

# Interesting and Important Points on Tax Audit



‘Audit Report’ in simple words means an opinion given by an auditor, after performing audit and evaluation on the auditee’s financial statements and books of accounts. Tax Audit Reports are supposed to be prepared carefully by the Tax Auditor. Any intentional or adverse mistake in reporting may result in seizure or cancellation of certificate of the tax auditor. After all, it is an assurance for the users of audit report against auditee. Hence, the auditors must perform their duties honestly and diligently. Read on to know more...



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The moment we listen the word ‘tax’, we may recall the line once said by Mr. Albert Einstein, physicist that *“The hardest thing in the world to understand is the income tax.”* Well... most of us (being CAs) shall disagree with this; because we know the importance of Income Tax as well as we can say that we are the specialist of Income Tax. There is another line about tax, however on which many of us shall agree. The line is *“Taxes are what we pay for civilized society.”* - Oliver Wendell Holmes, Jr., U.S. Supreme Court Justice.

We, the Chartered Accountants (CAs) bear responsibility to check the compliance of provisions of Income Tax Act and Rules thereof of certain class of assesseees by way of conducting Tax Audit.

We may have read somewhere the following line:

*“Like mothers, taxes are often misunderstood, but seldom forgotten.”*- Lord Bramwell, 19<sup>th</sup> Century English jurist. Laymen generally misunderstand the provisions of Income Tax Act; however, they do not generally forget the same. However, we the professional and specialist in the Taxation field are neither supposed to misunderstand nor forget the same.

The very basic but important provisions regarding Tax Audit can be explained as below:

### Tax Audit: Section 44AB

#### Applicability:

*Who is required to get his accounts audited?*

1. A Person carrying on business is required to get his/her/its books of account compulsorily audited under section (u/s) 44AB if the total sales, turnover or gross receipt in business for the previous year relevant to assessment year exceed or exceeds ₹1 Crore from the assessment year 2013-14.
2. A person carrying on profession is required to get his/her/its books of account compulsorily audited u/s 44AB, if his/her/its gross receipt in profession for the previous year relevant to the assessment year exceeds ₹25 lakh from the assessment year 2013-14.

This is further to clarify that in order to reduce the compliance burden on small businesses and on professionals, the threshold limit of total sales, turnover or gross receipts, specified under section 44AB for getting accounts audited has been increased from sixty lakh rupees to one crore rupees in the case of persons carrying on business and from fifteen lakh rupees to twenty five lakh rupees in the case of persons carrying on profession.

For the purposes of presumptive taxation under section 44AD, the threshold limit of total turnover or gross receipts has also been increased from sixty lakh rupees to one crore rupees.

These amendments take effect from 1<sup>st</sup> April, 2013 and will, accordingly, apply to the assessment year 2013-14 and subsequent assessment years.

3. A person covered u/s 44AE, 44BB or 44BBB is required to get his/her/its books of account compulsorily audited u/s 44AB if such person claims that the profits and gains from the business

are lower than the profits and gains computed under these sections (irrespective of the turnover).

4. A person covered u/s 44AD is required to get his/her/its books of account compulsorily audited u/s 44AB if such person claims that the profits and gains from the business are lower than the profits and gains computed in accordance with the provisions of section 44AD(1) and if his/her/its income exceeds the maximum amount which is not changeable to tax (i.e. basic exemption limit).

#### Forms Applicable

*Forms No. 3CA, Form No. 3CD* - in case of person who carries on business or profession and who is required by or under any law to get his accounts audited.

*Form No. 3CB and 3CD* - in case of a person who carries on business or profession but not being a person referred to above.

#### Due Date

Due date for getting the books audited in both the above cases is the due date of furnishing return u/s 139(1) i.e. 30<sup>th</sup> September of the relevant assessment year. Thus, Due Date of Tax Audit for FY 2012-13 (AY 2013-14) would be 30<sup>th</sup> September 2013.

It is to be noted that, In case where the accounts are required to be audited by or under any other law (especially in the case of companies, cooperative societies, etc.), it is sufficient if accounts are audited under such other law before September 30 of the assessment year and the assessee obtains before the said date, audit report as required under such law and also a report of audit from a chartered accountant in the audit forms under Income Tax Act i.e. Forms No. 3CA, Form No. 3CD.

However, please note that if the Accounting Year is different from the Accounting Year for which the Audit was done under any other Act, the Tax Audit would be required to be conducted again as per the Income Tax Act. Please refer Circular No. 561 dated 22-05-1990 issued by CBDT in this regard.

After taking note of above-mentioned generally known things, let's discuss some interesting and generally lesser known points regarding Tax Audit provisions:

***No penalty u/s 271B if audit report obtained within due date but return filed after due date:*** As we all know, the audit report u/s 44AB is NOT required

to be attached with the Income Tax Return. It should/ need not be furnished even separately before or after the due date. However, it is assessee's responsibility to get the audit report before the due date of the furnishing of the return and thus fill the relevant columns of Income Tax Return (ITR) on the basis of such report. The assessee is supposed to retain the report with himself/herself/itself and it may be furnished at the time of assessment proceedings. No penalty shall be attracted for not furnishing the audit report on or before due date. However, if audit report is not obtained before due date, penalty u/s 271B shall be attracted.

