

**Supplementary Guidance Note on
Tax Audit under section 44AB
of the Income-tax Act, 1961**

The Institute of Chartered Accountants of India

New Delhi.

Introduction

The Central Board of Direct Taxes has issued Notification No.208/2006 dated 10th August, 2006 containing the Income-tax (9th Amendment) Rules, 2006. These rules incorporate several significant amendments in Form No.3CD relating to tax audit. The Fifth Edition of the Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961 incorporating the law as amended by the Finance Act, 2005 was published in September, 2005. This supplementary Guidance Note gives guidance on the amendments made by the above-mentioned Notification in Form No.3CD.

Furnishing of Form No.3CA/3CB with Form No.3CD

Every person who is required to get his accounts audited under section 44AB has to furnish the audit report along with the required particulars by the specified date mentioned in section 44AB namely 31st day of October of the Assessment Year (A.Y.) For the A.Y. 2006-2007 the tax audit report is to be furnished latest by 31st October, 2006. The Notification No.208/ 2006 has been issued on 10th August, 2006. All tax audit reports signed on or after 10th August, 2006 whether in respect of A.Y . 2006-07 or the earlier assessment years should be in the revised format. The tax auditor cannot use the old format merely because the tax audit is in respect of accounts for the financial years corresponding to the A.Y. 2006-07 and/or any of the earlier years. The relevant date is the date of signing of the tax audit report and not the financial year in respect of which such audit report is furnished. However, in respect of assessment years preceding A.Y. 2006-07 the tax auditor while giving his tax audit report in the revised format on or after 10th August, 2006 should indicate only those particulars as per the requirement based upon the relevant law applicable to the assessment year in relation to the financial year for which the report is being furnished. Further, the tax auditor need not give information, which is not relevant for the concerned earlier assessment year. This is necessary having regard to the fact that the tax audit report is to be used by the Assessing Officer for the purpose of completing the assessment of the concerned assessee for the relevant assessment year in accordance with the law applicable to that assessment year.

Tax audit report furnished prior to 10th August, 2006

If any person who is required to get his accounts audited in terms of section 44AB has got the audit done and furnished the audit report prior to 10th August, 2006 in the earlier Form No.3CD, he need not submit a revised audit report furnishing the particulars in the revised Form No.3CD. However, if such a person after getting the tax audit report prior to 10th August, 2006 approaches the tax auditor for a revised tax audit report along with the revised Form No.3CD with Annexure II, the tax auditor may furnish a revised report. Attention is invited to the following extracts from para 13.9 of the Guidance Note on Tax Audit.

"It may be pointed out that report under section 44AB should not normally be revised. However, sometimes a member may be required to revise his tax audit report on grounds such as:

- (i) revision of accounts of a company after its adoption in annual general meeting.
- (ii) change of law e.g., retrospective amendment.
- (iii) change in interpretation, e.g. CBDT Circular, judgements, etc.

In case where a member is called upon to report on the revised accounts, then he must mention in the revised report that the said report is a revised report and a reference should be made to the earlier report also. In the revised report, reasons for revising the report should also be mentioned. [Reference may also be made to Guidance Note on Revision of the Audit Report (Handbook of Auditing Pronouncement Volume II, page 472)]

Amendments made by Notification No.208/2006

Notification No.208/2006 dated 10th August, 2006 has made significant amendments in Form No.3CD. It has also inserted Annexure – II for the computation of the value of fringe benefits in terms of section 115WC read with section 115WB. In the following pages the amendments made in various clauses of Form No.3CD, other than annexure II have been explained. Also the consequential impact of the Finance Act, 2006 and the Taxation Laws (Amendment) Act, 2006 have been discussed. This guidance note is a supplementary to and should therefore be read along with the Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961 (September, 2005 Edition). The amendments made in different clauses of Form No.3CD have been given. The portions deleted are shown in a strikethrough form. The new insertions are given in bold.

Part B of Form No.3CD

Clause 7

7. (a) If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.

(b) ~~If there is any change in the partners/ members or their profit sharing ratios, the particulars of such change.~~

(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

There is no change in clause 7(a). The amendment in clause 7(b) is clarificatory that the change since the last date of the preceding year is required to be reported. If there is any change in the partners of the firm or members of the association of persons or their profit sharing ratio since the last date of the preceding year, the particulars of such change must be stated. All the changes occurring during the entire previous year must be stated. Normally under the General Clauses Act, the word "year" refers to the calendar year. However, in this clause "preceding year" may be reckoned as the previous year ending before the commencement of the previous year for which tax audit is being conducted. Thus, for the audit of the year ended on 31st march, 2006, any change after 31st March, 2005 will have to be reported.

8. (a) ~~Nature of business or profession.~~

(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)

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

The amendment made in clause 8(a) is clarificatory in nature. In regard to the nature of business, the principal line of each business such as manufacturing of electronic goods, trading in chemicals, wholesale trade in foodgrains or a retail trade in grocery should be stated. In case of a person rendering services, the nature of each type of service should be broadly stated.

In regard to the nature of business or profession, Part 'B' of the annexure – I to Form 3CD needs to be referred to, which also requires to give nature of business. This Annexure provides details of various sector and sub-sector in which an assessee could be engaged. Information has to be furnished in respect of each business. An amendment similar to the one in sub-clause (b) of clause 8 has been carried out in Part B of Annexure I. Information provided under this clause should be in consonance with the information provided in Part B of Annexure – I.

