

'NAYA' FORM 3CD

After the new IT return forms, the Income tax department has notified the new Form 3CD on 10th August 2006 vide Notification no. 208/2006. This form is to be used for all Tax Audit reports signed on or after 10th August 2006. Though the form is titled 3CD, it has climbed 2 major sidi (steps) with the new changes: comprehensive reporting of contravention of TDS provisions and certification of Fringe Benefit Expenses by the auditor.

Changes in Form 3CD

- 1. Non-compliance with provisions of Tax Deduction at Source (Clause 27):** Delays and defaults in Tax Deduction at Source (TDS) have to be reported in this clause. The changes made in this clause are the most significant both from the point of view of the assessee and the auditor.

There is a prescribed format in which defaults/ delays in TDS have to be furnished under this clause. But somehow the focus till now was on delay in deposit of TDS only. Bigger defaults like no deduction or short deduction were not brought to the fore. Since the prescribed format did not specifically ask for cases of non-deduction and non-deposit, the same were generally not reported. Therefore, a delay of 5 days in deposit of tax deducted u/s 194C of Rs. 500/- was being reported in the tax audit report but the non-deduction of TDS on interest payment of Rs. 1 crore was left out as it was not required to be specifically reported.

But as they say, practice makes a man perfect. The taxmen have got wiser with experience and suitable inputs from fellow professionals. Accordingly, suitable changes have been made in the format to ask for details of cases of non-deduction, short deduction and non-deposit, besides delay in deposit.

To be able to comply with the new requirements, a comprehensive statement can be prepared for all payments on which TDS is applicable. The following format is suggested:

Sly. No.	Section	Nature of Expense	Amount of payment /credit	Date of payment/ credit	Prescribed Rate	Date of Deduction

Tax Deductible	Tax Deducted	Tax Deposited	Due date of deposit	Actual date of deposit	Delay (in days)

The above statement can be easily prepared in a spreadsheet. Alternatively, the accounts software or TDS software can provide this report. This report can be broken into 4 parts to report the defaults/delays under the different categories. The suggested formats for reporting are as under:

a. Tax deductible and not deducted at all.

Sly. No.	Section	Nature of Expense	Date of Payment/ credit	Amount paid/ credited	TDS Deductible

b. Shortfall on account of lesser deduction than required to be deducted.

Sly. No.	Section	Nature of Expense	Date of Payment/ credit	Amount paid/ credited	Tax Deductible	Tax Deducted	Shortfall



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c. Tax deducted late.

Sly. No.	Section	Nature of Expense	Amount paid/ credited	Tax Deducted	Due Date of deduction	Actual Date of deduction	Delay (in days)

d. Tax deducted but not paid to the credit of the Central Government.

Sly. No.	Section	Nature of Expense	Amount paid/ credited	Date of deduction	Amount of tax not deposited

Impact on Assessee

The assessee must take this amendment very seriously as ANY default in compliance with the TDS provisions shall now be reported in the tax audit report. Consequently, levy of penalty and prosecution would be more frequent now.

This amendment will give teeth to the IT department for disallowance under section 40(a)(ia) of expenses on which tax has not been deducted at source or after deduction has not been deposited within the prescribed time period. Though this provision is applicable from A.Y. 2005-06 onwards, not many assessee were caught in its web because this information was not separately available to the Assessing Officer. But now this information shall be readily available to him, duly certified by the auditor.

Impact on Auditor

From the point of view of the auditor, the responsibility is now much more onerous. In fact signing the tax audit report would mean that he is certifying that adequate tax has been deducted at source and deposited in time on ALL payments on which TDS is applicable.

The auditor and his staff cannot be expected to check each and every transaction, particularly where the volume of transactions is very large. For example in the case of a big bank branch interest is paid to a large number of depositors. The auditor cannot be expected to check each and every transaction for compliance of TDS provisions. Further, the same person may have opened several accounts with different combination of names etc. Probably, we need another DIN i.e. a Depositor Identification Number that will track a depositor

and his deposits. Is the auditor required to investigate and report such cases also? Going a step further, what about transactions not entered in the books of account, willingly or otherwise, on which TDS is applicable. The fact remains that we are 'watch dogs and not blood hounds'. It would have been reasonable to fix a threshold limit, say Rs. 50,000/- or Rs. 1,00,000/- and the auditor could be asked to certify that TDS provisions in respect of payments exceeding the prescribed limit have been duly complied with. Even though the IT department has not asked for it, it is recommended that the **auditor should obtain a TDS compliance certificate from the assessee.**

All said and done, the concept of materiality should not be lost sight of. Fellow professionals should note that every default is not to be reported unless it is material. For example, a short deduction of Rs. 100/- where tax of Rs. 50 crore has been deducted and deposited, is by no stretch of imagination significant and therefore may not be reported.

