

TAX AUDIT AND COMPLIANCE OF FORM 3CD

- **BY CA B N RAO**

Salient Features.

1. Tax Audit Report should be filed with the Return of Income before due date for filing of Return of Income.

However, due to electronic filing mechanism coming into existence, the Returns which are filed before due date of filing of Return containing details about Tax Audit date, Auditors' name and address and their PANo are considered as tax audit compliant returns and penalty under section 271B can be avoided. If the Return is filed a day late and still it contains the date of audit report prior to due date still it will amount to non filing of tax audit return in time. As a precautionary measure, it is advisable to file tax audit report in such case with a covering letter with the concerned Assessing Officer in case of extraneous circumstances beyond the control of the management.

2. Period to be covered by the Auditor:

In many cases the companies adopt accounting year different from the uniform accounting year (financial year) as suggested under Income tax Act for various convenience factors. In such case tax audit should be conducted for the previous year relevant to the assessment year. Hence, tax auditors have to carry out tax audit on the basis of the split information procured from two accounting period as per Companies Act and file Form No. 3CA as required in prescribed rule. [Circular No. 561 dtd 22.5.1990]

3. Incomplete Audit Reports - effect

The Government has decided that all cases where the information provided in the audit report is incomplete or such non committal replies are furnished so as to render the remarks or the report meaningless, should be reported by the Assessing Officer to the CIT. The matter thereafter, be taken up by the CIT to see if the case reflects any professional negligence on the part of the accountants signing the audit report. Action for initiation of disciplinary proceedings in terms of section 288 of the I T Act should be immediately taken by the commissioner of Income tax with the approval of the Chief CIT, as the case may be.

The CBDT has issued instructions with immediate effect to the field officers to report any professional negligence on the part of the chartered accountants in preparing the tax audit report to the ICAI in terms of section 288, as the ICAI is entitled to institute proceedings against its member chartered accountants who submit faulty tax audit reports. [Press release, New Delhi dated 10th Dec, 1999].

4. Limit of Tax Audit Assignments per Chartered Accountant:

Audit—Restriction of number of tax audit under the IT Act, 1961—Validity of notification issued by ICAI—Power of the Council of the ICAI under s. 30 of the Chartered Accountants Act, 1949, is without prejudice to the generality of the power under s. 30(1)—Specific powers enumerated in s. 30(3) have no effect on the all pervasive general power under s. 30—Audit is a time-bound work and the certificate issued by the Chartered Accountant under s. 44AB of the IT Act having statutory force, it requires precision—Notification under the 1949 Act issued by the ICAI restricting, for an individual Chartered Accountant, number of tax audit assignments to 30 in a financial year is not unreasonable or discriminatory and not violative of Arts. 14 and 19(1)(g) of the Constitution—Source of such restriction being traceable to the 1949 Act, it could not be challenged on the ground of lack of power also—A parallel provision already exists there in s. 224 of the Companies Act, 1956 since 1974 permitting a Chartered Accountant to audit only 20 companies in a financial year—Further, it was not the case of the petitioner that he had in any way suffered pursuant to impugned notification. Citation B K Kamath Vs. Institute of Chartered Accountants of India (2003) 185 CTR (Ker) 90.

5. Compliance of Form 3CD – Relevant Clauses

Clause No 1 to 7 – General in nature – needs no emphasis.

Clauses covered by other speakers are not covered.

Clause 8. (a) 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).

If any assessee is carrying on more than one business, it is essential to distinguish the different business activities. In such case nature of business or profession should be specifically mentioned. This helps Assessing Officer to know the background of the assessee whom he is assessing and How many P & L Accounts he has to verify. In the absence of this information, administratively it becomes difficult to correlate income mentioned in computation of total income especially when e-filing has become mandatory and it has provision for only one P&L Accounts and B.S (Consolidated)

Clause 8 (b) 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

This information is relevant under section 45 of the Act where the change in share has taken place by taking an new partner for the purpose of transferring the assets by withdrawing existing profit sharing pattern.

Controlling factor for administration of section 45(3) of the Act.