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.**

This is a new clause inserted by the notification. For furnishing the particulars required by clause 12A, the provisions of section 2(47), 45(2), 47(iv) and (v) and 47A have to be kept in mind.

From the A.Y. 1985-86 onwards the conversion by the owner of an asset into or treatment of such asset as stock-in-trade of a business carried on by him is treated as a 'transfer' within the meaning of section 2(47). Under section 45(2) such a conversion or treatment of capital asset into stock-in-trade will be deemed to be a transfer of the previous year in which the asset is so converted or treated as stock-in-trade. However, the capital gains arising from such a transfer will become chargeable in the previous year in which such converted asset is sold or otherwise transferred. In the case of long-term capital asset, indexation of cost of acquisition and cost of improvement, if any, will be with respect to the previous year in which such conversion took place. The fair market value of the asset, as on the date of such conversion or treatment as stock-in-trade, shall be deemed to be the full value of the consideration of the asset. The excess of the sale price over the fair market value as on the date of conversion would be treated as business income and taxed under the head 'profits and gains of business or profession'. The capital gains being the difference between the cost of acquisition and the fair market value on the date of the conversion or treatment as stock-in-trade will be chargeable to tax in the year in which the asset is sold.

Section 47 of the Act enumerates the transactions which will not be regarded as transfer. Under sub-clause (iv) any transfer of a capital asset by a company to its subsidiary company if the parent company or its nominees hold the whole of the share capital of the subsidiary company and the subsidiary company is an Indian company will not be treated as a transfer. Under clause (v) any transfer of a capital asset by a subsidiary company to the holding company if the whole of the share capital of the subsidiary company is held by the holding company and the holding company is an Indian company will not be considered as a transfer.

The capital gains exempted by virtue of clause (iv) or clause (v) of section 47 may become chargeable under certain circumstances. The provisions of section 47A are relevant here. Accordingly, where at any time before the expiry of a period of 8 years from the date of transfer of a capital asset referred to in clause (iv) or clause (v) of section 47, such capital asset is converted by the transferee company into, or is treated by it as, stock-in-trade of its business or the parent company or its nominees or, as the case may be, the holding company ceases to hold the whole of the share capital of the subsidiary company, the amount of profits or gains arising

from the transfer of such capital assets not charged under section 45 by virtue of the provisions contained in clause (iv) or clause (v) of section 47 shall be deemed to be income chargeable under the head "capital gains" of the previous year in which such transfer took place.

The particulars to be stated under new clause 12A should be furnished with respect to the previous year in which the asset has been converted into stock-in-trade. The clause does not require details regarding the taxability of capital gains or business income arising from such deemed transfer.

Under clause (a) description of the capital asset is required to be mentioned for example shares, security, land, building, plant, machinery etc.

Under Clause (b) the date of acquisition is to be reported. For ascertaining the correct date the tax auditor will have to refer the accounts of the financial year in which such capital asset is acquired. The date assumes importance for the purpose of determining whether the asset is long-term or short-term in nature.

Under clause (c) the cost of acquisition is required to be reported. Here the cost of acquisition as per the books of account is to be mentioned. In case of depreciable assets, the carrying cost appearing in the books will be the written down value. But the value to be reported will be the original cost of acquisition. Even in case of an asset acquired prior to the 1st day of April, 1981 the value to be reported will be the original cost of acquisition. The assessee may exercise the option of considering the fair market value of the asset as on 1st April, 1981 for assets acquired prior to that date for the purpose of computation of capital gains as provided under section 55(2)(b)(i).

Under clause (d) the amount at which the asset converted into stock-in-trade should be stated. Such an amount may not be the fair market value on the date of conversion or treatment as stock-in-trade. If a value other than carrying cost is

recorded then the auditor has to examine the basis of arriving such a value. The valuation of stock-in-trade is to be examined with reference to AS-2 – Valuation of Inventories. Non-compliance of AS-2 is to be properly qualified in the main audit report.

It is desirable that necessary accounting entry is passed in the books of account at the time of conversion of the asset into or treatment of the same as stock-in-trade.

In the case of assessee like a proprietorship concern, prior to the conversion of the asset into stock-in-trade, the details regarding the date of acquisition and cost of acquisition may not be recorded in the books of account. It is also possible that the year in which the capital asset is acquired, the accounts of the assessee may not have been subjected to audit. Also an assessee can acquire a capital asset through various modes such as discussed under section 49 of the Act. Under such circumstances the auditor may have to verify the cost of acquisition. The following broad principles need to be kept in mind.

While verifying the cost of acquisition of the fixed asset, the auditor should bear in mind the principles enunciated in Accounting Standard (AS) 10, Accounting for Fixed Assets. As per paragraph 20 of the said Accounting Standard, the cost of a fixed asset comprises of its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. Thus, in case of **capital assets** purchased by the assessee, it would relatively be easy for the auditor to verify the cost of acquisition, the evidence being provided by the supporting purchase invoices from the supplier, entries appearing in the bank statements in respect of payment to the supplier, entries appearing in the cash book/ bank statement for payment of cartage installment etc. In case of **self-constructed capital assets**, the cost would comprise those costs that relate directly to the specific capital asset and those that are attributable to the construction activity in general and can be allocated to the specific asset. Thus, in this case, the evidence would be provided by documents such as board resolutions and minutes. In case of a company, engineer's certificate on stages of completion, communication with the regulating agency, if any, payment made to the contractor, payments made for purchase of raw materials etc. and entries recorded in the fixed assets register may be verified. In the case of **Capital**

assets acquired in exchange or in part exchange for another asset, the cost of the asset acquired is either the fair market value or the net book value of the asset given up, whichever is more clearly evident, adjusted for any balancing payment or receipt of cash or other consideration. In case the capital asset is recorded at the net book value of the asset, the fixed asset register would provide the prime evidence of the value. If, however the capital asset so acquired is recorded at the market value the auditor would need to examine the basis for arriving at the fair market value, for example, the valuer's report, market quotes (in case of listed securities). While relying upon the valuer's report, the auditor should also bear in mind the principles outlined in Auditing and Assurance Standard (AAS) 9 - Using the Work of an Expert.

