

Issues in Tax Audit of Bank Branches

Under section 44AB of the Income Tax Act, the entities, whose turnover or gross receipts exceed Rs. 40 lacs during a financial year, are required to get their accounts audited from a Chartered Accountant. This audit is generally known as "Tax Audit". This article focuses on various issues involved in the Tax Audit of Bank Branches.

— Tarun Ghia and I.B Sonawala

Since generally the gross receipts of all the banks exceed Rs.40 lacs during a previous year, the statutory auditors of all the branches of such banks which are under audit, are generally appointed to carry out the tax audit assignment in respect thereof and submit their report in the prescribed format.

Audit Report & Format

The Tax Audit report formats applicable to bank are the same as applicable to entities who are covered by statutory requirements under laws governing them. The forms are— Form 3CA and Form 3CD. These forms have been revised with effect from November 2004.

However, it may be noted that amendment was brought in the form 3CD wherein part B dealing with certain parameters such as Paid up Share Capital, Share Application Money etc. and codes with respect to the business activity had been given. This information is applicable to the bank as a whole and not to the bank branch.

Form 3CA contains the auditor's expression of opinion as to the correctness of the accounts audited by him. Hence, this form is signed only by the auditor and not by the bank management.

Form 3CD, which is in the form of an annexure, contains disclosures/verification in respect of specified matters. It has 32 clauses divided into two parts – Part A and Part B. The responsibility of furnishing true and correct particulars in this form is that of the bank. The tax auditor has the primary responsibility to verify such particulars and to ensure that such particulars are in conformity with relevant provisions of the Income-tax Act, 1961. Hence, this form is first signed by the bank management and then verified by the auditor.

While reporting in Forms 3CA and with respect to details



and information given in Form 3CD, the auditor has to ensure compliance with Auditing & Assurance Standard (AAS).

Besides this, the auditor should obtain management representations on all matters, which are required to be considered and reported by him while giving his tax audit report.

Certain banks have issued instructions and even otherwise in view of the Guidance Note on Tax Audit issued by the Institute of Chartered Accountants of India (ICAI) it is imperative on the part of the auditor that if the auditor differs with the views expressed by the

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branch, the auditor should be requested to state both the viewpoints and reasons for his holding different view.

Form 3CA

In this form, the auditor expresses his opinion on the correctness of the particulars given in Form 3CD.

Form 3CD

Part A

It consists of 6 clauses relating to name, address, etc. which are all self-explanatory.

Part B

It consists of 26 clauses. Of these, there are about 12 clauses, which are generally not applicable at the branch level, as follows:

- Clause – 7* – pertaining to a firm or AOP
- Clause – 10* – pertaining to profit on presumptive basis
- Clause – 12* – pertaining to valuation of closing stock
- Clause – 15* – pertaining to amounts admissible under section 33AB, 33ABA, etc.
- Clause – 19* – pertaining to amounts deemed to be profits u/s 33AB etc.
- Clause – 23* – pertaining to details of amount borrowed

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- Clause – 25* – pertaining to brought forward loss or depreciation allowance
- Clause – 26* – pertaining to details of deductions admissible under chapter VIA
- Clause – 28* – pertaining to quantitative details of goods in case of trading concerns
- Clause – 29* – pertaining to details of tax on distributed profits u/s 115O
- Clause – 30* – pertaining to cost audit
- Clause – 31* – pertaining to audit under Central Excise Act, 1944
- Clause – 32* – pertaining to accounting ratios

Some of the clauses that need to be attended to are as follows:

Clause–11: Method of accounting

Though the banks generally follow mercantile system of accounting, there are a number of items in the bank which may be on cash basis – income on NPA accounts, commission, exchange, leave encashment benefits, safe deposit vault rent, etc.

The method of accounting employed in the previous year refers to cash or mercantile system of accounting. What is to be reported in clause 11(b) is change in accounting method, i.e. cash or mercantile and not a change in accounting policy.

Deviations from accounting standards prescribed under section 145 viz. disclosure of accounting policies and disclosure of prior period items, extraordinary items and changes in accounting policies need to be given in clause 11(d). AS 1 and AS 2 are applicable only to those entities, which follow mercantile method of accounting. ICAI has made compliance of AS mandatory to all members. Deviations from accounting standards prescribed by ICAI are to be reported. In both the cases, the effect of deviation has to be quantified.

Clause–13: Amounts not credited to Profit & Loss account

Generally, at the branch level, there are no items to be reported under this clause.

Clause–14: Particulars of depreciation allowable

Generally the only details provided

Though the banks generally follow mercantile system of accounting, there are a number of items in the bank which may be on cash basis– income on NPA accounts, commission, exchange, leave encashment benefits, safe deposit vault rent, etc.

by the branch are in sub-clause (d) regarding additions/ deductions during the year.

