Tax Audit

under section 44AB of Income Tax Act, 1961

Audit Report : <u>Form No. 3CA</u>

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<u>First part:</u>

Refers to the fact that the statutory audit of the assessee was conducted by a chartered accountant or any other auditor in pursuance of the provisions of the relevant Act, and the copy of the audit report along with the

- audited profit and loss account ;
- audited balance sheet and
- the documents declared by the relevant Act to be part of or annexed to the profit and loss account and balance sheet, are annexed to the report.

In case the statutory auditor is carrying out the audit under section 44AB, the fact that he has carried out the statutory audit under the relevant Act should be stated.

Audit Report : Form No. 3CA

Second part:

statement of particulars required to be furnished under section 44AB is annexed with the particulars in Form No. 3CD.

Third part:

To express further that, in his opinion and to the best of his information and according to the explanations given to him, the particulars given in the said Form No.3CD and the annexure thereto true and correct.

Fourth part:

Item No. 4 of the notes to Form No. 3CA requires that the person, who signs this audit report, shall indicate reference of his membership no. authority under which he is entitled to sign this report.

Form No. 3CD

PART A

Clause 1 to 6

Clause 1. Name of the assessee

- should be as per the Certificate of Incorporation / Partnership deed, as the case may be.

Clause 2. Address

- should be of registered office. However, if the administrative / corporate office is different from the registered office, the address of the same can also be given.

Clause 3. Permanent Account Number

- as per the PAN card or letter received from the Income tax authorities.
- if PAN has been applied for but not allotted, the fact should be stated.

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Clause 4. Status

Status refers to the different class of assessees included in the definition of ‘person’ under section 2(31) namely :

- individual,
- hindu undivided family,
- company,
- firm,
- an association of persons or a body of individuals,
- a local authority, or
- artificial juridical person

Status should be as per the return of income tax. residential status is not required.

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Clause 5. Previous year ended

It is 31st March (relevant financial year).

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Clause 6. Assessment year

If the financial year is 31st March 2009, the assessment year is 2009-2010.

PART B

Clause 7 to 32

Clause 7a. If firm or association of persons, indicate names of partners/members and their profit sharing ratio

- should be as per the Partnership deed / Constitution deed.
- profit sharing ratio also includes loss sharing ratio, because loss is nothing but negative profits.

Clause 7b. If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change

The tax auditor should verify the certified copy of the latest / amended partnership deed.

Clause 8a. Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession)

For this, reference can be made to the director’s report and / or abstract under Part IV of Schedule VI.

Clause 8b. If there is any change in the nature of business or profession, particulars of such change

Some examples of change in nature:

1) from manufacturer to trader or vice versa

2) change in principal line of business

In case of amalgamation / demerger, if similar line of activity, it would not amount to change in the nature.

The tax auditor should make proper enquiries, review the minutes of meeting (if made available), director’s report, etc.

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Clause 9a. Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed

The books of accounts prescribed in Rule 6F are:

1. a cash book,
2. a journal, if accounts are mercantile system of accounting is followed,
3. a ledger,
4. carbon copies of bills issued by the assessee, and
5. original bills and receipts issued to the assessee.

The tax auditor is required to give list of books so prescribed. This applies to specified profession (like legal, medical, engineering).

Clause 9b. Books of account maintained

(In case books of account are maintained in a computer system, mention the books of account generated by such computer system)

The tax auditor is required to obtain list of books both financial/non financial records from the assessee. The general list is as follows:

1) Cash/Bank Book
2) Petty Cash book
3) Journal register
4) Purchase/Sales Register
5) Debtors/Creditors Ledger
6) General Ledger
7) Inventory Records
8) Fixed Asset Register
9) Excise records

- Not an exhaustive list. Use of excel worksheets is not computer generated record

Note: Printouts listing individual transactions, maintained and generated in a computer system, are taken out as and when required.

Clause 9c. List of books of account examined

The statutory auditor puts tick marks/ identification at the time of finalization of accounts on all those records mentioned in clause 9b above. Hence, normally the same list as per clause 9b can be referred here.

Clause 10. Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (Sec 44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section)

This relates to civil construction, business of plying, hiring or leasing goods carriages, retail business, shipping business, business of exploration of mineral oils, operation of aircraft by non-resident, foreign companies engaged in civil construction.

Clause 11a. Method of accounting employed in the previous year

- Assessee can follow either cash or mercantile system of accounting, hybrid system is not permitted.