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

(b) 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)

(c) List of books of account examined.

Categories of assesses who are required to maintain books of account under section 44AA of the Act:

Conditions for profession	Professionals such as Doctors, Engineers, CAs, CSs, Interior Decorators, Architects, Technical Consultants - Income Limit Rs. 1,20,000 OR Gross Total Receipts Rs. 10,00,000/- [whether crossed or likely to cross]
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Conditions for Business	In case of the businesses covered under presumptive taxation under section 44AD, 44AE, 44AF, 44BB, 44BBB – and assessee claims lower profit than the prescribed limits.
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[Governing Rule to maintain books of account : Rule 6F]

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 section (44AD, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB or any other relevant section).

This clause is applicable if a person is having both regular business as well as business falling under presumptive taxation. In case of presumptive taxation, there is no need to maintain books of account if the income is shown above or at the limit prescribed. By passing a single accounting entry the profit and loss account may reflect such income. If it is included in Profit and Loss Account then, to deduct such some from regular business activity, this information is required. There may be entities / assesses directly crediting such presumptive income to Capital Account. In such case, the information need not be given separately.

11. (a) Method of accounting employed in the previous year.

(b) Whether there has been any change in the method of accounting employed vis-a-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) 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 thereof on the profit or loss.

Companies compulsorily should follow mercantile system. In case of other assesses, other than companies, they may opt for Cash System or Mercantile System. Hybrid system is out of question. If any assessee changes from one method to another method, it will have a bearing on the profitability which requires to be quantified.[Section 145(1)]

Accounting Standards prescribed under section 145 of the Act [Different from the Accounting Standards issued by the ICAI]

Accounting Standard I disclosure of accounting policies.

Accounting Standard II disclosure of prior period and extraordinary items and changes in accounting policies.

Notification No. 9949, dated 25-1-1996.

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

FIFO, Weighted Average, Net realizable value etc., method consistently employed by the assessee.

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

- (i) Value of purchase and sale of goods and inventory in accordance with the method followed regularly; and
- (ii) To adjust for tax, duty, cess or fee paid to bring to the place of its location and condition as on the date of valuation.

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.;

Section 45 (2) of the I T Act.

[(2) Notwithstanding anything contained in sub-section (1), the profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as, stock-in-trade of a business carried on by him shall be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.]

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

- (a) the items falling within 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, where such credits, drawbacks or refunds 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.

Certain entities have tendency to straight away transfer to Balance Sheet. If so, then only this information is required to be provided.

This has an impact on concealment of income one has to thoroughly scrutinize the credit side of balance sheet to see that such income is credit to balance sheet items instead of P & L items and should be enlisted under this 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 :

- (a) Description of asset/block of assets.
- (b) Rate of depreciation.
- (c) Actual cost or written down value, as the case may be.
- (d) Additions/deductions during the year with dates; in the case of any addition of an asset, date put to use; including adjustments on account of—
 - (i) Modified Value Added Tax credit claimed and allowed under the Central Excise Rules, 1944, in respect of assets acquired on or after 1st March, 1994,
 - (ii) change in rate of exchange of currency; and
 - (iii) subsidy or grant or reimbursement, by whatever name called.
- (e) Depreciation allowable.
- (f) Written down value at the end of the year.

In line with the New Appendix I, the block of assets should be selected.

More than 180 days items should be given careful look.

Adjustments on account of MODVAT Credit, exchange fluctuation and reimbursement of grants.

1. Subsidy - Depreciation—Actual cost—Central subsidy—Did not relate to the cost of the asset and could not therefore go to reduce the actual cost.—Pioneer Match Works vs. ITO (1983) 15 TTJ (Mad) 88 (SB) : (1983) 3 ITD 174 (Mad); CIT vs. Godavari Plywood (1987) (1987) 62 CTR (AP) 179 : (1987) 168 ITR 632 (AP) and CIT vs. Bhandari Capacitors (1987) 65 CTR (MP) 114 : (1987) 168 ITR 647 (MP) followed (Unanimous view)
2. Depreciation—Actual cost—Investment subsidy received by assessee will not go to reduce the cost of assets for purpose of computation of depreciation etc.—CIT vs. Kerala State Drugs and Pharmaceuticals

Ltd.(1990) 184 ITR 424 (Ker), CIT vs. Relish Foods (1989) 78 CTR (Ker) 197 : (1989) 180 ITR 454 (Ker) and CIT vs. Veneers & Laminations (India) Ltd. (1992) 193 ITR 145 (Ker) followed.

