

# CHALLENGES AND PRECAUTIONS IN TAX AUDIT REPORT



CA Ami Chheda

Email : amichheda0971.ac@gmail.com

## Introduction

The month full of tax audit reports and dealing with the challenges thereon! Many of the assesses receive intimations from tax department for the mismatches in the tax audit report and the income tax return filing, however when one looks into the matter it is quoted as ironical that the mismatch is only due to the lack of the transparency of the clauses between return and the tax audit report.

An auditor has to consider the following when carrying out the assignment of Tax Audit:

- Directions issued by Council including those relating to ethical requirements in regard to communication with previous auditor, limits for tax audit etc.
- Accounting Standards prescribed by ICAI (and notified standards under section 133 of the Companies Act 2013 in the case of Companies)
- Guidance Notes (G.N.) issued by ICAI

An attempt is made to discuss the challenges prevailing in tax audit report and the precautions to be taken thereon.

### **1. Use of Form 3CA or 3CB**

3CA – A taxpayer having business or profession and mandated to get his accounts audited under any other law (other than income tax)

Eg. Companies audited under Companies Act, 2013; LLPs audited under LLP Act, 2008

3CB - A taxpayer having business or profession and NOT required to get his accounts audited under any other law (other than income tax)

Eg. A proprietorship entity or partnership firm, having a turnover > 1 crore and not opting for presumptive income scheme, is not required to get its accounts audited under any other law except income tax. So, it will furnish Form 3CB.

### **2. Computation of total turnover for tax audit purpose**

- A. Where a person is carrying on 2 Business/2 Professions – the total turnover of both the businesses shall be clubbed together and tax audit shall be liable to be conducted if the Total Turnover exceeds Rs. 1 or 10 Crores / Rs. 50 Lakhs as the case may be.
- B. Where a person is carrying on business as well as profession and the Turnover of the business is Rs. 12 Crore and the Gross Receipts of the profession is Rs.48 Lakhs. In such a case, ICAI has clarified through a Guidance Note that the Assessee is liable to get the Tax Audit done of both the business as well as profession because the Gross Receipts from the business exceed the limit of Rs. 10 Crore. However, if his Total Turnover was Rs. 9 Crores and Gross Receipts from Profession was Rs. 48 Lakhs, he would not be required to get his Tax Audit done.

- C. In case where a person has a total turnover of Rs. 9.8 Crores and has received Rs. 80 Lakhs as remuneration from a partnership firm - In such a case, the total amount on adding up becomes Rs. 10.60Crores i.e. above Rs. 10 Crores. Confusion arose whether the person is liable to get an audit done in this case and ICAI in its Revised Guidance Note dated 14.08.2022 has clarified that the turnover will not include any amount of Interest, remuneration received by Partner from partnership firm in calculating total gross receipts in business for purpose of Sec 44AB.
- D. A person having a normal business and presumptive business-In such a case person needs to exclude the turnover of presumptive scheme from the total turnover in order to verify the normal business turnover. If in any case, the turnover limit for purpose of tax audit exceeds Rs. 10 crores / Rs. 2 crores, as the case may be, then the tax audit shall be liable to the assessee.

### 3. **CLAUSE 1, 2: Name of the Assessee, Address of the Assessee**

In case there is a change in the name / address of the Assessee between the last day of previous year and the date of tax audit report, both the names / addresses (old and new) shall be mentioned in the report.

A professional is obliged to provide / disclose all the details as on the date of tax audit report.

### 4. **CLAUSE 8: Reporting of the section under which the audit is being conducted**

#### Case 1:

Taxpayer = Individual with only business income

Turnover = 1.5 crore

Profit = Lower rate @ 1.5%

Not opted for presumptive scheme in past

Many professionals select Sec 44AB(e) as applicable in such a case.

Sec 44AB states

*“Every Person –*

*.....*

*(e) carrying on the business shall, if the provisions of sub-section (4) of section 44AD are applicable in his case and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year,”*

Sec 44AD(4) states

*Where an eligible assessee declares profit for any previous year in accordance with the provisions of this section and he declares profit for any of the five assessment years relevant to the previous year succeeding such previous year not in accordance with the provisions of sub-section (1), he shall not be eligible to claim the benefit of the provisions of this section for five assessment years subsequent to the assessment year relevant to the previous year in which the profit has not been declared in accordance with the provisions of sub-section (1).*

As per section 44AB(e), the conditions mentioned in the section 44AD(4) is to be satisfied and the income shall be greater than the maximum amount not chargeable to tax.