A suitable disclaimer may be given for this clause such as *"The provisions of tax deducted at source have been complied with as per the books of account and other records produced before us and explanations provided to us. We have not come across any major discrepancy. However, due to the large volume of transactions, it is not possible for us to verify each and every transaction."*

2. Fringe Benefit Tax (FBT) (Annexure II): The valuation of Fringe Benefits has been added to the new tax audit report. The assessee is already required to provide the basic information about FBT in the new IT return forms or in the FBT return (Form 3B) where IT returns have already been submitted in the old forms or where the person is not an income tax assessee. But the department is not satisfied with that and it also wants the tax auditor to certify it. If you recall, the H'ble Finance Minister (FM) had in Budget 2005 speech mentioned that the assessee would be required to obtain a certificate in respect of the value of fringe benefit from its tax auditor. We may have forgotten about it but FM still remembers it. The valuation of Fringe Benefits by the tax auditor would be accepted 'as it is'. That is,

no roving enquiries would be made once FBT is certified by the auditor. This shows the immense faith the FM and the IT department has in Chartered Accountants. But definitely, it is an additional responsibility for us, which must be performed to the best of our ability, knowledge and experience. The Assessing Officer may have a difference of opinion in some cases but he cannot challenge the valuation of the auditor unless and until the mistake/default is apparent and glaring.

The salient feature of the FBT schedule in Form 3CD are as follows:

- a. Certain changes such as different percentages for conveyance and tour & traveling, are applicable w.e.f. A.Y. 2007-08 and this should be borne in mind while preparing tax audit report for A.Y. 2006-07.
- b. The heads naturally are the same as in new IT return forms and FBT return. But here a single field exists for a particular expense. e.g. Hospitality of any kind is covered by a single head in Form 3CD whereas hospitality provided by hotels and others have to be shown separately in IT return forms. A uniform approach would have been better even though the difference in rates in the two cases is explained in the detailed note.
- c. Normally, expenses are debited to the Profit & Loss account and this case is obviously covered in the new Form 3CD. However, the taxmen seem to have got quite intelligent and they have envisaged the following cases:
 - Amount has been capitalized or shown in the balance sheet.
 - Reimbursement of expenses.

Still, they did not want to leave anything to the fertile imagination of assesseees. Accordingly, the amount of expenditure incurred or payment made (on which FBT is applicable) under any other head is also to be shown separately.
- d. The expenses have to be shown in full under the above heads and deduction, if any, has to be shown separately. Such a deduction may be due to any specific exemption. e.g. From A.Y. 2007-08, superannuation contribution to the extent of Rs. 1 lac is exempt in respect of each employee and such amount should be shown as a deduction.

- e. The net amount (after deductions) should match with the amount/value of fringe benefit expenditure given in the IT return.
 - f. The net amount is to be multiplied with the specified percentage to obtain the value of Fringe Benefits, which must tally with the corresponding figure in the IT return.
 - g. The above underlines the need to prepare a proper Reconciliation Statement wherein the figures in accounts are duly tallied with those in the Profit and Loss Account, Balance sheet etc. These figures should be further reconciled with those in the Tax audit report and the IT return. Though this would be an additional work, it would be very handy at the time of assessment. It would be quite difficult and time consuming to tally the various items at a later stage.
 - h. Please do not commit the folly of not giving this annexure in the tax audit report. This is because a note has been given specifically even in the earlier Form 3CD that 'the annexure(s) to this Form must be filled up, failing which the Form will be considered as incomplete'.
- 3. Disallowance of Payments not made by Account Payee Cheques/ Bank drafts (Clause 17(h)):** This clause requires the auditor to report the expenses exceeding Rs. 20,000/-, to be partially disallowed (20%) if the same have been incurred **otherwise than by a crossed cheque or crossed bank draft** (subject to certain exceptions like payment made to farmers for purchasing their agricultural output). In line with the changes made by the Taxation Laws (Amendment) Act, 2006, the amount shall be disallowed now if payment is made other than by an account payee cheque drawn on a bank or account payee bank draft. Normally, this is presumed to cover cases of payment exceeding Rs. 20,000/- in cash and payment by self-cheques. However, going strictly by the terminology, even payments made by credit advices, internet banking etc. should be disallowed but these are not normally reported as it does not seem to be the intention of the legislature to disallow such expenses.

