2)(vii)(c) not applicable
 - ACIT v. Subodh Menon HUF [2019] 103 taxmann.com 15 (Mumbai - Trib.)
 - CBDT circular - Sec. 56(2)(vii)(a) shall not be applicable in cases of receipt of shares as a result of fresh issuance of shares
 - Circular withdrawn

Clause 30A – Secondary Adjustment

- (a) Whether primary adjustment to transfer price, as referred to in sub-section 1) of section 92CE, has been made during the previous year? (Yes/No)
- (b) If yes, please furnish the following details:—
 - (i) Under which clause of sub-section (1) of section 92CE primary adjustment is made?
 - (ii) Amount (in Rs.) of primary adjustment:
 - (iii) Whether the excess money available with the associated enterprise is required to be repatriated to India as per the provisions of sub-section (2) of section 92CE? (Yes/No)
 - (iv) If yes, whether the excess money has been repatriated within the prescribed time (Yes/No)
 - (v) If no, the amount (in Rs.) of imputed interest income on such excess money which has not been repatriated within the prescribed time:

Clause 30A – Secondary Adjustment

Key considerations

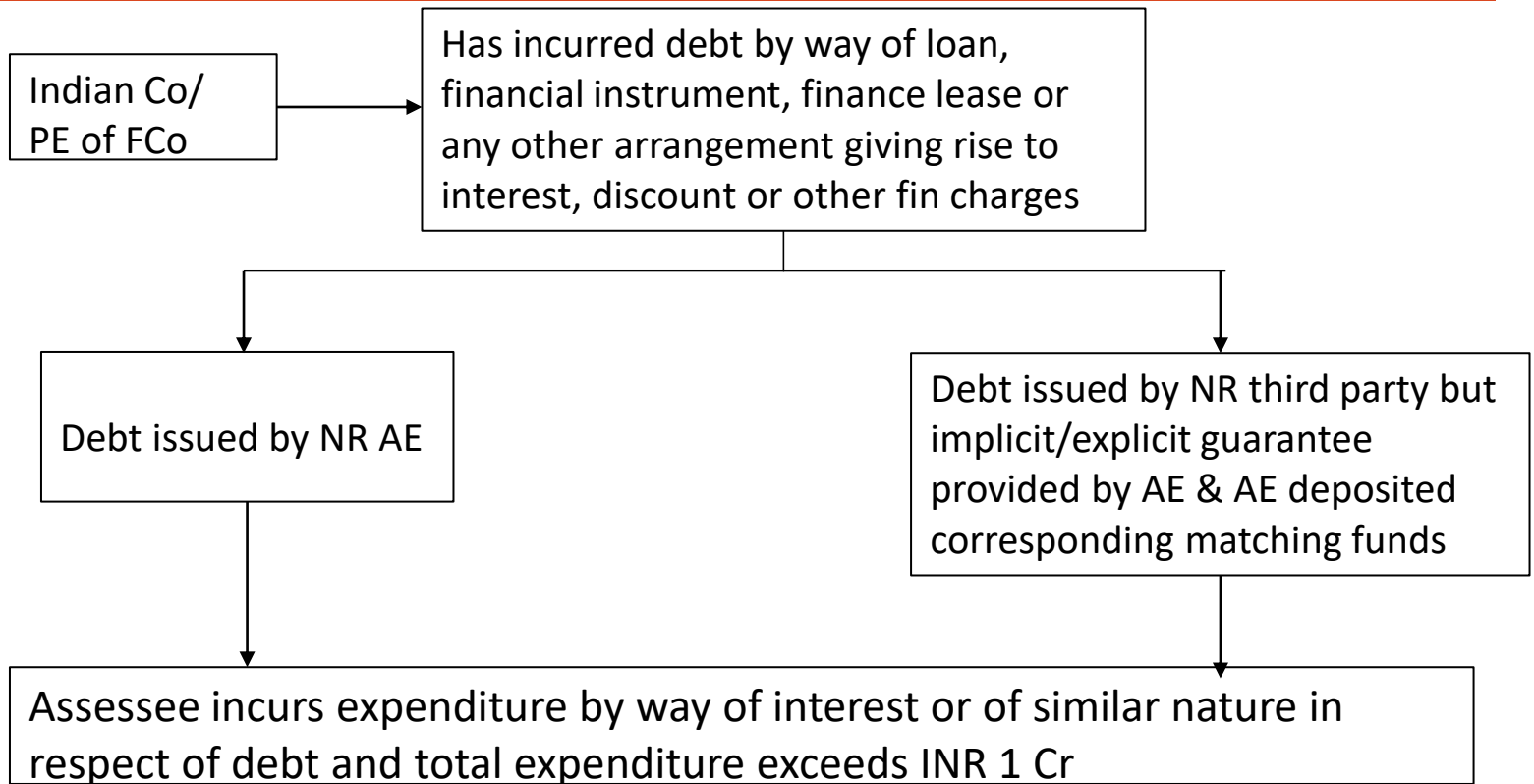
- Secondary adjustment to be made in case of specified primary adjustments
- Primary adjustment to transfer price-
 - Suo moto adjustment in return of income
 - Acceptance of adjustment made by AO
 - Determination in an APA
 - Adoption of safe harbor rules
 - Resolution under MAP
- Section not applicable if –
 - Amount of primary adjustment in any PY does not exceed INR 1 Cr
 - Primary adjustment made in respect of assessment year commencing on or before 1st April, 2016
- IF primary adjustment results in increase in total income or reduction in loss, excess money available with AE, if not repatriated to India within prescribed time, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed
- Rule 10CB prescribed the manner of computation of interest income pursuant to secondary adjustment