In any case the auditor would also need to look into how the assessee has decided the value at which the asset is recorded in the books of account is more clearly evident than the other value. In case of a capital asset **acquired by way of inheritance**, the auditor may find it difficult to verify the cost of acquisition to the original owner. In case there does not exist any documentary evidence as to the cost of acquisition of the asset to the original owner, say the sale/purchase agreement the auditor may need to rely upon the reports of the experts such as valuers. In addition to the above, the auditor should also refer to the guidance contained in the Guidance Note on Audit of Fixed Assets issued by the Institute.

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

(b) the proforma credits, drawbacks, ~~refund of duty of customs or excise, or refund of sales tax,~~ **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

The two items included by the amendment in sub-clause (b) of clause 13 are refund of service-tax and refund of value added tax. All the observations made in paragraph 24.3 are *mutatis mutandis* applicable in respect of refund of service tax and refund of value added tax.

15. ~~Amounts admissible under section 33AB, 33ABA, 33AC, 35, 35ABB, 35AC, 35CCA, 35CCB, 35D, 35E:-~~

Amounts admissible under sections –

- (a) 33AB**
- (b) 33ABA**
- (c) 33AC (wherever applicable)**
- (d) 35**
- (e) 35ABB**
- (f) 35AC**
- (g) 35CCA**
- (h) 35CCB**
- (i) 35D**
- (j) 35DD**
- (k) 35DDA**
- (l) 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.

This is an amendment to the existing clause 15. References to sections 35DD being amortisation of expenditure in case of amalgamation or demerger and section 35DDA being

amortisation of expenditure incurred under voluntary retirement scheme have been added by the amendment.

All the observations made in paragraph 26.1 are mutatis mutandis applicable in respect of sections 35DD and 35DDA.

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

Notification No.208/2006 has not made any amendments to clause 17(f). However, the Taxation Laws (Amendment) Act, 2006 has come into force on 13th July, 2006 made amendment in sections 40(a) and section 194J which have a bearing on the responsibilities of a tax auditor. Therefore, the following additional guidance has been given to guide the tax auditor to discharge his responsibility in the context of the above mentioned amendments.

The Taxation Laws (Amendment) Act, 2006 has amended sub-clause (ia) of clause (a) of section 40 w.e.f. the 1st day of April, 2006. The scope of inadmissible amounts mentioned in the sub-clause has been expanded to include rent and royalty. Accordingly, where tax has not been deducted in respect of rent and royalty or after deduction has not been paid during the previous year or in the subsequent year before the expiry of the time prescribed under sub-section (1) of section 200, the same shall not be deducted in computing the income chargeable under the head "profits and gains or business or profession".

It may be noted that section 194-I has also amended by Taxation Laws (Amendment) Act, 2006. However, this amendment is with effect from 13th July, 2006. Therefore, for the purpose of computing the inadmissible amount under section 40(a)(ia) for the assessment year 2006-07 rent will have the meaning as

per the Explanation (1) under section 194-I prior to its substitution by the Taxation Laws (Amendment) Act, 2006.

It is possible that an assessee may contend that the inadmissibility under section 40(a)(ia) with respect to the amended definition of rent and royalty does not apply in relation to assessment year 2006-07. In such a case the tax auditor should state the view point of the assessee and also provide the relevant information as mentioned above in order to enable the tax authority to take a decision in the matter.

17 (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]*

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

This is an amendment to the existing clause 17. The Taxation Laws (Amendment) Act, 2006 has amended section 40A(3) w.e.f. 13th July, 2006 to provide that the payment for expenditure is made only by account payee cheque or account payee bank draft. The present provision of allowing the expenditure in case the payment has been made by crossed cheque/bank draft has been discontinued.

The amended provisions of section 40A(3) are not applicable for the A.Y. 2006-07. They are applicable from 13th July, 2006. The certificate required under Item (A) of sub-clause (h) is based upon the amended provisions of section 40A(3). So far as A.Y. 2006-07 is concerned the tax auditor may state that clause (A) is not applicable.

However, the tax auditor has to verify whether the law contained in section 40A(3) as applicable for A.Y. 2006-07 has been complied with by the assessee. Although the reporting requirement is not strictly applicable for the previous year 2005-06 and also for the period from 1.4.2006 to 12th July, 2006, it is always desirable that the tax auditor should obtain suitable certificate as per the applicable law and keep it in his audit working papers file.