15. Amounts admissible under sections —

- (a) 33AB
- (b) 33ABA
- (c) 33AC (wherever applicable)
- (d) 35
- (e) 35ABB
- (f) 35AC
- (g) 35CCA
- (h) 35CCB
- (i) 35D
- (i) 35DDA
- (i) 35E

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

(b) not debited to the profit and loss account.

33AB Tea Coffee Rubber development account upto 50 % of the profits if deposited within six months from the end of the previous year or due date of filing of return whichever is earlier

3ABA Site Restoration Fund – In case of prospecting, extraction or production of Petroleum and Natural Gas, –up to 20% of the profits if deposited before the end of the previous year.

33AC Reserves for shipping business (wherever applicable) - 50% of such profits debited to Profit and Loss Account and reserve is created to the same extent (subject to 200% of paid up capital and free reserves + Share Premium Account) and utilized for the purpose of acquiring new ship within 8 years from the end of the year in which such reserve was created. Upon non compliance of certain conditions, such deductions will be called back.

35 Weighted deduction of 1 ¼ of the sums paid to scientific research associations, to a company for scientific research, to a University, college or any institution to be used for social science and or statistical research subject to fulfillment of certain conditions.

35ABB Expenditure for obtaining licence to operate telecommunication services- in respect of any expenditure, being in the nature of capital expenditure, incurred for acquiring any right to operate telecommunication services either before the commencement of the business to operate telecommunication services or thereafter at any time during any previous year] and for which payment has actually been made to obtain a licence, there shall, subject to and in accordance with the provisions of this section,

be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount of such expenditure.

35AC Where an assessee incurs any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme, the assessee shall, subject to the provisions of this section, be allowed a deduction of the amount of such expenditure incurred during the previous year : Incurring of expenses may be either by way payment of any sum as aforesaid or directly on the eligible project or scheme

Certificate from the recipient or CA as the case may be should be furnished along with Return of income

Deduction once allowed under this section, there cannot be any further deduction in the year or payment or any other year under any other section. This emphasizes that the deduction should not be duplicate.

35CCA Expenditure by way of payment to associations and institutions for carrying out rural development programmes.

35CCB Expenditure by way of payment to associations and institutions for carrying out programmes of conservation of natural resources.

35D Amortisation of Preliminary Expenses

35DDA Amortisation of Expenses incurred under voluntary retirement scheme.

35E Deduction of expenses in relation to prospecting of mineral oils.

16. (a) 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. [Section 36(1)(ii)].

Section 43B puts restriction on allowability of payment of bonus if made before due date for filing of Return. If the payment to employee in the form of bonus or commission not having any link with the profits to be attributed for such services, the same shall be allowable in its entirety.

(b) 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).

Employees' contribution collected by employer and not paid in time will call for disallowance.

If payments are made within grace period under that enactment, the amount shall not be disallowed.

17. Amounts debited to the profit and loss account, being,—

(a) to (e) *** *** ***

(f) amounts inadmissible under section 40(a);

Tax not deducted or deducted and not paid within time permitted under section 200(1) of the Act in case of payment made to Non Residents in India or payment made outside India towards Interest, Royalty and Fees for technical services, such payment will be inadmissible in that year. However, if the amount is deducted and paid in any subsequent year, deduction will be admissible in that year.

Form is silent about 40(a)(ia) -

(g) interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof;

1. Identify whether the partner is a working partner or not?
2. Whether partnership deed authorizes such payment to working partner/s?
3. Whether the period for which such remuneration is paid is covered by the partnership deed and authorized for such payment?
4. Interest paid to partner in the capacity of partner and in any other capacity should be traced.