Generally, fixed assets are controlled by the head office of the bank. Hence, the details of opening balance as per Income Tax Act are not available at the branch level. The auditor, therefore, may state that as the details are not maintained at branch level the same are not filled in here. Thus, information required in sub-clause (a), (b), (c), (e) and (f) have to be filled up at

the head office level only.

The key words for reporting in clause 14 are 'depreciation allowable' and would require exercise of judgment on the part of the auditor. The basis of the view may be cited in appropriate cases. Details of past litigations need to be stated, for e.g. depreciation on leased assets, classification rate, effect of subsidy, exchange rate fluctuation etc. In case of difficulty in classification of assets, the auditor may rely upon opinion of technical expert and state the fact of such reliance.

In calculating depreciation allowable under the Income Tax Act, the basis should be actual cost as defined in section 43(1). Thus, depreciation will have to be provided on full actual cost i.e. whether paid during the previous year or not.

For opening Written Down Value (WDV), the auditor can rely upon copy of last year's statement of the branch and should state about such reliance.

When the original cost of the fixed asset is not known, a note on accounts can be given to the effect that book value has been considered as a cost.

For reporting date of asset put to use, a management representation should be obtained. All relevant evidences should be consid-



ered and in case of necessity, certificate from technical expert may be obtained.

Clause 14 specifically requires stating depreciation as per Income Tax provisions. The auditor should reconcile difference between the depreciation as per books of account and as in Form 3 CD.

In case assets are financed through foreign currency loans, the exchange rate adopted to book the liability, exchange rate prevailing at the end of the financial year and treatment of exchange rate fluctuations in the books of account should be given.

With effect from A.Y. 2003-04, in view of amendment to section 43A, exchange difference arising in respect of liabilities incurred for acquiring fixed assets can be adjusted to cost of such assets only to the extent of payment, irrespective of method accounting followed by the bank.

Since the bank may be governed by Companies Act, 1956, the auditor will have to consider Schedule XIV to the Companies Act, 1956 regarding the concept of block of assets and provisions of section 50 of the Act. Explanation (8) to section 43(1) and proviso to section 36(1)(iii) will also have a bearing on cost of acquisition.

The practice of stating fixed assets at historical cost is based on the assumption of going concern. However, when such an assumption is doubtful, whether particulars in 3CD will be affected or not can be an issue. This issue may arise in banks where regular operations have been suspended by RBI for any reason.

Clause-16: Particulars of bonus, commission & contribution to provident fund

Sub-clause (a) regarding certain

payments to employees is generally not applicable at branch level.

In sub-clause (b), the particulars of amount deducted by the branch from salary of staff members towards employees' contribution to Provident Fund has to be given, with details such as date of deduction, amount deducted, due date and actual date of remittance.

Clause-17: Details of expenses debited to P & L account that may be disallowed

There are 10 sub-clauses under clause 17.

Sub-clause (a) is regarding capital expenditure debited to Profit & Loss account. Normal principles differentiating between capital and revenue expenditure should be applied while reporting under this clause.

Items like new fire or security alarms, computers, printers, fire extinguisher, electric fans, cell phones are of capital nature and need to be capitalised.

On the other hand, all repairs, maintenance, replacements, modifications and improvements to existing assets are revenue in nature and need not be capitalized—for eg. re-wiring of branch, re-flooring, re-painting, re-polishing etc. All such expenses, including the professional fees paid to architect, interior decorators for this purpose are considered revenue expenditure nature.

Petty items like calculators, briefcases, etc. are not of durable nature and should be treated as revenue expenditure.

Upgradation cost of existing computers, printers, fax machines etc. are of capital in nature and have to be capitalised. In the books, the Written Down Value (WDV) of the existing assets plus the upgradation cost duly depreciated will reflect as

the WDV of the asset.

If an asset is purchased in a trade-off scheme, i.e. the old item is handed over and a new item is taken by paying the difference, the new asset should be capitalised at its original cost (without excluding the rebate) and the old item should be removed from the books of account by following concept of block of assets in view of section 50. If different accounting treatment like booking the profit/loss has been given, the same should be reported, quantifying effects thereof.

Sub-clause (b) is regarding expenditure of personal nature debited to profit and loss account. These personal expenses exclude those which are payable to the employee under contractual obligation. Thus, LFC, leave encashment, medical aid, telephone bill of residence, etc. paid under contractual obligation should not be reported here.

Sub-clause (d) refers to expenditure incurred at clubs. Expenses incurred in respect of service organisations like Bankers club, Giants, Rotary, Jaycees, Lions, etc., which are for business development are not covered by this clause.

Sub-clause (h) refers to expenditure exceeding Rs. 20,000/- incurred otherwise than by way of crossed cheque or crossed bank draft, which is inadmissible under section 40A(3) read with rule 6DD. Generally, in a bank, such payments are never made in cash. However, still the expenditure accounts, particularly those relating to repairs expenses, payments to small contractors etc. should be scrutinised for this purpose.