In respect of A.Y. 2007-08 the reporting requirements under sub-clause (h) can be divided into two parts. In respect of the period commencing from 1st April, 2006 and ending on 12th July, 2006 the amended provisions of section 40A(3) are not applicable. Therefore, in respect of that period there is no reporting requirement under item (A) of sub-clause (h). In respect of the period commencing from 13th July, 2006 and ending on 31st March, 2007 and the subsequent financial year the reporting requirements of item (A) have to be complied with.

There may be practical difficulties in verifying the payments made through crossed/account payee cheque or bank drafts.

If no proper evidence for the verification of the payment by the crossed/account payee cheque or draft is available, such a fact could be brought out by appropriate comments in the following manner applicable to the relevant assessment year.

In respect of A.Y . 2006-07.

"It is not possible for me/us to verify whether the payments in excess of Rs.20,000 have been made otherwise than by crossed cheque or bank draft as the necessary evidence is not in the possession of the assessee".

In respect of A.Y . 2007-08

For the period commencing from 1st April, 2006 and ending with 12th July, 2006, it is not possible for me/us to verify whether the payments in excess of Rs.20,000 have been made otherwise than by crossed cheque or bank draft as the necessary evidence is not in the possession of the assessee and for the period commencing from 13th July, 2006 and ending on 31st March, 2007, it is not possible for me/us to verify whether the payments in excess of Rs.20,000 have been made otherwise than by account payee cheque or account payee bank draft, as the necessary evidence is not in the possession of the assessee.

The earlier sub-clause (h) required furnishing of the amount inadmissible under section 40A(3) read with rule 6DD along with computation. The amended sub-clause requires disclosure of amount inadmissible under section 40A(3) read with rule 6DD with the break-up of inadmissible amount.

Wherever possible individual items of inadmissible expenses may be given. However, where in view of the large volume of transactions it is not possible to give individual items of inadmissible amounts, the tax auditor may furnish such details under broad heads of accounts.

For the purpose of furnishing the above particulars, the tax auditor should obtain a list of all cash payments in respect of expenditure exceeding Rs.20,000 made by the assessee during the relevant year which should include the list of payments exempted in terms of Rule 6DD with reasons. This list should be verified by the tax auditor with the books of account in order to ascertain whether the conditions for specific exemption granted under clauses (a) to (l) of Rule 6DD are satisfied. Details of payments which do not satisfy the above conditions should be stated under this clause.

(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,

Section 14A was inserted in Chapter IV – Computation of total income by the Finance Act, 2001 with retrospective effect from 1.4.1962 i.e. A.Y. 1962-63. Accordingly, for the purposes of computing the total income under Chapter IV of the Act no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act.

The Finance Act, 2002 added a proviso to section 14A to the effect that nothing contained in the section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increase in the liability of the assessee under section 154, for any assessment year beginning on or before the first day of April, 2001.

The Finance Act, 2006 has inserted sub-sections (2) and (3) w.e.f. A.Y. 2007-08. Under sub-section (2) the Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the Act. Such determination should be in accordance with such method as may be prescribed. Such power of the Assessing Officer can be exercised only when he, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee.

Sub-section (3) provides that the provisions of sub-section (2) shall also apply in relation to a case 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 this Act.

It is primarily the responsibility of the assessee to furnish the details of amounts 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. The method of ascertaining the inadmissible expenditure as and when prescribed should be followed. 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. Attention is invited to para 5 of AAS-11, Representation by Management which is as under:-

During the course of an audit, management makes many representation to the auditor, either unsolicited or in response to specific enquiries. When such representations relate to matters which are material to the financial information, the auditor should;

- (a) seek corroborative audit evidence from sources inside or outside the entity;
 - (b) value whether the representations made by management appear reasonable and consistent with other audit evidence obtained, including other representations; and
 - (c) consider whether the individuals making the representation can be expected to be well informed on the matter.
- (m) amount inadmissible under the proviso to section 36(1)(iii).**

The provisions of section 36(1)(iii) provide that the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession would be allowed as a deduction in computing the income referred to in section 28 of the Act.

The proviso thereunder (inserted by the Finance Act, 2003 w.e.f. A.Y. 2004-05) provides that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books or account or not) 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 put to use, shall not be allowed as a deduction.

The Explanation provides that recurring subscription paid periodically by shareholders or subscribers in Mutual Benefit Society which fulfill such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of section 36(1)(iii).

The Explanation becomes applicable only where the computation of the income of such mutual benefit society is to be made under section 28 read with section 44A.

The requirements of sub-clause (m) are applicable in respect of capital borrowed for acquisition of an asset for extension of the existing business or profession. The assessee has to furnish the details of amount inadmissible under the proviso to section 36(1)(iii). The tax auditor has to verify the correctness of the particulars furnished by the assessee with the documentary evidence.

21.* (i) In respect of any sum referred to in ~~clause (a), (c), (d) or (e) of section 43B,~~ **clauses (a), (b), (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.

~~(ii) — In respect of any sum referred to in clause (b) 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:~~

~~(a) — nature of liability;~~

~~(b) — due date of payment under second proviso to section 43B;~~

~~(c) — actual date of payment;~~

~~(d) — if paid otherwise than in cash, whether the sum has been realised within fifteen days of the aforesaid due date;~~

~~(B) — was incurred in the previous year:~~

~~————— (a) — nature of liability;~~

~~(b) — due date of payment under second proviso to section 43B;~~

~~————— (c) — actual date of payment;~~

~~(d) — if paid otherwise than in cash, whether the sum has been realised within fifteen days of the aforesaid due 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.~~

Section 43B has been amended by the Finance Act, 2001 and Finance Act, 2003.