- However, assessee can adopt cash system for one business and and mercantile for other business. But the assessee has to consistently follow the method of accounting.

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- As per Section 209 of the Companies Act 1956, every Company is required to keep books of account under accrual basis. The tax auditor should refer the notes to the accounts.

- Normally mercantile system of accounting is followed with certain exceptions e.g. export incentives (duty drawback), interest (e.g. on MSEB deposit) which may be accounted for on cash basis. Tax auditor has to also keep in mind the materiality for certain transactions.

Clause 11b. Whether there has been any change in the method of accounting employed vis-à-vis the method employed in the immediately preceding previous year

- The change in the accounting policy may not be a change in accounting method. Hence, it need not be reported here.
- The method of accounting can be changed provided changed method is regular method and the assessee has not merely abandoned or changed it for a casual period to suit his own purposes.

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Clause 11c. If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss

The concept of materiality is the basic governing factor. If it is not possible to quantify effect, disclosure of such fact should be stated. Reference can be made to the notes to the accounts.

Clause 11d. Details of deviation, if any, in the method of accounting employed in the previous year from accounting standards prescribed under section 145 and the effect there on the profit or loss

Only 2 accounting standards have been prescribed under the Income Tax Act:

AS-I “Disclosure of Accounting Policies”

AS-II “Disclosure of prior period and extra ordinary items and changes in Accounting Policies”

The tax auditor has to report details of deviation in method of accounting in the previous year from accounting standards and effect thereof on profit or loss.

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Clause 12a. Method of valuation of closing stock employed in the previous year

The tax auditor should refer the method of valuation in significant accounting policies in the notes to the accounts. The word the “Closing Stock” includes all items of inventory.

Clause 12b. Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss

Section 145A has come into force from A.Y 1999-2000. It is not necessary to change the method of valuation of purchase / sale and inventory regularly employed in books of account.

The adjustments provided under the section can be made while computing the income for the return. The adjustments will affect opening stock, purchases, sales and closing stock. The adjustments are as follows:

any tax, duty, cess or fee actually paid or incurred on inputs, sales, inventory should be added, if not already added (to gross up)

Clause 12b. Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss

Example :

- Inventories are stated exclusive of Central Value Added Tax (CENVAT) / State Value Added Tax (VAT). The assessee follows the exclusive method in respect of accounting of CENVAT/VAT credits. However, there is no effect on the profit for the year as supported by the illustration given in “Guidance Note on Tax Audit under section 44AB of the Income-tax Act” issued by the Institute of Chartered Accountants of India.

- Sales are exclusive of sales tax/state value added tax and octroi (where separately recovered), which has not been debited to the profit and loss account. However there is no effect thereof on the profit for the year.

Clause 12A. Give the following particulars of the Capital asset converted into stock in trade

a) Description of Capital asset
b) Date of Acquisition
c) Cost of Acquisition
d) Amount at which the asset is converted into stock-in-trade

Clause 13. Amounts not credited to the profit and loss account, being:

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a. the items falling within the scope of section 28

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Section 28 prescribes certain items to be treated as income for e.g. sum received under Keyman insurance policy including the sum allocated by way of bonus on such policy, etc.

Under this clause various amounts falling within the scope of section 28 which are not credited to the profit and loss account are to be stated.

The information is to be given with reference to the entries in the books of accounts and records made available to the tax auditor.

Clause 13. Amounts not credited to the profit and loss account, being:

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1. the items falling within the scope of section 28

Example:

Sales tax/state value added tax and octroi (where separately recovered) aggregating Rs.10,00,000/- collected on sales, which in accordance with the accounting policy consistently adopted by the assessee, is considered as a liability and not a part of revenue. This treatment has no effect on the profit for the year.

b. the proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned

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The tax auditor has to examine all relevant correspondence, records and evidence in order to determine whether any claim has been admitted as due within the relevant previous year.

If cash system is followed, even if it is admitted within the previous year, but not actually received during the previous year, it need not be reported here.

c. Escalations claims accepted during the previous year

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Escalation claims would normally arise pursuant to a contract. Only those claims, to which the other party has signified unconditional acceptance need to be reported here.

d. Any other item of income

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Any other items which tax auditor considers as income based on verification of records, but not credited to Profit and loss account to be reported under this clause.

In giving details under sub clauses (c) and (d), due regard should be given to AS – 9 Revenue Recognition.

e. Capital receipt, if any

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The auditor should refer to Cash flow statement for this purpose and exercise his professional expertise and judgment.