Clause 30A – Secondary Adjustment

Procedure:

- Obtain full list international transactions and specified transactions entered into by the assessee from Form 3CEB and Transfer Pricing study report maintained by the company
- Check whether requisite money has been repatriated from AE within time limit mentioned in Rule 10CB.
- Compute imputed interest income for the amount not yet repatriated.

Clause 30B – Thin Capitalisation



Section 94B applicable and excess interest to be disallowed

Excess interest – Total interest paid/payable to NR AE less 30% EBIDTA or actual interest paid or payable to NR AE w.e. less

Clause 33 – Chapter VI-A and Chapter III deductions

Section-wise details of deductions, if any, admissible under Chapter VIA or Chapter III (Section 10A, Section 10AA)

Section under which deduction is claimed	Amounts admissible as per the provision of the Income-tax Act, 1961 and fulfils the conditions, if any, specified under the relevant provisions of Income-tax Act, 1961 or Income-tax Rules, 1962 or any other guidelines, circular, etc, issued in this behalf.

- Tax Auditor should report whether assessee fulfils the conditions, if any specified under:
 - Relevant provisions of Act
 - Rules
 - Any other guidelines, circulars etc. issued in this behalf
- Where separate audit certificates to be furnished for claiming deduction – state the amount admissible basis such certificates

Clause 34(a)

(a) Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes please furnish:

Tax Deduction and collection Account Number (TAN)	Section	Nature of payment	Total amount of payment or receipt of the nature specified in column (3)	Total amount on which tax was required to be deducted or collected out of (4)	Total amount on which tax was deducted or collected at specified rate out of (5)	Amount of tax deducted or collected out of (6)	Total amount on which tax was deducted or collected at less than specified rate out of (7)	Amount of tax deducted or collected on (8)	Amount of Tax deducted or collected not deposited to the credit of the Central Government out of (6) and (8)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)

Clause 34(a)

- Obtain a copy of the TDS/TCS returns filed by the assessee which shall form the basis of reporting
- Auditor can apply test checks and compliance tests on the transactions reported in the TDS return due to voluminous nature
- Column 4 - aggregate of payments on which tax is liable to be deducted as well as not liable to be deducted
- Column (5) - total amount on which the tax was required to be deducted or collected.
 - Mismatch between column 4 and 5 - applicability of certificates u/s 195/197 for NIL withholding or threshold limits provided in respective section
- Column (6) - total amount out of the amount mentioned in column (5) at which the tax was deducted or collected at the specified rate
 - rate lower than the specified rate on the basis of certificate issued under section 195 or 197 will be considered as the specified rate for this clause

Clause 36 – Dividend Distribution tax

In the case of a domestic company, details of tax on distributed profits under section 115-O in the following form:

- a) total amount of distributed profits;
- b) amount of reduction as referred to in section 115-O (1A)(i);
- c) amount of reduction as referred to in section 115-O (1A)(ii);
- d) total tax paid thereon;
- e) dates of payment with amounts.