It is advisable to give a suitable note in such a case like "Payments made by credit advices,

Internet banking etc. have not been reported here". But please exercise discretion and caution as it may invite trouble.

Cash deposited in Core Banking Solution (CBS) branches by debtors is a normal business phenomenon these days. The same should be reported even though it is through regular banking channel. Though IT tribunals have been taking a lenient view in such cases, the Assessing Officer may create problems for the assessee.

The computation of such disallowance is also required to be given but generally the total amount of disallowance is reported without giving the breakup of the same. Now it has been clarified that the breakup of amount disallowed has to be given. A sample format could be as follows:

Sl. No.	Nature of Expense	Amount paid	Mode of Payment	Amount disallowed (20%)

A standard reply for this clause was "The assessee's bank does not return back the issued cheques to it and in the absence of same, it is not possible to quantify the amount of disallowance, if any". Some auditors also follow the practice of taking a certificate from the assessee to the effect that no expense has been incurred otherwise than by the permissible mode. Now, it has to be specifically reported in the tax audit report whether such a certificate has been taken or not. It is to be noted that obtaining a certificate has not been made mandatory. But the department understands that it is not possible for the auditor, in most cases, to certify this information. Accordingly, the onus is now on the assessee to certify it.

4. Particulars of Loans Accepted or Repaid by Account Payee Cheques/ Bank drafts (Clause 24(c)): Under sub clauses (a) and (b) of clause 24 particulars of loans or deposits exceeding Rs. 20,000/- accepted or repaid have to be given in the prescribed format, if the payment has not been made by an account payee cheque or an account payee bank draft. Now under this new sub clause also the auditor has to report whether a certificate has been obtained from the assessee regarding taking or accepting loan or deposit, or repayment of the same otherwise through the prescribed means. The particulars are not required to be given in the case of

a repayment to Government, Government company, banking company or a corporation established by a Central, State or Provincial Act. Therefore, the impugned certificate though optional in the case of other assessee, is not required in such cases.

5. Conversion of Capital Asset into Stock-in-trade (Clause 12A): We all are aware that capital gains are deemed to arise when a capital asset is converted into stock in trade of an assessee. But practically, such capital gains are not offered for taxation. Therefore, a new clause has been added whereby the auditor is supposed to give the particulars necessary for computation of capital gains i.e. details of the asset, cost and date of acquisition and the amount at which it has been converted. The date of sale though important, has not been asked for. The auditor has to be vigilant and report such cases of conversion in the tax audit report. Though 'singular' includes 'plural' as per the Law of Interpretation of Statutes, the language of this clause makes one believe that the details have to be given in respect of one capital asset only, which definitely is not the intention of the department. It is hoped that it will change the language the next time the form is amended.

6. Disallowance of Expenses for Exempt Incomes (Clause 17(I)): This is a new sub clause. The amount of expenses incurred in relation to incomes not forming part of total income (exempt incomes) should be reported here if the same have been claimed as deduction in the computation of income. This was implied but now such instances have to be specifically reported by the auditor to enable the taxmen to catch such double whammies. To take a practical example, banks earn substantial tax-free interest income on government securities etc. But in most cases they claim the entire interest expense in the computation of income tax. Now it is necessary for the auditor to bifurcate the amount of interest expense for the purpose of working out the disallowance. In case of mixed use of funds, the interest expense can be apportioned in a suitable manner. A proper disclaimer must be given in cases where it is not possible to work out the quantum of such expenditure.

