

TAX AUDIT REPORTING – IMPACT OF AMENDMENTS MADE BY FINANCE ACT 2020 & FINANCE ACT 2021



CA Gautam Mola

Email : gautam@cgcaindia.com

Introduction

It's the return filing season, everyone would be gearing up to challenge of being able to file the income tax returns and tax audit in Form 3CD on 'E filing Portal 2.0' within the stipulated time to avoid penal consequences for late / non-filing. There have been several amendments by the Finance Act 2020 and Finance Act 2021, which have a direct impact on the computation of total income and reporting under Form 3CD for AY 2021-22.

To gear up to the task in hand, it would be essential for the taxpayers as well as Auditors to revisit the impact of amendments while carrying out reporting requirements under the Form 3CD. Accordingly, an attempt has been made to evaluate the impact of amendments on reporting under Form 3CD.

1. Applicability of Tax Audit

Every person carrying on a business whose sales/ turnover / gross receipts exceeds one crore is required to get his books of accounts audited under Sec. 44AB. The said threshold was increased to 5 crores for AY 2020-21, in a case where an aggregate of cash payment / receipts was below the specified threshold.

Finance Act, 2021 has further increased the said threshold from 5 crores to 10 crores from AY 2021-22, subject to fulfilling the aggregate cash transaction limits. Accordingly, the limit for applicability of audit now stands revised at 10crs.

2. Clause 9 – Change in Partners / Ratio

There has been change in the taxation on account of reconstitution and dissolution of partnership firms by introduction of section 9B and amending the existing provisions of Sec. 45(4), which now treats reconstitution of the firm and transfer of asset to partner as two separate taxable transactions. One would have to be careful while reporting under the said clause, as the department would try and evaluate taxability in hands of a partnership firm based on reporting made under the said clause.

In case of taxability on account of deeming fiction by Sec 9B, one would also have to evaluate whether suitable reporting is now required under Clause 16 which deals with items of income not credited to profit and loss account.

3. Clause 17 – Transfer of land or building or both - section 43CA or 50C

In cases where the consideration received on transfer of asset being land or building or both is more than 105% of stamp duty value, then stamp duty value was deemed to be consideration for the purpose of computing the total income. Finance Act, 2021 has now increased the said safe harbour tolerance limit from 105% to 110%.

Further, in case of transfer of specified assets (fulfilling the following conditions) the safe harbour limit would stand at 120% instead of 110%.

- a) Transfer of residential unit takes place during 12/11/2020 to 30/06/2021
- b) Its transfer by way of first time allotment of the residential unit to any person
- c) Consideration received / accruing for such a transfer is less than 2 crores

Even before the amendment by the Finance Act, Mumbai ITAT in the case of Surendra S Gupta (93 taxmann.com 456) had allowed higher than specified tolerance limit while evaluating the taxability under Sec. 43CA and Sec. 50C.

4. Clause 18 - Depreciation on Goodwill

Claim of depreciation on goodwill has always been a contentious point, until the Supreme Court in the case of CIT v. Smifs Securities Ltd - 24 taxmann.com 222, held that goodwill acquired on amalgamation (being the difference between the net book value of assets and consideration paid) was a capital right which would fall under the expression 'any other business or commercial right of a similar nature' and hence eligible for depreciation while computing business income.

Finance Act 2021, overturned the SC ruling by amending Sec. 2(11), Sec. 32 and Sec. 43(6) to specify that claim of depreciation on Goodwill is not to be allowed as deduction while computing the business income.

The substance of the amendment is to state the following.

- Expression 'intangible asset' will include assets such as know-how, brand, copyright etc. as well as business and commercial rights not being goodwill irrespective of the mode of acquisition of goodwill
- Goodwill remains a capital asset but not a depreciable asset
- Seller of goodwill will pay tax; However, the buyer will not be eligible to claim depreciation

The said amendment is also applicable to the purchase of goodwill that has been acquired before 1st April, 2020 and are already forming part of block of assets, which would mean that the said amendment would be retrospective in nature.

Taxpayers and Auditors would have to judiciously apply their mind to give impact to the above amendment and while applying following points:

- Re-computation of Written down value of intangible assets in accordance with Sec. 43(6) read with rule 8AC
- Where purchase price allocation was not done accurately (bifurcating goodwill and other commercial assets), whether same can now be reclassified in the block of asset and limit denial of depreciation only to the value of goodwill

5. Clause 20(b) - Contributions received from employees for various funds

5.1. Determining due date for employee contribution to various funds

Employee contributions to various funds if not deposited within timelines mentioned in specified Act, are not allowed as a deduction under Sec. 36(1)(va). However, judicial authorities while interpreting the law applied the provision of section 43B on employee's contribution and allowed such amounts as a deduction on actual payment basis even though same were paid beyond the specified due date.

To ensure that deduction is denied to an employer for delay in depositing the employee contribution, Finance Act 2021 has inserted new explanations to Sec 36 (1) (va) and Sec 43B. As per the explanation provisions of Sec. 43B shall not be available for determining the due date for employee contribution. Accordingly, in case of delay, no deduction would be allowed to the employer.

However, it would be interesting to evaluate whether the deduction could be claimed under Sec 37, as the employee contribution is linked wholly and exclusively for the purpose of business.