- Ascertain the gross amount of dividend paid from the notes to balance sheet
- Tax auditor should keep working papers to reveal how the net amount is arrived at
- Ascertain the date of payment from the duly received challan and books of account
- Ascertain the amount of dividend received from the subsidiary, if any, from the notes on —Related Party Transactions in the financial statements

Clause 36 – Dividend Distribution tax

Key consideration

- To ascertain:
 - Whether there is any distribution of debentures to shareholders or distribution of bonus to preference shareholders?
 - Whether there has been any reduction in capital?
 - Deemed dividend u/s 2(22)(e)

Clause 36A – Deemed Dividend

Whether the assessee has received any amount in the nature of dividend as referred to in sub-clause (e) of clause (22) of section 2? (Yes/No.)

If yes, please furnish the following details:—

(i) Amount received (in Rs.):

(ii) Date of receipt:

- With effect from AY 2018-19, Company liable to pay dividend distribution tax on payment of dividend as per section 2(22)(e)

Other relevant clauses

Clause 20(b) – Employees contribution towards PF/ superannuation fund/ other funds

- Section 36(1)(va) – allows deduction only if paid before due date
- Section 43B -applicable for employer contribution only
- Contrary rulings
 - Adverse
 - Gujarat State Road Transport Corporation [2014] 41 taxmann.com 100 (Guj)
 - Unifac Management Services (India) (P.) Ltd. [2018] 100 taxmann.com 244 (Madras)
 - Favourable
 - Rajasthan State Beverages Corpn. Ltd. [2017] 84 taxmann.com 173 (Rajasthan) – SLP dismissed by SC

Other relevant clauses

Clause 31 – Section 269SS, section 269ST, section 269T

- Transactions by Journal entry whether covered ?
- Whether to report such transactions?

Clause 32 – Details of brought forward loss or depreciation allowance

- Details to be provided as per return and assessment orders
- Applicability of Section 79

Case Studies

Applicability of Tax Audit

Case study 1 - Applicability of Tax Audit

1) Is tax audit applicable to such entity?

“A foreign Company has business income from India. It has no permanent establishment in India. There are no separate books of account for the Indian business.”

2) Is tax audit applicable when income is exempt under Section 10?

Case study 1 - Applicability of Tax Audit

Non-Residents

ICAI Guidance Note clarifies that

- **No distinction** between a resident and non-resident under the Section
- If turnover / gross receipts exceeds the threshold, then the non-resident assessee is also **required to get his accounts audited** and to furnish report under Section 44AB
- Since there are no separate books of account for the Indian business, tax auditor should obtain **relevant information from the overseas auditor** as regards the India business
- However, only business carried out in India should be covered
- Further, Section 44AD and 44ADA expressly applicable to residents only. However, in case Section 44AB, no such clarification

Case study 1 - Applicability of Tax Audit

Exempt income

ICAI Guidance Note clarifies that

- Section 44AB does not stipulate exemption from tax audit in case of exempt income
 - Trust carrying on business enjoying exemptions under sections 10(21), 10(23A), 10(23B), 10(23BB), 10(23C) or section 11
 - Co-operative society carrying on business enjoying deduction under section 80P
- Such institutions shall be governed by Section 44AB if their turnover / gross receipts in business exceeds the prescribed limit
- **Contrary view:** India Magnum Fund [2002] 81 ITD 295 (Mumbai)
 - If entire income of taxpayer is exempt under section 10, tax audit is not applicable even though turnover/ sales/ gross receipts exceed prescribed limits

Income below taxable limit - Section 44AB applicable if turnover/gross receipts exceeds prescribed limit

Assessment on Presumptive basis

Case study 2 - Books maintained for presumptive business

- Assessee is carrying out a business which has turnover of Rs. 70 lacs during FY 2018-19. Is it mandatory to apply Section 44AD? If assessee does not opt for Section 44AD and declares lower income, whether audit u/s 44AB would be mandatory?
- Similarly, in case where the assessee is carrying on the profession with gross receipts of Rs. 40 lacs during FY 2018-19, whether it mandatory to apply Section 44ADA?