Consequent to the above amendments a uniform treatment is being given in respect of all sums specified in clauses (a) to (f) of section 43B.

Section 43B provides that notwithstanding anything contained in any other provisions of the Act, the following amounts shall be allowed as deduction in computing the business income of an assessee in the previous year in which such amounts are actually paid:

(a) any tax, duty (sales tax, value added tax, service tax, excise duty, municipal tax, etc.), cess or fee, by whatever name called, payable by the assessee under any law for the time being in force.

(b) employer's contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.

(c) any bonus or commission payable by the assessee to its employees.

(d) interest on any loan or borrowing from any public financial institution, a state financial corporation or a state industrial investment corporation payable in accordance with the terms and conditions of the agreement governing such loan or borrowing.

(e) any sum payable by the assessee as interest on any loan or advances from a scheduled bank in accordance with the terms and conditions of the agreement governing such loan or advances.

(f) any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

In the case of an assessee maintaining its accounts on the mercantile system, the tax auditor should verify the aforesaid particulars, referred to in clauses (a) to (f) above from the books of account for the year under audit as well as from the books of account, vouchers and documents of the immediately succeeding assessment year so that the information about the aforesaid payments made in the subsequent year can be furnished.

All the payments referred to in clauses (a) to (f) above incurred in the previous year are to be reckoned. They will be allowable to the extent they are paid by the assessee on or before the due date for furnishing the return of income under section 139(1). It may be noted that the requirement for disclosing of such sums is covered by clause 21(i)(B). It may be noted that the effect of the amendment to the said clause is only for the amount of employer's contribution and the employees contribution would still be governed by the provisions of section 2(24)(x) read with section 36(1)(va) and as such information required to be provided in respect of employees contribution under clause 16(b) of Form No.3CD shall continue to be on the basis of due date under the relevant law.

While the deduction for liability in respect of the specified sums incurred during the previous year is available for payments actually made till the due date of filing the tax return for the said year, 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. The requirement for disclosure of such sums is covered by clause 21(i)(A). The tax auditor, in his tax audit report, should, therefore, clearly distinguish the liability incurred during the previous year in respect of all the specified sums referred to in clauses (a) to (f) from the liability that pre-existed on the first day of the relevant previous year so that allowable deduction u/s 43B is capable of being verified .

If the assessee is following the cash basis of accounting, sums referred to in clause (a), (b), (c), (d), (e) and (f) of section 43B which are debited to the profit and loss account will be allowable as they would have been actually paid during the year.

Under the first proviso to section 43B, deduction is available in respect of any sum which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income under sub-section (1) of section 139. Since the due date of filing of the return would usually be subsequent to the signing of the tax audit report the tax auditor would be able to give information in respect of matters only upto the date of signing of the tax audit report. This fact should be stated under this clause by way of note as follows:

Note: Information given under clause 21(i)(B) is only up to..... and does not include any payment which the assessee may make subsequently before the due date of filing of the return under section 139(1).

The payment made subsequent to that date but before the date of filing of the return, will still be eligible for deduction under section 43B. Hence the tax auditor should advise the assessee to include necessary evidence of payments made after the signing of the tax audit report but before the due date of filing. This evidence may also be in the form of a certificate from a chartered accountant obtained specifically for this purpose - Circular No.601 dated 4.6.1991 vide Appendix XVII.

The provision made in the accounts for excise duty payable on finished goods in the bonded warehouse will also have to be disclosed under this clause. For enabling the assessee to claim this amount as a deduction the tax auditor may have to verify that the said goods have been cleared and that excise duty thereon has been paid or adjusted against CENVAT credits before the due date applicable in his case for furnishing the return of income under section 139 (1).

Payments made in lieu of leave standing to the employees' credit is covered under clause (f) of Section 43B. This clause was introduced by the Finance Act, 2001 effective assessment year 2002-03. Earlier, the Supreme Court in the case of *Bharat Earth Movers Ltd. v CIT [2000] 245 ITR 428* ruled that provision made by an assessee company for meeting the liability towards leave encashment proportionate to entitlement earned by the employees of the company (subject to ceiling on accumulation as applicable on the relevant date) is fully deductible in view of the said liability being a certainty and not a contingent liability. In view of the aforesaid decision many assessees who had provided for leave encashment liability were given the benefit of deduction without actual payment or discharge of such liability till the previous year 2000-01. Effective A.Y. 2002-03, with the introduction of clause (f) in section 43B, leave encashment liability is allowable as deduction only upon payment. The tax auditor has to check and satisfy himself whether the payments for leave encashment made during or after the previous year 2001-02 have been already claimed by or allowed to the assessee in an earlier year in terms of the above decision of the Supreme Court. The tax auditor, while reporting on payment covered by clause (f) should proper distinguish the leave encashment payments made by the assessee during the previous year that were earlier allowed from the payments that were disallowed in the earlier years.

The 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.

The tax auditor is not required to determine any admissible or inadmissible amount(s).

Under section 43B(a), sales-tax when paid is allowed as a deduction. Although under clause (a) of section 43B items that have been debited to the profit and loss account but not paid during the previous year, are to be specified, where it is the practice of the company to maintain a separate sales-tax/excise duty account and treat the sales tax/excise duty collected as a liability, it would be necessary to show by way of note under this clause, the amount of sales tax/excise duty collected but not paid. In case, any sum has been paid before the due date of

filing the return the fact of payment along with the amount paid should also be disclosed.