5.2. Change in due dates on account of COVID relief

On account of the COVID pandemic, various relaxation has been provided in due date for depositing employee contribution. One would have to carefully go through the extension provided under the specified law for reporting of due date under Form 3CD.

Reference:

1. EPFO circular No C-I/Misc/2020-21/Vol.I/1112 dated 15th May 2020
2. ESIC - P-11/12/Misc/SST Misuse/ 2019-Rev II dated 1st January, 2021

6. Clause 26 – Allowability of Interest charged during Moratorium period added to principal amount

Reserve Bank of India (RBI) on 27th March announced a relief package to mitigate the burden of the COVID 19 pandemic for loan borrowers, as per the package 3 months moratorium for term loans and working capital facilities was offered. RBI further extended the moratorium by another 3 months vide its order dated 23rd May, 2020. As per the guidelines issued by the RBI, the moratorium only granted deferment to a borrower in respect of repayment of borrowing, accrual of interest continued as usual during the moratorium period. The interest charged during the moratorium period was later added to the principal amount of the loan.

This resulted in the following question being asked on the allowability of interest under Sec. 43B, which was charged during the moratorium period but later on added to the principal amount, which has been subsequently repaid by the borrower.

- Whether interest charged would never be allowed as deduction
- If allowed as deduction, then in which year
 - Entirely in first year
 - Entirely in last year
 - Proportionate deduction

Finance Act 2006, had inserted Explanation Sec. 3D to Sec. 43B, which provided that deduction of interest, shall be allowed only if such interest was actually been paid. **Interest which has been converted into a loan or advance shall be deemed not to have been actually paid.** To avoid concerns raised by the taxpayers and banks at the time of introduction of the said provision, the Central Board of Direct Tax (CBDT) issued a Circular No. 7/2006 vide its order dated 17th July, 2006.

The Circular clarified that the amendments were only reiterating the rationale that conversion of interest into a loan or borrowing or advance does not amount to 'actual payment'. **Further, converted interest, by whatever name called, will be eligible for deduction in the computation of income in respect of the previous year in which the converted interest is 'actually paid'.**

Illustration 4 in the CircularNo 7/2006, clearly states that when interest is merged with the original principal and borrower continues to repay the installment. In such situation the repayment would constitute payment of interest as well as repayment of part of the principal. **Accordingly, the amount of deduction on account of actual payment of interest will have to be calculated on a proportionate basis.**

For Example:

Principal Amount as on 1 st April 2020	A	10,00,00,000
Rate of interest	B	10%
Moratorium Interest added to principal (6 months)	$C = A * B$	50,00,000
Revised Principal Amount	$D = C + A$	10,50,00,000
Installment paid till time date of return filing	E	75,00,000
Amount of eligible deduction on account of interest	$F = E * C / D$	3,57,143

Based on the reading of Circular and above illustration, it would be clear that taxpayers would be entitled to claim proportionate deduction in respect of moratorium interest added to principal amount.

It would be interesting to evaluate a proposition whether entire moratorium interest should be allowed in the first year itself, since the amount of repayment is higher than the amount of moratorium interest charged during the year.

7. Clause 33 – Deduction in respect of Dividends

Finance Act, 2021 has reinserted the provision of Sec. 80M which deals with deduction in respect of certain inter corporate dividends.

The provision provides deduction to a Domestic Company which has received dividends and has also distributed dividend to its own shareholders, then deduction is available for dividend received or dividend distributed, whichever is lower.

8. Clause 34

8.1. TCS on sale of goods – Sec. 206C(1H)

Finance Act 2020, inserted a new provision with effect from 1st October, 2020, requiring the specific seller to collect tax on receipt of sales of goods. Further, to avoid ambiguity arising on account of implementation of provision, CBDT issued circular No. 17/2020 dated 29th September, 2020.

Though the provision required liability to be discharged on a receipt basis, practically most of the taxpayers have raised debit notes for TCS alongwith the sale invoices. It would be essential for the taxpayer and auditor to make proper reconciliation to ensure that proper liability has been discharged during the year.

8.2. Change on account of COVID relief

- **Reduction in TDS / TCS rates by 25% (Clause 34(a))**

To mitigate the hardship faced by taxpayers on account of the COVID 19 pandemic and to avoid additional liquidity in hands of the business, the CBDT reduced the TDS / TCS rates by 25% for amounts paid or credited during the period 14th May, 2020 to 31st March, 2021.

The said change in TDS rates will create an additional burden on taxpayers and auditors to ensure proper reconciliation for figures reported in Clause 34(a) and to reconcile the same with profit and loss.

- **Change in due date for filing the TDS returns (Clause 34(b))**

On account of COVID 19, CBDT extended the due date for filing the TDS/ TCS return for Quarter 1 and quarter 2 till 31st March, 2021. Appropriate care and caution is required while reporting the due date in Clause 34(b).

Conclusion

The above is only a summary of additional changes / issues that might come up on account of the changes / amendments brought in by the Finance Act or relief package announced by CBDT on account of COVID. The readers may note that all the existing issues for reporting of Form 3CD will continue and taxpayers / auditors would be required to take proper actions to mitigate the same by making proper disclosures in Form 3CD.