Case study 2 - Books maintained for presumptive business

Approach to be adopted

- Unlike Section 44ADA, Section 44AD does not stipulate mandatory audit u/s 44AB if lower income is declared by the assessee. Therefore, even where an assessee declares lower income, audit u/s 44AB would not be mandatory
- However, under Section 44ADA, it is specifically provided that where income declared is lower than minimum amount, such assessee would be required to get accounts audited

Case study 3 - Books maintained for presumptive business

- Taxpayer has more than 1 business (including business assessed on presumptive basis)
- Regular books of accounts are maintained
- Profit & Loss account includes income from the business assessable on a presumptive basis
- How should the auditor report in Form 3CD?

Case study 3 - Books maintained for presumptive business

Approach to be adopted

- Apportionment of common expenditure to arrive at a correct amount of profit based on evidence in possession of assessee
- Such apportionment should arrive at a fair and reasonable estimate of such expenditure
- Basis of apportionment should be disclosed by tax auditor
- If tax auditor is not satisfied regarding the basis adopted – such fact shall be disclosed

Case study 4 - No books maintained for presumptive business

- Taxpayer has more than 1 business (including business assessed on presumptive basis)
- Regular books of accounts are maintained for main business
 - No books maintained for presumptive business
- Net income (from presumptive business) is credited to main Profit & Loss account
- How should the auditor report in Form 3CD?

Case study 4 - No books maintained for presumptive business

Approach to be adopted

- State net income shown in Profit & Loss statement
- Suitable Note in Form 3CD
- Tax auditor will not be able to form an opinion on true and fair view of the accounts
 - suitable qualification may be provided in the tax audit report in Form 3CB

Carry forward of losses

Case study 5 - Change in shareholding within same group

Clause 32(b) of Form 3CD

Composition of beneficial shareholding	Year 1	Year 2	Year 3
Mr. A	95%	40%	1%
Mr. B	5%	60%	50%
Mr. C	-	-	49%
Total	100%	100%	100%

Whether change in shareholding pattern of the company within the same group of shareholders hit by the embargo of section 79?

79 . Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year,—

(a) in the case of a company not being a company in which the public are substantially interested and other than a company referred to in clause (b), 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 the previous year, the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred;

Case study 5 - Change in shareholding within same group

Clause 32(b) of Form 3CD

Points to ponder

- The reference in the Section 79 is to 'persons' i.e. the phrase is used in plurality and not in singularity.
- On literal reading of provisions of Section 79, it would not apply if shares carrying 51% of the voting power continue to be held by the same group which held shares carrying 51% of the voting power in the year in which the loss was incurred, although within the group itself there may be any amount of change in shareholding
- **Sunanda Capital Services Ltd (28 SOT 484) (Mumbai – Trib.)**

Case study 6 - Change in shareholding between the years

Clause 32(b) of Form 3CD

Particulars	Year 1	Year 2	Year 3
Profit / (Loss)	(10,00,000)	(15,00,000)	30,00,000
Composition of beneficial shareholding			
Mr. A	80%		5%
Mr. B	20%	30%	50%
Mr. C	-	70%	45%

For the purpose of carry forward of loss incurred in a particular previous year, whether it is necessary that conditions stipulated under section 79 are required to be satisfied in each of the subsequent previous years until the previous year in which the set off is claimed?

79 . Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year,—

(a) in the case of a company not being a company in which the public are substantially interested and other than a company referred to in clause (b), 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 the previous year, the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred;

Case study 6 - Change in shareholding between the years

Clause 32(b) of Form 3CD

Points to ponder

View 1: Loss is allowable in year 3 as 51% of beneficial shareholders at year 3 matches with similar shareholding at year 1