Format (to be prepared and typed)

As suggested under clause 16(b), given herein before, here also, in view of the voluminous nature of the information the tax auditor can apply test checks and compliance tests to satisfy himself.

In some cases the tax auditor may find amounts of the nature referred to in section 43B being credited to the profit and loss account although the relevant provisions for such liability had not been allowed as a deduction in any previous year in view of the specific provisions of section 43B requiring actual payment as a condition precedent to allowance. The amounts so credited to the profit and loss account are not chargeable to tax since the conditions referred to in section 41(1) have not been satisfied. The tax auditor should identify such items in his report so that the assessee, while preparing his return of income may exclude such items.

The Finance Act, 2006 has added Explanation 3C to section 43B w.r.e.f A.Y. 1989-90 and Explanation 3D w.r.e.f. A.Y. 1997-98. The Explanations clarify that a deduction of any sum being interest payable under clause (d) and clause (e) of section 43B shall be allowed, if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or advance shall not be deemed to have been actually paid. Circular No.7/2006 dated 17th July, 2006 observes that the clarificatory Explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to "actual payment". The circular clarifies that the unpaid interest whenever actually paid to the bank or financial institution will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, the converted interest, by whatever name called, in the wake of its conversion into a loan or borrowing or advance, will be eligible for deduction in the computation of income of the previous year in which the converted interest is 'actually paid'. In other words, nomenclature

of the sum of converted interest will make no difference as the sum of converted interest whenever is actually paid will not represent repayment of the principal. The circular clarifies that the fundamental principle remains that once an amount has been determined as interest payable to the banks or financial institutions, any subsequent change of nomenclature of interest will not affect its allowability and deduction in terms of section 43B will have to be allowed on its actual payment. The Assessing Officer would therefore be justified in seeking a certificate from the assessee to be obtained by the assessee from the lender bank or financial institution etc. as evidence of "actual payment" of interest to banks or financial institutions.

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]

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,

The tax auditor has to state 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. The mere obtaining of such certificate from the assessee does not reduce the scope of the responsibility of the tax auditor to verify the compliance with the provisions of sections 269SS & 269T.

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, the particulars (i) to (iv) mentioned in sub-clause (b) of clause 24 and also the certificate mentioned above need not be given.

However, section 269T does not exclude loans repaid by Government companies, banking companies, corporation established by a Central, State or Provincial Act from the scope of its applicability. As such, details of repayment made by such entities are to be shown.

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

<i>Serial Number</i>	<i>Assessment year</i>	<i>Nature of loss/ allowance (in rupees)</i>	<i>Amount returned (in rupees)</i>	<i>Amount as assessed (in rupees) reference to relevant order)</i>	<i>as (give reference to relevant order)</i>	Remarks

(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.

Section 79 of the Act provides that, notwithstanding anything contained in Chapter VI of the Act, in the case of a company, not being a company in which the public are substantially interested, where a change in shareholding has taken place in a previous year, then no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of that previous year and on the last day of the previous year in which the loss was incurred, the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

This provision shall not apply to a change in the voting power consequent upon:

- (a) the death of a shareholder, or
- (b) on account of transfer of shares by way of gifts to any relative of the shareholder making such gift.
- (c) any change in the shareholding of an Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51 per cent of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

Section 79 applies to all losses, including losses under the head Capital gains. However, the overriding provisions of section 79 do not affect the set off of unabsorbed depreciation which is governed by section 32(2). [*CIT v Concord Industries Ltd. (1979) 119 ITR 458 (Mad)*], *CIT v. Shri Subbulaxmi Mills Ltd. 249 ITR 795 (SC)*.

Sub-clause (b) requires a statement 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.

The comparison of the composition of the shareholding is to be done with reference to the last day of the current previous year and the last day of every previous year in which the loss was incurred. The carry forward of the loss incurred in respect of different previous years is to be determined with respect to the individual previous years.

The above comparison of the shareholding can be done by referring to the Register of Members. In this connection reference may be made to paragraph 11.2 dealing

with making the necessary records available for examination by the tax auditor. The company concerned should make the relevant records available to the tax auditor.

27. (a) Whether the assessee has deducted tax at source and paid the amount so deducted to the credit of the Central Government in accordance with the provisions of Chapter XVII-B.

(b) If the answer to (a) above is in the negative, then give the following details:

<i>Serial Number</i>	<i>Particulars</i>	<i>Amount</i>	<i>Due date</i>	<i>Details</i>	<i>Remarks</i>
	<i>of head of tax for</i>			<i>of</i>	
	<i>under deducted remittance payment</i>			<i>which tax at source to Govt</i>	
	<i>is (in rupees)</i>			<i>Amount (in rupees)</i>	
	<i>deducted at source</i>			<i>(in rupees)</i>	

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]

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

		<i>Amount</i>
(i)	<i>Tax deductible and not deducted at all</i>	<i>.....</i>
(ii)	<i>Shortfall on account of lesser deduction than required to be deducted</i>	<i>.....</i>
(iii)	<i>Tax deducted late</i>	<i>.....</i>
(iv)	<i>Tax deducted but not paid to the credit of the Central Government</i>	<i>.....</i>

"Please give the details of cases covered in (i) to (iv) above".