Here, the conditions mentioned in the sub-section 4 of the section 44AD is not satisfied since the taxpayer hasn't opted the presumptive scheme in past and hence the audit shall not be conducted under the section 44AB(e) instead shall be conducted under section 44AB(a).

Case 2:

Taxpayer = Individual with only business income

Turnover = 4 crore with 6% of cash payments

Profit = lower rate @ 5%

Taxpayer opts out of the presumptive scheme in 3<sup>rd</sup> year

Here, the taxpayer is eligible for tax audit by more than one section. Which section is to be selected for the purpose of Clause 8?

Eg. Sec 44AB(a) and 44AB(e)

Since the turnover of the Assessee is more than Rs. 1 crore but less than Rs. 10 crore and has more than 5% of cash receipts of the total receipts, taxpayer is liable to tax audit as per the proviso to Sec 44AB(a).

Also, the taxpayer withdraws from presumptive scheme in the 3<sup>rd</sup> year of the previous year in which he opted into the scheme. As per the conditions held in sec 44AD(4) and total income being more than the threshold limit, the taxpayer is liable to tax audit under sec 44AB(e).

In my view, Section 44AB(c) to 44AB(e) are specific provisions. If the Assessee does not fall under the purview of the same, he shall be liable to tax audit as per the provisions of Sec 44AB(a) or (b) after meeting the conditions of applicability.

#### **5. CLAUSE 8a – Opting for taxation u/s 115BA/115BAA/115BAB/115BAC/115BAD**

The said clause requires reporting of the Section under which the assessee has opted the taxation, if any. If the assessee has not chosen any of the new tax regime as the case may be, then the same needs to be mentioned accordingly.

Here, the tax audit report shall be uploaded before the income tax return which has its due date lying in the subsequent month. There are chances of change in the stand taken by the assessee while opting for tax regimes.

Given a case, at the time of filing tax audit report, the assessee opts for the new tax regime u/s 115BAA. Thereafter, while filing the income tax return, the Assessee changes its view and does not opt for the new tax regime instead remains in the old tax regime. There are intimations flowing from the department for the mismatch in the tax calculation due to change in the tax regimes opted. In such a case, the tax auditor shall get a written representation from the assessee clarifying its view as on the date of the tax audit report in order to avoid any miscommunications thereon.

Alternatively, revising the tax audit report by the tax auditor shall invite doubts and notices from the department and also affect the normal practice of the professional. It is advisable to avoid revision in such a case.

#### **6. CLAUSE 9(a) – Names of partners/members of firm or association of persons and their profit-sharing ratios**

If a partner is a partner in representative capacity, then name of the beneficial partner should also be indicated.

Since the Profit sharing ratio also includes loss sharing ratio, and if loss sharing ratio is different from the profit sharing ratio – both should be mentioned

## **7. CLAUSE 9(b) - Change in partners/ members of firm/ AOP**

An AOP covers a society or a trust, etc. Usually there are various AOPs where the share of the members is indeterminate.

In such a case, the same shall be disclaimed in the para 3 (Form 3CA) or para 5 (Form 3CB) of the report.

## **8. CLAUSE 11 - Address at which Books of Accounts are maintained**

Under clause 11 the Taxpayer is required to mention the address under which the books of the accounts are kept.

It is highly advisable not to mention the residential address of the taxpayer as section 132 of the act states that the Authorised Officer can enter any building or the place where the books of the accounts are kept in case any search and survey is being conducted pursuant to the section 132 and the section 133A.

## **9. CLAUSE 12 - Whether P & L a/c includes profits assessable on presumptive basis?**

Reporting is for amounts included in P & L a/c. If 2 or more business exist and presumptive section is applicable for some businesses, allocation of expenses may become necessary if common books are maintained.

In this case, it is duty of the auditor to confirm whether any of the businesses fall under this category, to confirm and verify whether common or separate books is maintained for such businesses.

If amount included in P & L a/c does not match the amount assessable under the presumptive section, note may be added to that effect.