7. **Interest allowable after use of asset (Clause 17(m)):** The general practice is that till a project starts, interest is capitalized and thereafter interest is claimed as revenue expenditure. However, the amount of interest paid for purchase of an asset for extension of existing business or profession, is allowed as a deduction only after the same is 'put to use' in the business. The interest for the period the asset is not put to use is disallowed as per the proviso to Section 36(1)(iii). The taxmen could not easily detect such cases and therefore the auditor has an additional responsibility here to report the amount of disallowance in such cases.
8. **Particulars of expenses allowable on payment basis (Clause 21(i)):** Under section 43B, some deductions such as any tax, duty, cess, interest payable to public financial institutions etc., are allowed only on payment basis. The details of such deductions for the earlier years and the current financial year have to be given under this sub clause. For some strange reason, contribution to any superannuation, gratuity fund etc. for the welfare of employees was to be reported in greater detail under the next sub clause even though it was similar to other items under section 43B. Now sub clause (ii) has been deleted and the information about the contribution to welfare funds has to be given as in case of other items in section 43B. The expense in relation to leave encashment (which was added to section 43B from A.Y. 2002-03 onwards) has also to be reported under this sub clause now. These amendments show that the selective and discretionary approach (of the IT department) has given way to a more simple and comprehensive approach, which would be definitely revenue friendly.
9. **Past Losses not allowable after major change in shareholding (Clause 25(b)):** If there has been a change in majority shareholding of a company during a financial year, then the losses incurred prior to the previous year cannot be carried forward by it (section 79). This is not applicable to companies in which public are substantially interested and certain other companies. Such change, if any, has to be specifically reported in tax audit report now to enable the taxmen to make disallowance in such cases.
10. **Key figures (Annexure I):** The annexure of some important balance sheet and profit and loss items has been renumbered as Annexure I as there are two annexures to Form 3CD now, the other one being that of Fringe Benefit Tax. The nature of business and profession is now required to be given for each business and profession now. This annexure has been suitably modified to make it applicable even to non-corporate assessees. Accordingly, Capital of Partner/ Proprietor has been added to Paid up Share Capital, Current Account of the Partner/Proprietor has been added to Share Application Money and Reserves and Surplus now has the company of Profit and Loss account. Further, Gross Receipts has been added to Gross Turnover so that the

professionals and other service providers do not mention the more convenient 'not applicable' against this item. It has also been clarified that the figure of Profit or Loss before tax, has to be as per the Profit and Loss account.

Other Minor/ Explanatory changes

These are not changes in the true sense of the word. They merely explain what needs to be done in a particular case. Most of us know what is 'implied' but now that it being made 'express' for those for whom *ishara* is not *kaafi* (hint is not sufficient). Some of these changes are as follows:

11. Changes in Partnership/ profit sharing ratio since last year (Clause 7b):

It has been made clear that if there is any change in the constitution of the partnership or the profit sharing ratio of the partners after the preceding financial year, then only the particulars of such change have to be reported. Changes that have taken place prior to that are not required to be given. It is not clear whether changes that have taken place during the financial year or those upto the date of signing of the tax audit report have to be reported in this clause. Use of simple words 'Changes during the previous year' could have been used to avoid confusion.

12. Nature of all businesses (Clause 8a):

It has been clarified that if more than one business or profession is carried on during the previous year, then the type of business or profession has to be reported for each one. The language of the earlier clause suggested that the information had to be given in respect of any one business only.

13. Deductions to be given separately (Clause 15):

The amount of deductions claimed under various specified sections (most of which are not applicable to normal businesses such as those relating to expenditure on scientific research, tea development account etc. but also including deduction in respect of preliminary expenses u/s 35D) had to be given separately. Most of the times, we routinely write N.A. in case of such items. The requirement here was to show 'the amount debited and deduction allowable under each section separately'. However, even those who were giving the

figures separately for those debited and not debited to Profit and Loss account, used to club all the deductions under the two heads due to paucity of space in the form. Now, the space has been increased to reveal the information about deduction claimed under each individual section.

14. Service Tax and VAT refund etc. not credited to Profit & Loss account (Clause 13(b)):

This clause casts an obligation on the auditor to report instances where refunds, credits etc. of duties, taxes etc. are not shown in the Profit and Loss account even though their claim has been accepted by the respective department like customs, excise and sales tax. Service tax and Value Added Tax have been added to this list so that any refunds, credits etc. from these departments do not go unreported.

Virtually, every default of TDS has to be reported in tax audit report now. But the assesses and auditors may breathe easy as delays and defaults in Tax Collection at Source (TCS) have still not been incorporated in the revised 3 CD form. When a comprehensive review of the form was undertaken, such omissions could have been rectified.

No specific format of certificates to be taken from a client for compliance of provisions of section 40A(3), 269SS and section 269T has been prescribed. A standard format could definitely be a better option. It is hoped that specimen certificates to be taken from the assesses, wherever necessary, shall be provided in the revised edition of the Guidance note on Tax Audit by the Institute of Chartered Accountants of India.

The new IT return forms are self-contained and do not require any annexure including tax audit report. The tax audit report has been revised but the particulars of the same incorporated in the IT returns are as per the earlier format. Ideally, the new IT forms should have incorporated the new tax audit report even though it would have meant some more delay in the notification of new forms. But this has not been done. Therefore, the tax audit details in the two forms would be different for some clauses, at least and the auditors would have to find ways to correlate the two. It is recommended that wherever possible information should be given as per the revised clause, with a suitable note. Hopefully, the necessary changes shall be made by the next year. □