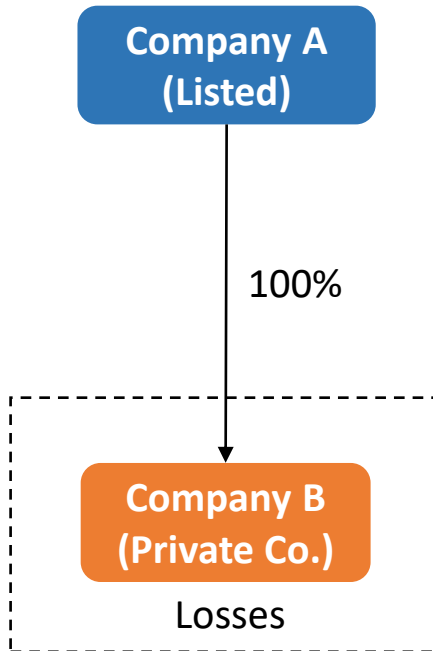
- On strict interpretation of Section 79, parity of beneficial holding is required with respect of the year of which loss is contemplated to be set off
- **M.D. Traders & Chit Fund Financiers (P) Ltd (178 ITR 388) (P&H)**
The change in the shareholding which was contemplated in the section was one which was found on the comparison between the position of voting power on the last date of the previous year for which the assessment was sought to be made and corresponding position of earlier year in which the loss was incurred which was claimed to be set off

View 2: If section 79 limitation is attracted in year 2, further carry forward of loss is not permissible

- The loss of year 1 has to enter computation process of year 2. Since there is change in shareholding in year 2, limitation of Section 79 is triggered in year 2 and hence no part of loss of year 1 can be carried forward and set off in year 2.
- Since loss is not successfully carried forward from year 1 to year 2, the same cannot be carried forward to year 3. As a result, loss of year 1 is not available for set off in year 3 even when the shareholding of year 3 is section 79(a) compliant

Case study 7 - Applicability of Section 79

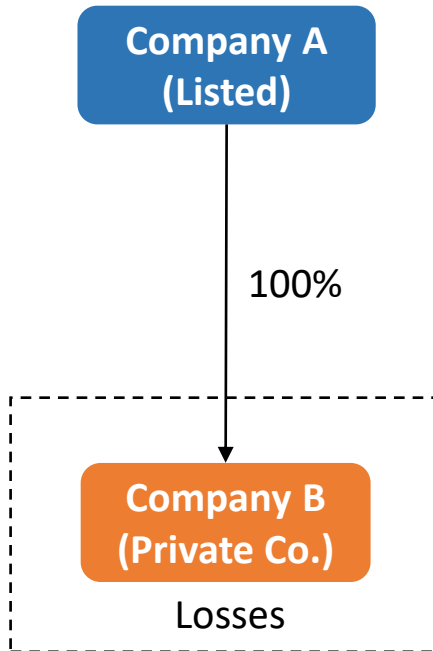
Clause 32(b) of Form 3CD



- Company B, a private limited company, is a WOS of Company A which is listed on recognised stock exchange.
- Company B has brought forward business losses and unabsorbed depreciation during FY 2018-19
- Evaluate the applicability of section 79 on Company B during FY 2018-19