Some examples are :

1) Capital subsidy received in the form of government grants which are in the nature of promoters' contribution.

2) Government grants in relation to a specific fixed asset where such grant has been shown as a deduction from gross value of fixed assets.

3) Compensation for surrendering certain rights.

4) Profit on sale of fixed assets / investments to the extent not credited to the profit and loss account.

Clause 14.Particulars of depreciation allowable as per the Income tax Act, 1961 in respect of each asset or block of assets, as the case may be in the following form:

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a) Description of asset/block of assets

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b) Rate of depreciation

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c) Actual cost or the WDV as the case may be.

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d) Additions/deductions during the year with dates; in case of any addition of an asset, date put to use; including adjustments on account of Modvat, change in rate of exchange of currency, subsidy or grant or reimbursement, by whatever name called.

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e) Depreciation allowable

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f) Written down value at the end of the year

Tax Auditor needs to examine:

- Classification of block of assets
- Working of actual cost and the WDV
- Date of acquisition and date put to use
- Applicable rate of depreciation
- Date and sale value in case of deduction
- Adjustments required on account of CENVAT, exchange difference and subsidies/grants.

- Exchange difference to be adjusted to the carrying cost of the fixed asset as per Section 43A i.e. on payment basis.
- If there is any dispute with regard to the classification of an asset in a particular block or the rate of depreciation applied, the tax auditor must give his working with suitable reasons.
- The adjustments on account of exchange difference, CENVAT to be verified by the auditor.
- Subsidy or grant received from the Government against the particular asset / assets to be reduced from the actual cost of the asset.

Section 32(1)(iia) outlines the conditions prescribed for claiming additional depreciation in respect of new machinery or plant which has been acquired and installed by the assessee engaged in the manufacture or production of any article or a thing:

- Plant & Machinery, before its installation, should not be used either within or outside India by any other person.
- The same should not be installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house.
- Not eligible on any office appliances or road transport vehicles.
- If the whole of the actual cost is allowed as a deduction in computing income chargeable under the head, profits and gains of business or profession, than no additional depreciation.

Clause 15. Amounts admissible under sections 33AB, 33ABA, 33AC, 35, 35ABB, 35AC, 35CCA, 35CCB, 35D, 35DD, 35DDA, 35E

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a) debited to the profit and loss account (showing the amount debited and deduction allowable under each section separately;

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b) not debited to the profit and loss account

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- Section 33AB: Tea / Coffee / Rubber Development Account
- Section 33ABA: Site Restoration Fund
- *Section 35: Expenditure on Scientific Research*
- *Section 35ABB: Expenditure for obtaining license to operate telecom services*
- Section 35AC: Expenditure on eligible projects/schemes
- Section 35CCA: Expenditure by way of payments to associations and institutions for carrying out rural development programmes
- *Section 35D: Amortisation of certain preliminary expenses*
- Section 35E: Deduction for expenditure on prospecting etc. for certain minerals

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- Tax auditor to state the amount debited in the profit and loss account and the amount actually admissible in case of sub clause a.
- Tax auditor should verify the working of amount debited to the profit and loss account.
- In sub clause b, the amount not debited to the profit and loss account and admissible as a deduction under any of the above sections is to be stated.
- If assessee is eligible for deduction under one or more of the above sections, the tax auditor has to state the deduction allowable under each of the above sections separately.

Clause 16a. Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend

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- If any such sum is paid, this would not be normally allowed as deduction

- The requirement is only in respect of disclosure, the tax auditor is not expected to express an opinion about the allowability or otherwise

- The tax auditor should verify the contract with the employees so as to ascertain the nature of payments

Clause 16b. Any sum received from employees towards contributions to any provident fund or superannuation fund or any other fund mentioned in section 2(24)(x); and due date for payment and the actual date of payment to the concerned authorities under section 36(1)(va)

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- Deduction of such sums received from the employees is allowed, if it is credited by assessee to the account of employees on or before the due date as per the applicable law.

- Otherwise, the same is treated as his income under Section 2(24)(x)

- Tax auditor should get a list of various contributions recovered from the employees and verify the actual payments from the evidence available.