(h) (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 bank draft, as the case may be (Yes/No)

Form is silent about 40A(3A)

Management Representation is a must since the banks statement normally do not mention about the name of the parties in whose name account is debited due to electronic infusion into the banking system.

(B) amount inadmissible under section 40A(3), read with rule 6DD (with break-up of inadmissible amounts)

(i) provision for payment of gratuity not allowable under section 40A(7);

(j) any sum paid by the assessee as an employer not allowable under section 40A(9);

(k) particulars of any liability of a contingent nature.

(l) 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

Whether any direct nexus expenses are seen in the P & L Account relating to earning exempt income.

(m) amount inadmissible under the proviso to section 36(1)(iii)

Criteria: Borrowed for the purpose of business.

Interest on borrowings diverted from business.

Interest for pre commencement period not deductible

Interest on moneys borrowed for acquiring capital assets would be disallowed till the capital asset is brought to use

Borrowing may be fixed or working capital.

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

Obtain management representation in the beginning in the form of list of directors/ Partners holding partnership, directorship or proprietorship in any concern and the nature of business transacted with those entities – through ledger scrutiny.

19. Amounts deemed to be profits and gains under section 33AB or 33ABA or 33AC.

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20. Any amount of profit chargeable to tax under section 41 and computation thereof.

41(1) Expenses of earlier year if received during the year by the assessee or successor to the assessee it shall be chargeable to tax in the year in which it is received.

41(2) If sales realization of assets exceed the written down value, so much of the excess as does not exceed the difference between the actual cost and wdv shall be chargeable to tax.

41(3) Gains on asset representing expenditure of a capital nature on scientific research – excess amount of deduction – chargeable to tax.

41(4) Bad Debts written off earlier and recovered in the current year, such realization shall be chargeable to tax in the year of receipt.

41(4A) Reserve created under section 3(1)(viii) and subsequently withdrawn.

41(5) Income from discontinued business after setting off certain admissible losses.

21.* (i) In respect of any sum referred to in clauses (a), (c), (d), (e) or (f) of section 43B, the liability for which,—

(A) pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was

(a) paid during the previous year;

(b) not paid during the previous year;

(B) was incurred in the previous year and was

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

(1);

(b) not paid on or before the aforesaid date.

*State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost, etc. is

passed through the profit and loss account.

Tax includes Municipal tax, water tax, conservation tax. They are the statutory liabilities. Hence those items also should be included. However, interest on excise liability is not a statutory liability and hence its non payment does not amount to disallowance under section 43B of the Act.

22. (a) Amount of Modified Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.

Section 145 A (b) - further adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Upon purchase MODVAT account (B S Item) is debited instead of debiting the Profit and Loss Account. Upon Sales, MODVAT collected will be adjusted to the extent of MODVAT paid and balance amount only is paid. However, at the end of the year it unutilized modvat amount is lying to the debit of that account, such amount should be added to the closing stock. Opening Stock also will have effect and simultaneously closing stock also. Net difference will be an adjustment to closing stock.

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

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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].

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Proviso: If any amount borrowed on a hundi has been deemed under the provisions of this section to be the income of any person, such persona shall not be liable to be assessed again in respect of such amount under the provisions of this section on repayment of such amount.

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 :

- (i) 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.

*(These particulars need not be given in the case of a Government company, a banking company or a corporation established by a Central, State or Provincial Act).

There are certain exceptions such as if both the persons taking loan and giving loan are having agricultural income and neither of them has any income chargeable to tax under the Act.

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

There are certain exceptions such as if both the persons taking loan and giving loan are having agricultural income and neither of them has any income chargeable to tax under the Act.

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

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(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.

Obtain list of shareholders as on opening date and closing date of the accounting year with documentary proof for such changes. If no change is there, obtain management representation to that effect since you will not be able to know the shareholding pattern through public domain.

26. Section-wise details of deductions, if any, admissible under Chapter VI-A.

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

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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

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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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Legend: *** *** *** are not discussed due to their routineness in nature.