Case study 7 - Applicability of Section 79

Clause 32(b) of Form 3CD



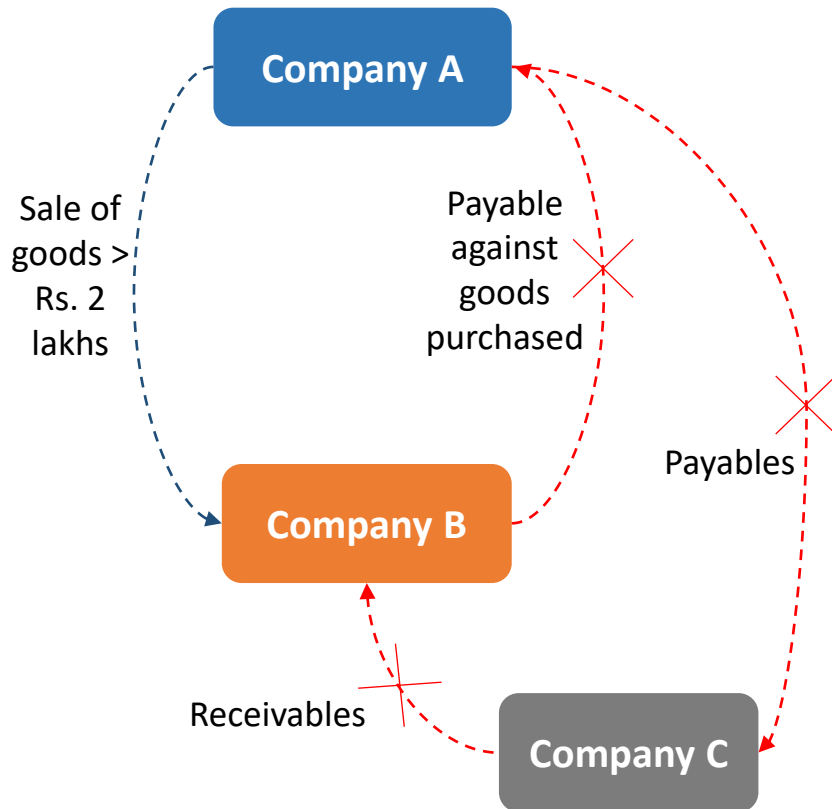
Points to ponder

- As per Section 2(18), WOS of listed company is also considered as company in which public are substantially interested
- However, Clause (b) of Section 2(18) does not apply to private company as per Companies Act, 1956
- As per Section 2(71) of the Companies Act, 2013, a company which is subsidiary of a company, not being a private company, shall be deemed to be public company even where such subsidiary company continues to be private company

Restriction on cash transactions

Case Study 8 - Receipt by journal entries

Clause 31 of Form 3CD



- Company B purchased goods from Company A worth Rs. 3,00,000 on credit basis
- Company A has dues payable to Company C
- Company B has dues receivable from Company C
- On the basis of internal arrangement between the 3 companies, Company A receives payment from Company B by set-off of inter-company balances

Section 269ST restricts receipts otherwise than through specified modes. Whether settlement of debt by book entry are also restricted?
How should such transactions be reported in Form 3CD?

Case Study 8 - Receipt by journal entries

Clause 31 of Form 3CD

Points to ponder

- A similar provision regarding loans and deposits exists in section 269SS and section 269T
- Courts are divided as to whether receiving loans and repayments through journal entry attracts section 269SS or section 269T
- Unfavourable ruling –
 - **Triumph International Finance (I) Ltd. 345 ITR 270 (Bom. HC)**
where loan/deposit has been repaid by merely debiting account through journal entries, it must be held that assessee has contravened provisions of section 269T