Clause 17. Amounts debited to Profit and loss account, being :-

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Clause 17a. Expenditure of Capital nature

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- Capital expenditure, if any, debited to the profit and loss account to be disclosed stating the amounts under various heads separately

- Tax auditor needs to scrutinize records and obtain information and make necessary inquiries in this behalf
- General tests should be applied to determine whether a particular expenditure is of a capital nature i.e.
  - where it brings into existence an asset or
  - advantage of enduring benefit, or
  - whether it relates to the frame work of the assessee's business etc.

Clause 17b. Expenditure of personal nature

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- Tax auditor needs to scrutinize the ledger to verify whether any expenses of personal nature have been incurred by the assessee.

- Section 227(1A) requires the auditor to inquire whether personal expenses have been charged to the revenue account.

- *Note: According to the information and explanation given by the assessee, no personal expenses have been debited to the profit and loss account other than those payable under contractual obligations or in accordance with the generally accepted business practice.*

Clause 17c. Expenditure on advertisement in any souvenir, brochure, tract, pamphlet, or the like, published by a political party

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- If there is any such expenditure debited to the profit and loss account, the same will be disallowed under section 37(2B) and has to be reported under the above clause.

- For this purpose the tax auditor should scrutinize the ledger accounts and make enquiries in this behalf.

Clause 17d. Expenditure incurred at clubs-

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1. As entrance fees and subscriptions
2. As cost for club services and facilities used

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- The expenditure may be incurred for directors, employees, partner, proprietors.
- The fact that whether they are of personal nature or incurred in the course of business should be ascertained. If they are of personal nature, they should be shown under clause 17b.
- The tax auditor should make a close scrutiny of the ledger in such cases

Clause 17e. (i) Expenditure by way of penalty or fine for violation of any law for the time being in force

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(ii) Any other penalty or fine

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(iii) Expenditure incurred for any purpose which is an offence or which is prohibited by law

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- Tax auditor should obtain in writing the details of all payments made by way of penalty or fine from the assessee and how such amounts have been dealt in the books of accounts

- The tax auditor is not required to express any opinion as to allow ability or otherwise of amount.

- It does not cover payment for contractual breach.

Note: The assessee has represented that, the assessee has not incurred:

i) any expenditure by way of penalty or fine for violation of any law for the time being in force;

ii) any other penalty or fine; and

iii) any expenditure for any purpose which is an offence or which is prohibited by law.

Clause 17f. Amounts inadmissible under section 40(a)

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It basically includes :

- Interest, royalty, fees for technical services or any other sum payable outside India or in India to a non resident or a foreign company
- Interest, commission or brokerage, rent, royalty, fees for professional or technical services, payments to resident contractors/subcontractors
- Securities transaction tax, Fringe benefit tax, Income tax and

Wealth tax

- Salaries payable outside India or to a non resident on which tax has not been deducted at source
- Tax actually paid by an employer referred to in section 10(10CC)

- In case of any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services to a resident, or amounts payable to a contractor or sub-contractor, being resident; on which tax has not been deducted, or after deduction, has not been paid

1. In a case where the tax was deductible and was deducted during the last month of the previous year, **on or before the due date specified in section 139(1);** or

1. In any other case, **on or before the last day of the previous year**

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the same will not be allowed as a deduction in the previous year.

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- *If the same is paid subsequently, it will be allowed as a deduction in the year in which it is paid.*

Clause 17g. Interest, salary, bonus, commission or remuneration admissible under section 40(b)/40(ba) and computation thereof

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- Tax auditor is required to state the inadmissible amount under this clause after applying the conditions for allowance or disallowance and accordingly determine the prima facie inadmissibility of the deduction and also quantify the same

- Conditions for admissibility:

a) Remuneration to working partner

b) Remuneration/interest is authorized by partnership deed

c) The interest should not exceed 12% p.a. and the remuneration should not exceed the maximum permissible limits.

d) The same should not pertain to a period prior to the date of partnership deed.

Clause 17h.(A). Whether a certificate has been obtained from the assessee regarding payments relating to any expenditure covered under section 40A(3) that the payments were made by account payee cheques drawn on a bank or account payee draft, as the case may be, [Yes/No]

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- Confirmation of obtaining a certificate from the assessee regarding payments relating to any expenditure covered under section 40A(3) to be given in the above clause

- Management Representation obtained from clients could be regarded as a certificate for this clause

- Certificate need not be attached with the Tax Audit Report

Clause 17h. (B) amount inadmissible under section 40A(3), read with rule 6DD [with break up of inadmissible amounts]

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- Section 40A(3) provides that where assessee incurs any expenditure in respect of which payment is made in a sum exceeding Rs.20,000 otherwise than by a account payee cheque / account payee bank draft, **no deduction** shall be allowed in respect of such expenditure.