Clause-18: Payments to persons specified in section 40A(2)(b)

This clause refers to payments made to bank's directors, their relatives, etc. The auditor should obtain

& verify the list of persons specified in this clause if such a list is not available at the branch level, the auditor should make a mention against this column of his inability to verify the same.

In view of the Guidance Note on Tax Audit issued by the ICAI it is imperative on the part of the auditor that if the auditor differs with the views expressed by the branch, the auditor should be requested to state both the viewpoints and reasons for his holding different view

Clause-20: Profit chargeable to tax under section 41

Bad debts written off in the previous years and now recovered get covered under this clause.

Clause-21: Deductions requiring actual payment under section 43B

Certain types of expenditure like tax, duty, cess, fees, etc. payable under any law are allowed as a deduction in computing the total income only in the year in which it is actually paid. Similarly, interest provision on any loan or borrowing from any financial institution/ corporation is allowed as deduction, only if it is actually paid. Hence, all such liabilities, which existed at the

beginning of the financial year and were paid during the financial year, are to be reported. Similarly, liabilities incurred during the financial year, but not paid till the end of the financial year are required to be reported. If such liabilities are paid before the audit report is finalised, the date of such payment has to be specified.

In sub-clause (ii), the information regarding bank's contribution to Provident Fund is required to be given. This amount is generally deposited along with the employees' contribution. Hence, if the format specified in clause 16(b) is extended, this information can be added there itself and a reference to it can be given in this clause.

The due date for remittance of employees' as well as employer's contribution is the date of deduction itself.

Clause-22: Prior period income/ expenditure debited to P&L account

Prior period items are material items of charges or revenue, which as a result of errors or omissions, could not be accounted for in the earlier years to which they pertain and in rectification of such errors or omissions, these are recorded in the accounts of the current year.

Thus, any transaction which came to be known to the branch after the accounts of earlier year(s) were finalised, cannot be considered as 'prior period' item. Similarly, an item which was provided for at the zonal/central office level in the year in which it arose, but is reflected in the accounts of the branch in the current year, cannot be considered as 'prior period' item. Further, if in the result of the accounting estimate, certain provision was made in the previous years, the difference between the

actual figure subsequently determined and the earlier estimate does not constitute a 'prior period' item.

Clause-24: Acceptance/repayment of deposits in cash exceeding specified limits

Sub-clause (a) relating to acceptance of loan or deposit exceeding Rs.20,000/- is not applicable to banking company.

Sub-clause (b) refers to repayment of deposits made in cash to a person where the aggregate amount of deposits held by the depositor in

his own name or jointly with any other person, on the date of repayment together with accrued interest payable thereon is Rs.20, 000/- or more. It may be noted that balance in current account and savings account is not covered by this clause.

Clause-27: Delay in deposit of TDS

Generally, banks have to deduct tax at source from payment of salaries, interest on deposits, rent, professional fees, payment to contractors, etc. and deposit it with the Central

Government within the stipulated period.

Under this clause, it is to be reported whether the branch has deducted tax at source and paid the amount deducted as tax to the credit of Central Government within the stipulated time limit. The details of delay, if any, have to be reported.

It is suggested that before the auditor finalises the report, he should discuss it with the Branch Manager, so that if any matter is incorrectly reported, the same can be rectified, if necessary. ■

ANNOUNCEMENT

The Committee on Insurance invites members and other readers of "The Chartered Accountant" to contribute articles on Insurance related topics. The topics could be:

- Insurance – Global Business with native practices.
- General Insurance De-tariffing – To be or not to be?
- Insurance Industry – Professional Opportunities
- Differentiation between an Insurance Agent and an Insurance Broker

and other topics of relevance to Chartered Accountants in the field of insurance.

The articles could be submitted to the Secretary, Editorial Board of 'The Chartered Accountant', Post Box No. 7100, I.P. Marg, New Delhi-110 002.

The Committee on Insurance also wishes to develop data bank of part-time examiners to evaluate the Eligibility Test Papers submitted by candidates registered for the Post Qualification Course for its members titled "Diploma in Insurance and Risk Management". Persons should have sufficient and wide experience (minimum 15 years) of evaluating answer scripts on insurance related topics. The papers for the DIRM Examination are as under:-

- Principles and Practice of Insurance
- Technical Aspects of Insurance
- Risk Management and Reinsurance
- Business Strategic Planning and Information Technology

Faculty working in various Training Centres of Insurance Companies can also be considered for empanelment as part-time examiners.

The Committee also proposes to develop a data bank of Faculty for addressing, on the above topics, the participants to the Orientation Course which is organized for those who qualify the Technical Examination for the DIRM Course, every six months. The purpose of the Orientation Course is to provide an opportunity of interaction to the members to enable them to understand the case laws, insurance legislation and various other formalities to be complied with for processing of claims under various types of insurance, through power point presentation. Applications for empanelment as a faculty and for empanelment as a part-time examiner may be sent to the Secretary, Committee on Insurance, The Institute of Chartered Accountants of India, Post Box No. 7100, I.P. Marg, New Delhi-110 002.