Case Study 8 - Receipt by journal entries

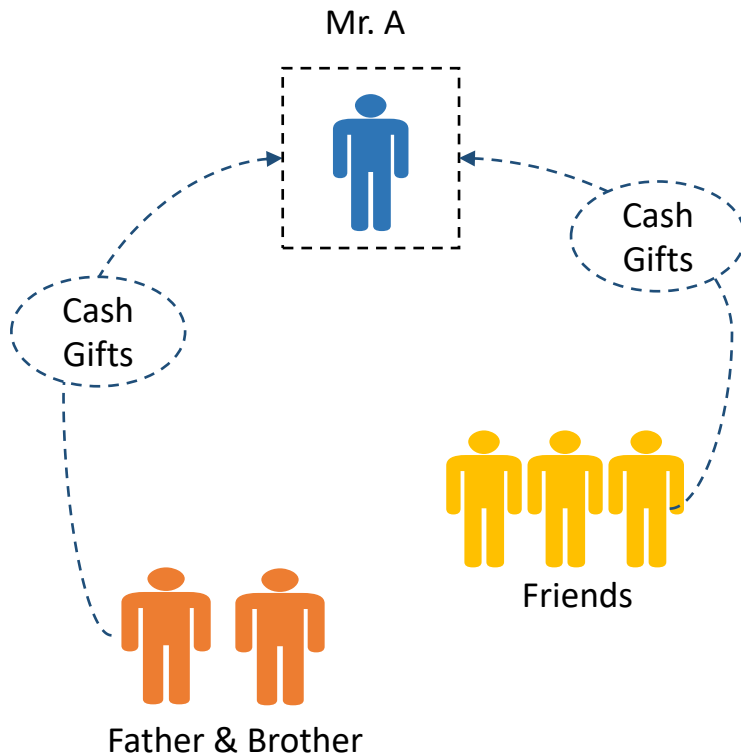
Clause 31 of Form 3CD

Points to ponder

- Favourable rulings –
 - **Worldwide Township Projects Ltd. (367 ITR 433) (Del. HC)**
Object of section 269SS is to prevent transaction in currency, it is not intended to affect cases where a debt or a liability arises on account of book entries
 - **Ajitnath Hi-Tech Builders (P.) Ltd. (92 taxmann.com 228 (Bom. HC) – SLP dismissed by SC**
There was reasonable cause to receive loan through journal entries. Non-compliance of section 269SS would certainly be a reasonable cause under section 273B for non imposition of penalty under section 271D
 - Vardaan Fashion (38 ITR(T) 247) (Delhi Trib.)**
- Objective of the provision is to discourage cash receipts. Hence, going by the intent of the provision, it may be argued that receipts through journal entries are not covered by section 269ST. However, such receipts are prone to litigation

Case Study 9 - Receipt by cash gifts

Clause 31 of Form 3CD



- Mr. A, received cash gifts in following manner –
 - Rs. 2,50,000 each from his father and brother on a single day
 - Rs. 1,80,000 each from his 10 friends on occasion of his marriage
- Evaluate the applicability of section 269ST
- Section 269ST, *inter alia*, states that –

“No person shall receive an amount of two lakh rupees or more

(a) in aggregate from a person in a day; or

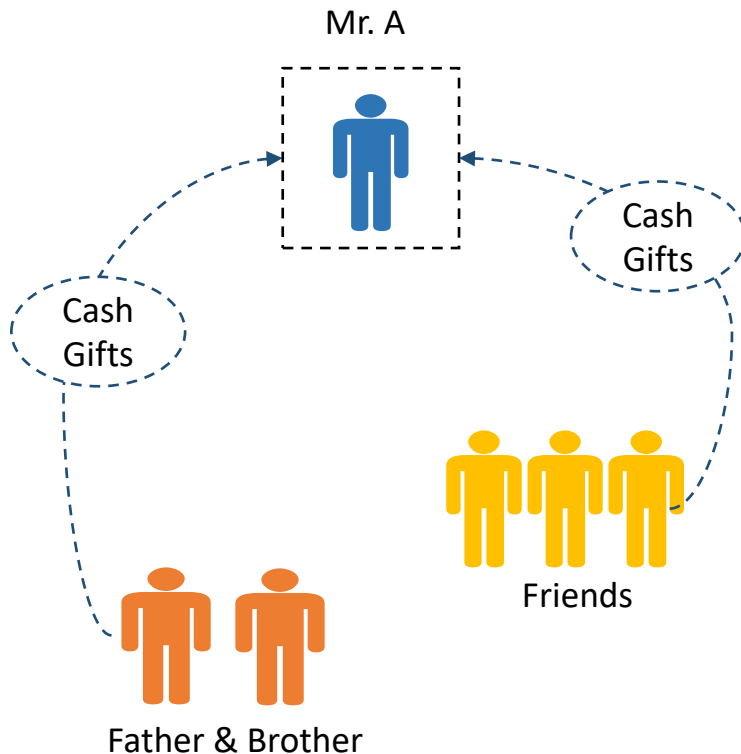
(b) in respect of a single transaction; or

(c) in respect of transactions relating to one event or occasion from a person,

otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account:”

Case Study 9 - Receipt by cash gifts

Clause 31 of Form 3CD



Points to ponder

Gift from father and brother – Rs. 2,50,000 each

- Any sum received from relatives shall not be taxable u/s 56(2)(x)
- Section 269ST provides that no amount shall be received in excess of Rs. 2 lakhs from a person on a single day otherwise than specified mode
- Hence, cash gift from father and brother, though exempt u/s 56(2)(x), shall be liable for penalty u/s 271DA