Clause 27 (a)

The newly inserted clause 27 is different from the earlier clause. In the earlier clause the requirement was with reference to the tax deducted at source but not paid to the credit of the Central Government in accordance with the provisions of Chapter XVII-B. The new clause requires reporting on the compliance with the provisions of Chapter XVII-B regarding deduction of tax at source and payment thereof to the credit of the Central Government. Thus, the scope of reporting under the new clause is much wider. This reporting requirement is to be read with the specific non-compliances stated under clause (b).

It may be noted that in the context of reporting on the inadmissible amounts under section 40(a)(ia) where the assessee submits that the tax is not required to be deducted on any payment covered under clause (ia), the tax auditor may exercise his judgement in the light of the applicable laws and report accordingly about the compliance of this provision. The tax auditor may rely upon the judicial pronouncements while taking any particular view. In case of difference of opinion between the tax auditor and the assessee, the tax auditor should state both the view points. Further, in view of the voluminous nature of the transactions, the tax auditor can apply tests checks and compliance tests for verifying the information required to be provided under this clause. These principles equally apply here.

It is essential to note that it is the primary responsibility of the assessee to prepare the information in such manner so that the tax auditor can verify the compliance as required in the new clause. The tax auditor is required to verify that no items have been omitted in the information furnished to him and reasonable tests checks would reveal whether or not the information furnished is correct. The extent of check undertaken would have to be indicated by the tax auditor in his working papers and audit notes. The tax auditor would be well advised to so design his tax audit

programme as would reveal the extent of checking and to ensure adequate documentation in support of the information being certified. In the case of large organizations it is in their own interest to get a separate and independent audit conducted in respect of tax deducted at source and remitted to the credit of the Central Government.

From the above it is clear that while answering the issue of compliance with the provisions of Chapter XVII-B, a number of debatable issues will arise before the assessee as well as the tax auditor. Therefore, it may not be possible to say yes/no in many of the tax audits. The answer to the question may have to be qualified depending upon the facts and circumstances of each case. Where the tax auditor is satisfied regarding the compliance with the provisions of the Chapter XVII-B he may consider bringing out such compliance by appropriate comments in the following manner:

"We have verified the compliance with the provisions of Chapter XVII-B regarding the deduction of tax at source and regarding the payment thereof to the credit of the Central Government in accordance with the Auditing Standards generally accepted in India which include test checks and the concept of materiality. Such audit procedures did not reveal any significant non-compliance with the provisions of Chapter XVII-B."

In case the tax auditor is not satisfied regarding the compliance with the provisions of Chapter XVII-B he may consider bringing out such non-compliance by appropriate comments in the following manner:

"We have verified the compliance with the provisions of Chapter XVII-B regarding the deduction of tax at source and regarding the payment thereof to the credit of the Central Government in accordance with the Auditing Standards generally accepted in India which include test checks and the concept of materiality. The non-compliance as revealed during such audit procedures are as mentioned in clause (b) hereunder."

Clause 27(b)

The reporting requirement in clause (b) arises where the tax auditor is not satisfied as to the compliance by the auditee with the provisions of the Chapter XVII-B regarding deduction of tax at source and the payment thereof to the credit of the Central Government. Such non-compliance is required to be reported under sub-clause (i), (ii), (iii) and (iv).

In regard to sub-clause (i) the tax auditor has to verify the particulars regarding tax deductible and not deducted at all from the information furnished by the assessee. The various provisions of Chapter XVII-B requires different classes of assesseees to deduct tax at source on various nature of payments. The tax auditor should consider the applicability of the different provisions relating to tax deduction at source taking into consideration the status of the assessee and the applicability of the relevant provision. As regards the applicability of the provisions the tax auditor should take into consideration the relevant sections, rules, notifications, circulars and various judicial pronouncements. There may be occasions when the tax auditor may not agree with the interpretation/ view taken by the auditee. In such cases it will be advisable to report both the views. The tax auditor may give the information under this sub-clause in the following format:

S.No.	Particulars of payment	Tax deductible but not deducted	Remarks

The shortfall on account of lesser deduction is required to be reported in sub-clause (ii). This will include deduction at a lower rate than what is prescribed, application of wrong rate of deduction of tax at source, non-inclusion of surcharge and education cess etc.

Further, as per the provisions of sections 195 and 197 the deductee can obtain a certificate of no deduction or lower deduction. The tax auditor should refer to the relevant provisions, rules, circulars, notifications and such certificates obtained from the auditee to verify the cases where tax has been short deducted at source. In the case of payment to non-residents the applicable rate of tax deduction at source is to be read along with the Double Taxation Avoidance Agreement. The tax auditor may give the information under this sub-clause in the following format:

S.No.	Particulars of payment	Tax deductible	Tax deducted	Remarks

Sub-clause (iii) requires the tax auditor to verify and report on tax deducted late. The due dates of deduction have been prescribed under the various provisions of the Act and the rules framed thereunder. The auditor should verify the date of actual deduction with reference to the due date of deduction as per the Act, rules/circulars/notifications for reporting under this clause. The tax auditor may give the information under this sub-clause in the following format:

S.No.	Particulars of payment	Tax deductible	Due date of deduction	Date of deduction	Remarks

Sub-clause (iv) requires information regarding cases where tax has been deducted at source but the same has not been deposited. As such the tax auditor should verify the cases where the tax has been deducted at source but not paid before the last date of the previous year under audit. Only those cases where tax has not been deposited before that date are to be reported under this clause. For example, in respect of previous year ending 31st March, 2006 details of tax deducted but not remitted to the Government before 31st March, 2006 should be furnished. The tax auditor may give the information under this sub-clause in the following format:

S.No.	Particulars payment	Tax deducted	Tax not paid	Remarks

In the case of items which are also covered under clause 17(f) the information provided in clause (i), (ii) and (iv) should agree with the information provided in clause 17(f).