- Tax auditor should obtain a list of all payments exceeding Rs. 20,000 made by the assessee during the previous year which should also include the list of payments exempted in terms of Rule 6DD with reasons.

- List should be verified by the tax auditor with the books of account in order to ascertain whether the conditions for specific exemption granted in Rule 6DD are satisfied.

- Details of payments which do not satisfy the above conditions should be stated under this clause

Rule 6DD – Disallowance of cash payments

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As per Rule 6DD as amended by Rules 2007 ‘no disallowance shall be made even if payment is made in excess of Rs. 20,000, in the cases and circumstances specified hereunder, namely:-

- Where payment is made to-

i) RBI

ii) SBI

iii) Any co-operative bank or land mortgage bank

iv) Any primary agricultural credit society

v) LIC

It may be noted that sub-clauses vi) to xviii) [i.e payment to IDBI, ICICI, UTI etc] of the said rule have been omitted by Notification 208/2007, dated June 27, 2007.

Where the payment is made by-

i) Letter of credit

ii) Mail or telegraphic transfer

iii) Book adjustment from one bank account to any other account

iv) Bill of exchange

v) Use of electronic clearing system through bank account

vi) Credit card

vii) Debit card

It may be noted that sub-clauses v) to vii) as above have been inserted **by Notification no. 208/2007 dated June 27, 2007**

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<u>Note:</u> The assessee maintains that all payments for expenses made from bank accounts in excess of Rs. 20,000/- have been made by account payee cheques or account payee bank drafts. However, this could not be verified by the examining Chartered Accountants as the necessary evidence is not in the possession of the assessee.

Clause 17i. Provision for payment of gratuity not allowable under section 40A(7)

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- As per section 40A(7), deduction of any provision is allowable only if provision is made for contribution to any approved gratuity fund or the provision relates to the amount of gratuity which has become payable during the previous year.

- The tax auditor should call for the order of Commissioner of I.T granting approval for gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed.

Clause 17j. Any sum paid by the assessee as an employer not allowable under section 40A(9)

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- Under section 40 A(9), any payments made by an employer towards the setting up or formation of or as contribution to any fund, trust, company, or other institutions (other than contributions to recognised provident fund or approved superannuation fund or approved gratuity fund)is not allowable.

- Tax auditor should furnish the details of payments which are not allowable under this section

Clause 17k. Particulars of any liability of a contingent nature

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- Detailed scrutiny of account heads like outstanding liabilities, provision etc to be made to ascertain any such particulars of contingent nature debited to profit and loss account.

Clause 17I. 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.:-

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- Section 14A provides that no deduction shall be made in respect of expenditure incurred by assessee in relation to income which is exempt from tax.

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- The tax auditor has to verify the details furnished by the assessee and should satisfy himself that the inadmissible amounts have been worked out correctly.

- Where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Act and does not furnish the necessary particulars for the purpose of ascertaining the inadmissible expenditure under section 14A, the tax auditor has to make a proper disclaimer / qualification.

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Clause 17m. Amount inadmissible under the proviso to section 36(1)(iii)

- Section 36(1)(iii) provides that interest on borrowed capital would be deductible only if :

a) The assessee has borrowed money.

b) It is used for the purpose of business and profession.

c) Interest is paid/payable on such money.

- The proviso to the above section requires that capital borrowed for acquisition of asset for extension of existing business or profession for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed as a deduction.

- Tax auditor has to thus report the amount inadmissible under the above proviso.

Clause 17A.

Amount of interest inadmissible under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.

- Newly inserted clause from this year.

- The auditor should report here the amount of interest paid to the Micro, Small and Medium Enterprises.

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 18. Particulars of payments made to persons specified under section 40A(2)(b)

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- Section 40A(2) provides that expenditure for which payment has been or is to be made to specified persons may be disallowed (excess portion) if in opinion of A.O, such expenditure is excessive or unreasonable having regard to,

1.) Fair Market value.