Now the next question arises that how much Penalty shall be attracted for failure to get accounts audited within due date: If any person fails to get his/her/its accounts audited as required under the provisions of section 44AB before the due date u/s 139(1), the Assessing Officer (AO) may impose penalty which may be a sum equal to one-half percent of the total sales, turnover or gross receipts subject to a maximum of ₹1.5 lakh.

Now let's discuss the instances where penalty may not be levied even in case of default.. For this explanation, Section 273B comes into the picture. As per Section 273B, *NO penalty shall be levied under section 271B if there is a "reasonable cause" for such failure.* Listed below are some of the instances where Penalty u/s 271B was not levied and which also have been accepted by the Tribunals and Courts in many judgments as "Reasonable Cause". The same are as follows:

- (a) Death or physical inability of the partner in charge of the Accounts.
- (b) Labour problems such as strikes, lock-outs for a long period of time during the previous year.
- (c) Resignation of the Tax Auditor and consequent delay due to the same.
- (d) Natural calamities such as flood, earthquakes, etc.
- (e) Loss of Accounts because of fire or theft, etc. reason behind which is beyond the control of the Assessee.

### What is the turnover for the purpose of determining the threshold?

The important questions that may be coming in your mind are:

- *What is the meaning of turnover/sales?*
- *Is it Gross sales or Net Sales?*
- *Does it include VAT, Sales tax, excise duty, etc.?*

To answer all the abovementioned questions on has to refer the "Guidance Note on Terms used in Financial Statements" published by the ICAI. Here the expression "Sales Turnover" is defined as: *"The aggregate amount for which sales are effected or services rendered by an enterprises. The term 'gross turnover/sales' and 'net turnover/sales' are sometimes used to distinguish the sales aggregate before and after deduction of returns and trade discounts"*

Further, in the statement issued by the ICAI on the companies (Auditors' Report) Order 2003 the word 'turnover' has been defined as- *"The term 'turnover' for the purposes of this clause may be interpreted to mean the aggregate amount for which sales are effected or services rendered by an enterprises"*

**'Turnover' in case of broker:** It was held in *CIT Vs. Hasmukh M. Shah[2003] 85 ITD 99 (Ahd.)* that the transactions by a share broker of sale or purchase of shares on behalf of parties can NOT amount to 'sale turnover or receipt' of share broker himself within the meaning of section 44AB.

**What if a person is having 'Other' Income more than ₹1 Crore?:** It was held in *Thai Constructions Vs. State of Maharashtra[2009] 184 Taxman 52 (Bom.)* that the provisions of Section 44AB are applicable only in the case of business/profession income. It is not applicable in respect of other incomes.

Thus, we can conclude that if one is receiving huge amount of Capital Gain by way of sale of land/house, etc., he/she needs not to get his/her accounts audited.

**Will Work-in progress(WIP) form part of 'Turnover':** It was held in *CIT Vs. B.K Jhala & Associates [1999] 69 ITD 141 (Pune)* that the value of work in progress in case of the assessee engaged in construction of shop and/or flats would NOT constitute 'turnover' within the meaning of section 44AB.

Many of you may be wondering that even after reading above paragraphs, it is still not clear whether VAT, Sales tax, excise duty are to be included in the sales/turnover or not?

In author's opinion, VAT, Sales tax, excise duty should be included even if Assessee has not included the same in Profit and Loss account and shown the same as current Liability. The opinion about inclusiveness of VAT, Sales tax, excise duty in 'Turnover' is based on Section 145A of Income-tax Act, 1961.

Section 145A of the Income-tax Act, 1961 clearly states that purchase, sale and inventory shall be valued by taking into account the amount of any tax, duty, cess or fee.

An extract of section 145A for readers' ready reference is as follows:

*145A- Notwithstanding anything to the contrary contained in section 145,*

- (a) *The valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head Profits and gains of business or profession shall be*
- (i) *In accordance with the method of accounting regularly employed by the assessee; and*
- (ii) *further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.*

Hence, as said earlier, maintaining excise duty, VAT, etc. accounts separately is NOT correct in terms of section 145A of the Income-tax Act 1961.

In a nutshell, for determining the meaning of the word "sales turnover" VAT or excise duty should also be considered for purpose determining the criteria for getting accounts audited u/s 44AB of the Income-tax Act 1961 as far as Section 145A is concerned.