## **10. CLAUSE 14 - Reporting of the valuation of the closing stock**

Sub Clause (a) of clause 14 requires for the reporting of the closing stock valuation which includes the finished goods and raw materials valuation as per the section 145A. It mandates that the valuation should be done as per the cost or the net realisable value whichever is lower.

Sub Clause (b) states that if there is any deviation from the prescribed method then its effect on the profit and loss should be evaluated.

Method employed for valuation of closing stock shall be ascertained with reference made to the Annual Financial Statements (SAP) or a management representation may be obtained after duly satisfying himself regarding the method of valuation of closing stock.

The issue for the consideration is that as per the **AS 2**, the raw materials should be evaluated at the cost except in the circumstances as prescribed, but section 145A r.w. ICDS mandates that the stock which includes the raw materials should be evaluated as per the methodology stated above.

In my view, if the value of the raw materials is below its cost, then its effect on the profit and loss should be reported and if the same cannot be evaluated then it is advisable to qualify our report in the para 3 (Form 3CA) or para 5 (Form 3CB) of the report.

## 11. CLAUSE 16 – Amounts not credited to the profit and loss account

This clause is the most recently triggered clause in every intimations received by the Assessee. The wordings of the above clause 16(d) are – “16. Amounts not credited to the profit and loss account, being – (d) any other item of income”. The income reported in the above clause are mainly (i) salary / remuneration from other concerns (ii) rental income (iii) remuneration / interest / profit share from partnership firm etc. (vi) other interest etc. other source income (v) agricultural income (vi) other exempt income etc. The above list is only illustrative list.

The above incomes are mainly those incomes which are not related to the business (of whose accounts are being audited) but have been recorded in the books of account of the business under audit. Since they are not related to the above business they are not credited to the profit and loss account but are credited directly to the capital account.

Eg. If the auditor has reported 'remuneration from partnership firm' at clause no. 16(d) of Form no. 3CD, and also mentioned in Point no. 24(a) in Schedule BP. However, nothing has been mentioned at point no. 5(d) of Schedule Part A : OI Other Information since the same shall be taxed under the head 'Income from Business or Profession'.

Income Tax department started issuing notices as below:

Particulars: There is inconsistency in amount mentioned in return at SI. No. 5(d) of Part A OI 'Any other item of income' and Tax Audit report

Rs. xxxx Amount mentioned in Form Annexure 3CD (b)	Rs. 0 Amount mentioned in Income tax return (a)	Rs. xxxx Variance (b)-(a)
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Departments are adding the said income again under point 23 of Schedule BP – 'Any Other item or items of addition under section 28 to 44DA' leading to double income being taxed.

Many professionals are revising the tax audit by removing the disclosure done in Clause 16(d) of Form 3CD. This is not advisable since the said disclosure is not incorrect to be revised. If such documents are revised casually and in large nos. then it may lose its reliability in the eyes of the government, authorities and ordinary public. So, its frequent and casual revision should be avoided.

In present condition, the initial step to be taken by the auditors is to file rectification u/s 154 of the Act. Since the said issue shall still prevail as long as IT Dept update their systems for better clarity, the taxpayer shall file appeal against the intimation notice received u/s 143(1) or 143(1a).

## 12. CLAUSE18 – Depreciation

The purchase dates and the put to use dates of the assets shall not necessarily be the same. It is deemed to verify the working condition of the assets and whether it is put to use in the current year. Many of the professionals rely on the dates given by the management as purchase dates being the assets put to use. Since the same may be materially affecting the depreciation calculated on the same, it is advisable to take a certification done by the management with regards to the dates of the assets put to use.

Additionally, the auditor is required to check if payment for the acquisition of any asset is in violation of the proviso to section 43(1), the expenditure should be excluded from the actual cost.

**13. CLAUSE 19 - Amounts admissible under various sections**

Here there are 2 separate columns specifying the details of amounts debited to profit and loss a/c and amount admissible as per the provisions of the IT Act, 1961.

An Auditor should indicate the amount debited to the Profit & Loss Account and the amount actually admissible in accordance with the said sections. Also, amounts not debited to Profit & Loss Account but admissible under any sections mentioned in the clause have to be stated.

Various provisions of sections require fulfilment of prescribed conditions based on which the amount is admissible as per IT Act. While reporting, the auditor should verify the documents and records in support of the various payments/contributions made and deductions claimed and also conditions of allowability of various deductions.