2.) Legitimate needs of business/profession

3.)Benefit derived by assessee

- Tax auditor should obtain a full list of specified persons as contemplated in this section and obtain details of expenditure/payments made to specified persons

- Tax auditor should scrutinize all items of payments to above persons

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

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If necessary, indicate in Form 3CD by way of a note as under *:*

“The Company does not have a complete list of "relatives" of directors or a list of "persons" who carry on business or profession in which a director of the Company or a relative of such director or such individuals together with the assessee Company has/have a substantial interest. According to the information with the Company, the Company has certified that there are no payments other than disclosed above made to persons specified in Section 40A(2)(b) of the Income tax Act; this has not been verified by the auditors.”

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 19 :- Amounts deemed to be profits and gains under section 33AB or 33ABA or 33AC

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- Sections 33AB and 33ABA lay down the circumstances under which amount withdrawn from deposits covered thereby for purposes other than specified purposes, is to be deemed income chargeable as profits and gains. Tax auditor is required to report such amounts

- Similarly Section 33AC (3) lays down the circumstances in which the amount of reserve account shall be deemed to be profits and gains chargeable to tax

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 20 :- Any amount of profit chargeable to tax under section 41 and computation thereof

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Section 41 mainly includes

a.) Recovery of any loss, expenditure or trading liability, earlier allowed as deduction.

b.) In case of undertaking engaged in generation/ distribution of power, if building, machinery, plant or furniture is sold/discarded/demolished or destroyed.

c.) When an asset used for scientific research is sold.

d.) Subsequent recovery of bad debt, earlier allowed as deduction.

e.) Amount withdrawn from special reserve created under section 36(1)(viii).

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 21:- In respect of any sum referred to in clause (a), (b), (c), (d), (e) or (f) of section 43B, the liability for which;

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1. pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was

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(a) paid during the previous year;

(b) not paid during the previous year;

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- Traced the amount of liability which was pre-existed on 1st April 2008 from statements attached to the Tax audit report for clause 21(i)(A) & 21(i)(B) for the year ended 31st March, 2008.
- Obtained the closing balance from the trial balance for the year ended 31.03.08
- E. g. Bonus to employees, Compensated Absences

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

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(B) was incurred in the previous year and was

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a) paid on or before the due date for furnishing the return of income of the previous year under section 139(1);

1. not paid on or before the aforesaid date

- Traced the closing balances of unpaid liability from the audited trial balance (current liability).
- Obtained the details of subsequent payment from the client.
- Verified respective ledger accounts to verify the subsequent payments remained unpaid.
- E.g. Excise duty, Sales Tax / Value Added Tax, Work Contract Tax, Commission to Managing, Bonus to employees , Leave Encashment, P F contribution, ESIC contribution, Gratuity - Officers‘, Interest accrued but not due

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Section 43B mainly includes:

- any tax, duty, cess or fee payable under any law for the time being in force
- employer's contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees
- any bonus or commission payable by the assessee to its employees
- interest on any loan or borrowing from any public financial institution, state financial corporation or a state industrial investment corporation
- interest on any loan or advances from a scheduled bank
- sum payable by the assessee in lieu of any leave at the credit of employees

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

- In respect of the specified sums incurred during the previous year, the deduction for liability is available for payments actually made till the due date of filing the tax return for the said year

- The deduction for payments made against liability that pre-existed on the first day of the relevant previous year is restricted to only those payments made up to the close of the relevant previous year.

- Above particulars are required irrespective of the fact whether they have been debited to profit and loss account or not and such a fact should be stated under this clause

- Tax auditor is not require to determine any admissible or inadmissible amounts

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

In respect of the expenditure covered by clauses (a) to (f) of section 43B, the particulars may be furnished in the Following form,

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

1. Liability pre- existing on first day of previous year

Sr. No.	*Nature of liability*	*Outstanding opening balance not allowed in any earlier previous year(s)*	*Amount paid/set off during the year against column 3*	*Amount written back to the profit and loss account*	*Amount remaining unpaid as at the end of the year*	*Whether passed through profit & loss account*	*Remarks*
1	2	3	4	5	(3-4-5)=6	7	8

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

B) Liability Incurred during the Previous year

Sr. No.	*Nature of liability*	*Amount incurred during the previous year but remaining outstanding as on the last day of the previous year)*	*Amount paid/set off before the due date of filing return/date upto which reported in the tax audit report, whichever is earlier against column (3)*	Amount unpaid on the due date of filing the return/date upto which reported in the tax audit report whichever is earlier	Whether passed through the profit & loss account	*Remarks*
1	2	3	4	5	6	7

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 22 (a) Amount of Modified Value Added Tax credits availed of or utilized during the previous year

its treatment in the profit and loss account

treatment of outstanding Modified Value Added Tax credits in the accounts.