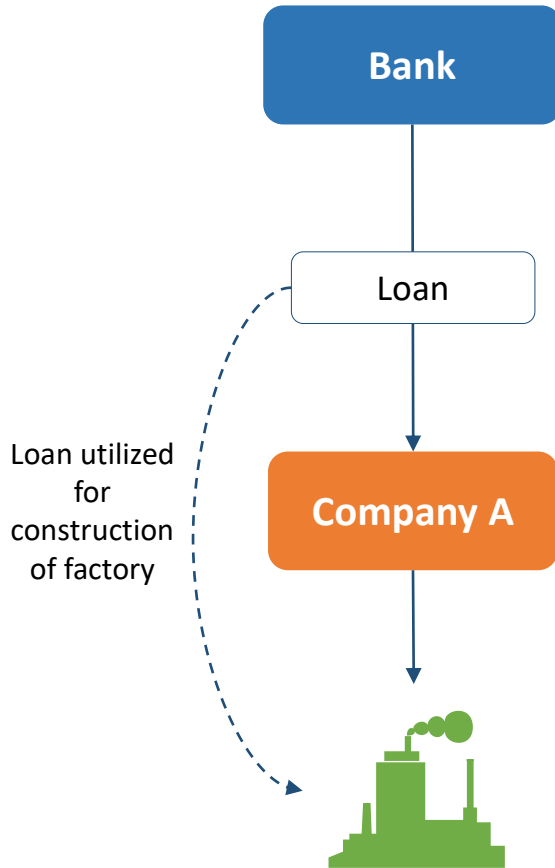
Gift from friends – Rs. 1,80,000 each

- Any sum received on occasion of marriage shall not be taxable u/s 56(2)(x)
- Section 269ST provides that no amount shall be received in excess of Rs. 2 lakhs on an occasion from a person otherwise than specified mode
- Since cash gift from each friend is less than Rs. 1,80,000 though on a single occasion, should not be liable for penalty u/s 271DA

Income Computation and Disclosure Standards

Case study 10 - Borrowing cost for interrupted period

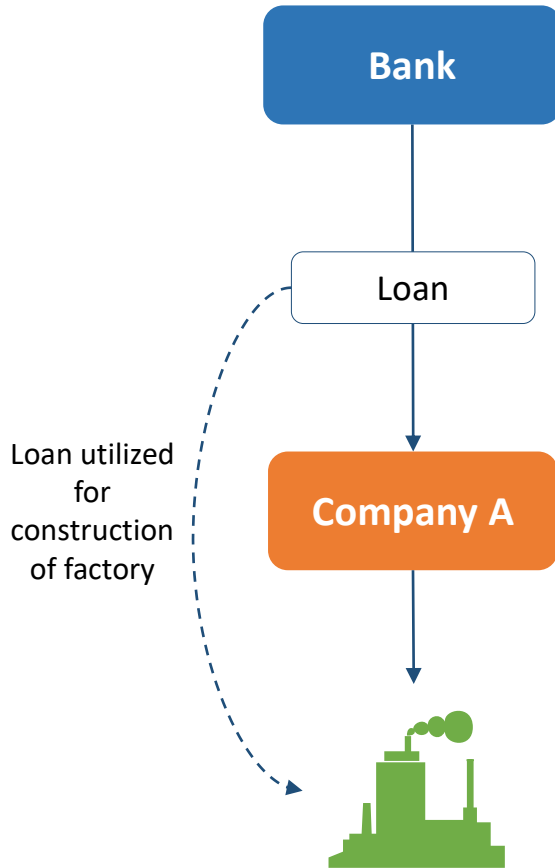
Clause 13 of Form 3CD



- Company A had borrowed loan from Bank which is utilized for the purpose of construction of factory
- During FY 2018-19, due to strike of labors, work for construction of factory was interrupted for 3 months
- Following Accounting Standard 16, Company A suspended the capitalization of interest on loan during the interrupted period and charged the same to profit and loss account
- Analyse the allowability of interest expenses under section 36(1)(iii) and provisions of ICDS

Case study 10 - Borrowing cost for interrupted period

Clause 13 of Form 3CD



Points to ponder

- As per Section 36(1)(iii) read with ICDS IX on borrowing costs, interest paid for acquisition of asset to be capitalized for period from date on which capital was borrowed till date on which such asset was first put to use
- As per AS 16, interest paid for interrupted period not to be capitalized and to be debited to Profit & Loss A/c
- So such interest cannot be allowed as deduction u/s 36(1)(iii)