If a separate audit report has been obtained, a reference to that report is to be made.

However, if condition under relevant sections is not fulfilled then they are treated as deemed profits & gains of business and are taxable in certain cases and the same should be reported under clause 24 of Form 3CD.

Generally, the amount covered by these sections is debited to P&L, but in certain sections, a deduction is based on capital expenditure, these are treated as an asset and thus not debited to profit and loss accounts. In such a case auditor should ensure it is stated either Nil/NA under the second column of the table in which amount admissible is to be mentioned.

**14. CLAUSE 23 - Payments made to persons specified u/s 40A(2)(b)**

Tax Auditor has to report payments made by the Assessee to their Related Parties. It may be noticed that relationships/parties covered under AS-18 are not identical.

After scrutinizing all the payments made to the related parties, tax auditor is required to report / disclose all the payments made irrespective of the fact whether the same is reasonable in the eye of law. The Tax Auditor is not required to comment on the reasonableness or otherwise of such payments. The same is dealt with by the Assessing Officer and questioned accordingly.

In case of voluminous transactions, grouping the similar transaction based on their nature and disclosure of such consolidated information as per their nature individual party wise may be considered.

**15. CLAUSE 26 - Certain deductions to be only on actual payment**

Where taxes, duties, etc. referred to in Sec 43B are paid after tax audit reporting date but before the due date of filing return (or actual date of filing return), there is a mismatch in the allowability of the taxes paid within the return filing date.

In this case, the tax auditor is liable to opine on the allowability on the taxes, duties paid as on tax audit reporting date.

Sec 43B states that:

*Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of –*

- (a) *any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or*

.....

*shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which such sum is actually paid by him:*

*Provided that nothing contained in this section shall apply in relation to 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** in respect of the previous year in which the liability to pay such sum was incurred as aforesaid and the evidence of such payment is furnished by the assessee along with such return.*

Hence, if the taxes are paid after the date of tax audit report and within the return filing due date, the same is practically allowed u/s 43B leading to a mismatch in the reporting done by the tax auditor. Thereafter, the bunch of intimations for such mismatches are received by the Assessee.

Practically, sometimes, the systems in the department do not work logically and hence it is advisable to take a consistent stand in both the reporting and the return filings in order to avoid a series of rectification and replies against the intimations received. If the taxes or duties, etc are unpaid up till the date tax audit report, then the same shall be disallowed in the returns to be filed on a later date. However, the same can be allowed in the subsequent year of payment.

Alternatively, the original tax audit report filed can be revised on a later date but within the return filing due date, once the tax payable is paid by the assessee. The same is not allowed as per the Income Tax laws but the same is practically allowed on the Income Tax Portal.

There can be individual views taken on the same.

#### **16. CLAUSE 27 - Details of CENVAT credits availed and utilised and its treatment in P&L A/c**

The requirement of the clause is to factually report about the amount of CENVAT credits availed of or utilized during the year as well as its treatment in profit and loss account and treatment of outstanding CENVAT credits in the accounts.

The revised Guidance note on Tax Audit dated 14.08.2022 still states about reporting of CENVAT and not the Input Tax Credit (ITC) of GST. There is an ambiguity in the applicability of the said clause for the reporting requirement of ITC of GST.

However, the income tax schema of Tax Audit Report specifies the words ITC under the said clause.

Many professionals take a view of not reporting the ITC of GST availed and utilised under the said clause whereas some practitioners declare the same under this clause.

According to the schema available on the Income tax portal, it is advisable to report the Input Tax Credit of GST and also disclaim our report in the para 3 (Form 3CA) or para 5 (Form 3CB) of the report.

#### **17. CLAUSE 28 - Purchase of shares of company for inadequate consideration**

This clause shall also attract Standards on Auditing – 620 “Using the work of an Auditor's expert” incase a valuation report is obtained to determine the FMV of the shares in case of unquoted instruments.

When the shares are issued for no consideration, then the Tax Auditor can verify the same by share certificates, demat account statements etc. as the same will not be reflected in the books of accounts.

### **Conclusion**

The above issues are inclusive list of the challenges faced by the tax auditor while filing the tax audit report. It is important to take precautions while giving opinion in the report, hence I have tried to list down few in the respective clauses. The readers may note that proper disclosures and disclaimers are mandatory as a measure of precautions from the prevailing challenges.