.

- Tax auditor should verify that there is a proper reconciliation between balance of CENVAT credit in the accounts and relevant excise records. (Viz. RG-23)

- Tax auditor should verify that the information furnished under this sub-clause is compatible with the information under clause 12(b)

.

- Reporting in following format

Balance at beginning of the year XXX

Add: CENVAT Credit available during the year XXX

Less: CENVAT Credit utilised during the year (XXX)

Outstanding at the end of the year XXX

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

1. Particulars of income or expenditure of prior period credited or debited to the profit and loss account.

.

- Accounts audited----Annual Accounts

Accounts not audited----Close scrutiny of ledger to determine period to which income/expenditure relates.

- Both AS 5 and AS(IT)-II notified by Govt under section 145 state that if the material adjustments arising due to error or ommission in earlier years, then prior period item.

- There is difference between expenditure of any earlier year debited to the profit and loss account and the expenditure relating to any earlier year, which has crystallised during the relevant previous year

- Material adjustments necessitated by circumstances which though related to previous periods but determined in the current period, will not be considered as prior period items.

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 23. Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D]:-

.

Statute: As per Sec 69 D, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount aforesaid for the previous year in which the amount was borrowed or repaid

Hundi---Promissory Note.

.

Audit Procedures:

- The Tax auditor to obtain a complete list of borrowings and repayments of hundi loans otherwise than by account payee cheques
- Verify the same with the books of account.
- Verify records in possession of assessee.
- If records are not available, give appropriate disclaimer to that effect.
- Scrutinize cash and petty cash book

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 24 (a) * Particulars of each loan or deposit in an amount exceeding the limit specified in section 269SS taken or accepted during the previous year :—

1. name, address and permanent account number (if available with the assessee) of the lender or depositor;

.

(ii) amount of loan or deposit taken or accepted;

.

(iii) whether the loan or deposit was squared up during the previous year;

.

(iv) maximum amount outstanding in the account at any time during the previous year;

.

(v) whether the loan or deposit was taken or accepted otherwise than by an account payee cheque or an account payee bank draft.

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Statute: If loan or deposit to be accepted together alongwith loans or deposits already accepted, exceeding Rs. 20,000 to be availed only through account payee cheque or account payee bank draft.

Audit Procedures: The Tax auditor to obtain details of all loans or deposits taken and verify the same with records maintained by the assessee. Where records are not available auditor to give a disclaimer that necessary evidence is not in possession of assessee.

Other Considerations:

- Payments not made through account payee cheques or bank drafts but through bank transfers like RTGS, NEFT , then tax auditor should give an appropriate note to that effect.
- Sec 269SS applies even when loans are taken free of interest.
- Deposit also includes current account, security deposit against contracts.
- Scrutinize advances account to verify whether advances are in nature of deposits.
- Sec 269SS shall not apply when loans are accepted by Government, Banking Company, Govt. Co. or Co. established under Central, State, Provincial Act.

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 24 (b) * Particulars of each repayment of loan or deposit in an amount exceeding the limit specified in section 269T made during the previous year :—

.

.

(i) name, address and permanent account number (if available with the assessee) of the payee;

.

(ii) amount of repayment;

.

(iii) maximum amount outstanding in the account at any time during the previous year;

(iv) whether the repayment was made otherwise than by account payee cheque or account payee bank draft.

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Statute: Sec 269T is attracted when repayment of loan or deposit is made to a person

When aggregate amount of loans or deposits held by such person on date of repayment exceeds Rs. 20000

Even though repayment amount may be less than Rs. 20000

Note:

- Loans or deposits may be held singly or jointly with some other person.
- Repayment includes interest thereon
- Only for company assessee, loans or deposits include loans repayable on notice and after a particular period and not on demand.

.

Audit Procedures: The Tax auditor to obtain details of all loans or deposits repaid and verify the same with records maintained by the assessee. Where records are not available auditor to give a disclaimer

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

<u>Clause 24.(c) Whether a certificate has been obtained from the assessee regarding taking or accepting loan or deposit, or repayment of the same through an account payee cheque or an account payee bank draft. [Yes/No]</u>

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The particulars (i) to (iv) at (b) and the Certificate at (c) above need not be given in the case of a repayment of any loan or deposit taken or accepted from Government, Government company, banking company or a corporation established by a Central, State or Provincial Act.