Annexure – I

Part B

<i>Nature of business or profession in respect of every business or profession carried on during the previous year</i>	Code*				
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The information required under Part B regarding the nature of business or profession in respect of every business or profession carried on during the previous year is the same as required to be given under clause 8(a). However, under this clause code of the nature of business is to be selected from the list of various nature of businesses given in the Annexure itself. The relevant code numbers in respect of each class of business or profession is to be given. The tax auditor should further verify that there is no contradiction between the particulars given in clause 8(a) and this item. Reference may also be made to paragraph 19.1 for this item.

<i>Sl. No.</i>	<i>Parameters</i>	<i>Current year</i>	<i>Preceding year</i>
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1. ***Paid up share capital/ capital of partner/ proprietor***
 2. ***Share Application Money/ Current Account or Partner or Proprietor, if any***
 3. ***Reserves and Surplus/ Profit and Loss Account***
 4. Secured loans
 5. Unsecured loans
 6. Current liabilities and provisions
 7. Total of Balance Sheet
 8. ***Gross turnover/Gross receipts***
 9. Gross profit
 10. Commission received
 11. Commission paid
 12. Interest received
 13. Interest paid
 14. Depreciation as per books of account
 15. ***Net Profit (or loss) before tax as per Profit and Loss Account***
 16. Taxes on income paid/provided for the books
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(b) Parameters

The statement of particulars contains 16 parameters. This information is to be given by all assesseees though the nomenclature of some of the parameters does not match with the nomenclature used in the case of non-corporate assesseees. For such assesseees, such information is to be given with suitable modification/clarification by way of footnote. Information on these parameters has to be given both in respect of the current year as well as the preceding year. These parameters are discussed below:

1. *Paid-up share capital/capital of partner/proprietor*

The Guidance Note on terms used in financial statements defines "paid-up share capital" as that part of the subscribed share capital for which consideration in cash or otherwise has been received. This includes bonus shares allotted by the corporate enterprises. There is no difficulty in giving information regarding "paid-up share capital" for a corporate assessee. In respect of non-corporate assessees like sole proprietorship or partnership firm the term "capital" has to be understood in terms of the capital contribution made by the sole proprietor or the partners as the case may be. In practice assessees follow two types of accounting policies for maintaining capital account. One policy is to maintain the capital in a fixed manner and to make all the adjustments regarding share of profit or loss, drawings, interest, remuneration payable to the sole proprietor or the partners in the drawings/current account. In such a case the amount of fixed capital is to be stated as capital. Alternatively, where the floating capital concept is followed, i.e. all the above-mentioned adjustments are made in the capital account itself, then the net capital is to be stated.

2. *Share application money/ current account of partner or proprietor, if any*

The information regarding share applicable money is applicable for corporate assessees. Particulars about the amount received as share application money should be furnished under this clause. *Regarding partner or sole proprietor, the net balance in the current account is to be shown. The tax auditor should verify the amount received in regard to application and ensure proper disclosure under this clause. In regard to current account of partner or proprietor he has to verify the correctness of the particulars of the current account.*

3. *Reserves and surplus/ Profit and loss account*

The Guidance Note on terms used in financial statements defines "reserves" as the portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a provision for depreciation or diminution in the value of assets or for a known liability. The reserves are primarily of two types: capital reserves and revenue reserves. Further, surplus is the credit balance in the profit and loss statement after providing for proposed appropriations, e.g., dividend or reserves. Part III of Schedule VI of the Companies Act, 1956 contains interpretation of the terms "provision", "reserve" and "capital reserve". The tax auditor should have due regard to these definitions and ensure that proper information is given in regard to reserves and surplus. In the case of non-corporate assessee besides reserves, surplus in the profit and loss account not appropriated to the capital accounts of partners or proprietor is to be disclosed under this item.

8. *Gross turnover/gross receipts*

The term sales, turnover or gross receipts has been explained in paragraph 5 of this Guidance Note. The term "gross turnover" is a commercial term and it should be construed in accordance with the method of accounting regularly employed by the assessee. Further, the Guidance Note defines "sales turnover" as the aggregate amount for which sales are effected or services rendered by an enterprise. The terms "gross turnover" and "net turnover" (or gross sales and net sales) are sometimes used to distinguish the same aggregate before and after deduction of returns and trade discounts. The information to be provided under this item accordingly shall be the gross turnover/ *gross receipts* as per the method of accounting being followed by the assessee. The tax auditor should have due regard to the method of accounting while verifying the particulars regarding "gross turnover/ *gross receipts*".

15. *Net profit (or loss) before tax as per profit and loss account*

The net profit or loss as per the books of account before tax is to be furnished under this item. The Guidance Note defines net profit as the excess of revenue over expenses during a particular accounting period. When the result of this computation is negative it is referred to as net loss. The tax auditor should verify the figure of net profit or net loss with the profit and loss account and the balance sheet. The net profit to be stated here should be the same as considered for working out/turnover ratio under sub-clause (b) of clause 32. For this, attention is invited to para 56.3