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 25. (a) Details of brought forward loss or depreciation allowance, in the following manner, to the extent available :

.

Serial Number	*Assessment Year*	*Nature of loss/allowance (in rupees)*	*Amount as returned (in rupees)*	*Amount as assessed (give reference to relevant order)*	*Remarks*

Audit Procedures: The Tax auditor to study the assessment records i.e. income tax returns filed, assessment orders, appellate orders and rectification / revisied orders and trace the amounts of loss / allowance from the income tax returns and the assessment orders.

Clause 25 (b) whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of section 79

Statute: Notwithstanding anything contained in Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, 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

(a) 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

Audit Procedures: The Tax Auditor to enquire with the management and review statutory records of the entity to ascertain whether there is a change in shareholding of the company and report accordingly

Clause 26. Section-wise details of deductions, if any, admissible under Chapter VIA.

.

Audit Procedures: Tax Auditor to perform corroborative inquiry with the entity to ascertain if there are any Deductions

1. In respect of certain Payments
2. In respect of certain Incomes
3. Others

Tax auditor to scrutinize books of account and other documents for ascertaining value of deductions under Chapter VIA

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 27. (a) Whether the assessee has complied with the provisions of Chapter XVII-B regarding deduction of tax at source and regarding the payment thereof to the credit of the Central Government. [Yes/No]

.

Clause 27. (b) If the provisions of Chapter XVII-B have not been complied with, please give the following details*, namely:-

.

Amount Rs

(i) Tax deductible and not deducted at all

(ii) Shortfall on account of lesser deduction than required to be deducted

(iii) tax deducted late

(iv) tax deducted but not paid to the credit of the Central Government

.

Audit Procedures: Tax Auditor to test the controls instilled by the entity for appropriate deduction of tax a source. Tax auditor also to obtain and verify details of payment of TDS deducted, for timely payment, with TDS returns

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 28(a) In the case of a trading concern, give quantitative details of principal items of goods traded:

.

(i) opening stock;

.

(ii) purchases during the previous year;

.

(iii) sales during the previous year;

.

(iv) closing stock;

.

(v) shortage/excess, if any.

.

Clause 28(b) In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products :

.

A. Raw materials :

.

(i) opening stock;
(ii) purchases during the previous year;
(iii) consumption during the previous year;
(iv) sales during the previous year;
(iv) closing stock;
(v) yield of finished products;
(vi) percentage of yield;
(vii) shortage/excess, if any.

.

Clause 28(b) In the case of a manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products :

.

B. Finished products/By-products :

.

(i) opening stock;

(ii) purchases during the previous year;

(iii) quantity manufactured during the previous year;

(iv) sales during the previous year;

(iv) closing stock;

(v) shortage/excess, if any.

.

*Information may be given to the extent available.

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Audit Procedures:

Tax Auditor to obtain certificates from the assessee in respect of principal items of goods traded, manufactured (raw materials, finished goods and by-products).

Auditor to verify the figures reported on a sample basis, in order to satisfy himself of the as to the correctness of the figures furnished

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

Clause 29. 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) total tax paid thereon;

.

(c) dates of payment with amounts

.

Audit Procedures:

Tax Auditor to verify the statutory records / minutes to ascertain the amount of profits distributed. Auditor to verify the tax paid thereon and the date of payment, on the basis of duly received challan and books of account.

Note: Dividend Distribution Tax to be paid @ 15% within 14 days of declaration/distribution or payment whichever is earlier.

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TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

30.) Whether any cost audit was carried out, if yes, enclose a copy of the report of such audit [See section 139(9)]

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31.) Whether any audit was conducted under the Central Excise Act,1944, if yes, enclose a copy of the report of such audit.

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Audit Procedures:

The tax auditor to ascertain from the management whether an audit was carried out and if yes enclose a copy of the report of such audit.

Where an audit may have been ordered and is not completed by the time the tax auditor gives his report, he has to state the same in his report.

TAX AUDIT UNDER SECTION 44AB OF THE INCOME TAX ACT, 1961

32.) Accounting ratios with calculations as follows :—

(a) Gross profit/Turnover;

(b) Net profit/Turnover;

(c) Stock-in-trade/Turnover;

(d) Material consumed/Finished goods produced.

.

Audit Procedures:

The Tax auditor to verify the ratios. The tax auditor should assign meaning to the terms used in the above ratios having due regard to the generally accepted accounting principles. Ratios mentioned in this clause are to be calculated in terms of value only.