➤ *What is to be included & excluded from the 'turnover'?*

It can be seen from the following explanation. Let us go through one by one:

- (a) *Sales proceeds of investment:* Sales proceed of any property held as investment will NOT form part of turnover for the purpose of tax audit. That is why sale proceeds of any shares, securities and debentures, etc. which are held as investment will not form part of turnover.  
However; please note that if shares, securities, debentures, etc. are held as stock in trade, the sale proceeds there from will form part of turnover for the purpose of tax audit.
- (b) *Luxury Tax:* As held in *Pandyan Hotels Ltd. Vs. CIT [2004] 266 ITR 172 (Mad.)* a luxury tax collected by an hotelier is also a trading

receipt in his hand and hence the same should be included in the turnover.

- (c) *Commission on sales:* Commission on sales included in the sales payable to the consignee/ third person should not be deducted from the figure of turnover for the purpose of section 44AB.
- (d) *Sales of Scrap:* Sales of scrap shown separately under the heading "Miscellaneous/Other Income" will have to be included in the turnover.
- (e) *Sales Returns:* Price of goods returned should be deducted from the figure of turnover. It is to be noted that the same treatment should be given even if the returns are from the sales made in earlier years.
- (f) *Trade Discount:* Trade Discounts are to be deducted from sales. Trade Discounts are generally allowed in the sales invoice itself; therefore the discount allowed in the sales invoice will reduce the sale price and, therefore, can of course be deducted from the turnover.
- (g) *Cash Discount:* Cash Discount otherwise than that allowed in a cash memo/sales invoice is in the nature of a financing charge and a revenue receipt and is not related to turnover only. Hence the same should not be deducted from turnover.
- (h) *Sales proceeds of fixed assets:* Sales proceeds of fixed assets would NOT form part of turnover for the purpose of section 44AB simply because the fixed assets are not held for resale.

For instance, if a person is having total turnover of ₹95 lakh from business and has sold a car for ₹10 lakh. Here, the total amount on adding sales value of car becomes ₹105 lakhs i.e. above ₹100 lakh and hence, many people may get confused as to whether the person is liable to get a tax audit done or not? As explained above, the 'turnover' will NOT include any amount on the sale of the fixed assets simply because fixed assets were held by the person for business use and not for the purpose of sale/trading. Hence, 'turnover' u/s 44AB shall be ₹95 lakh ONLY and, therefore, no need to get Tax Audit done.

Now let's discuss the judgment of the following case in the ITAT Pune Bench 'B'

*Banwari Sitaram Pasari HUF Vs. Assistant Commissioner of Income-tax IT Appeal No. 1489 (PUNE) of 2011 [Assessment year 2006-07] November 22, 2012*

In the instant case, the transaction of *buying and selling of commodities is a speculative activity where no physical delivery* is taken or given. It is held that there was no turnover constituted in the amount of ₹1,86,66,488 for the purposes of considering the liability of assessee to get the accounts audited under section 44AB.

Hence, there was no requirement to get the accounts audited under section 44AB. That is why, the penalty under section 271B imposed by the Assessing Officer (AO) was directed to be deleted.

Hence, we can conclude that total of 'Net' Profit plus total of 'Net' loss from Future & Option transactions as mentioned above will be the 'turnover' for the purpose of Section 44AB.

For instance, Mr. XYZ made profit of ₹2,00,000 and booked loss of ₹(1,50,000) in certain financial year from the activity of Future & Option. Then, his 'turnover' shall be ₹3,50,000 only and thus there is no need to get his books of accounts audited.

- *What if a person is carrying on 2 or more Business/Professions?* The total turnover of both/all the businesses shall be clubbed together and tax audit shall be liable to be conducted if the Total Turnover exceeds ₹1 crore/₹25 lakhs as the case may be.
- *What if a person is carrying on business as well as profession?* If a person is carrying on 'business' having turnover of say ₹5 crore and also having the gross receipts from the profession say of ₹10 lakh ONLY.

Now question arises as to whether assessee is liable to get books of accounts audited in respect of Professional Receipts of just ₹10 lakh?

Here, to get the answer, again we have to refer ICAI's clarification made through a Guidance Note as below:

*Assessee is liable to get the Tax Audit done of both the business as well as profession simply because the Gross Receipts from the business exceed the limit of ₹1 crore.*

However, it is to be noted that if his Total Turnover from 'business' was say ₹93 lakh and Gross Receipts from profession was same i.e. ₹10 lakh, then assessee would not be required to get books of accounts audited u/s 44AB.

Let us move ahead... *'The only CONSTANT in the life is CHANGE'*... And it remains true for the Income Tax department as well.

### e-Filing

The Income Tax Department through its E-filing website i.e. the website which is found in almost every CA's Bookmark/Favorite list i.e. <https://incometaxindiaefiling.gov.in/e-Filing> has undergone a massive change. One of the important changes is the addition of professional window for Chartered Accountants (CA) on the portal. The site has been modernised in line with growing need of industry and professionals. Hence it is advisable for all CAs to get themselves registered online on Income Tax website.

Second and most important change is that professionals (CAs), now have to certify their Tax Audit Report along with filing of Income Tax returns (ITR) only. Please note that it was required to be done even till now, but the submission of Tax Audit Report through online mode was not required before. Hence, all CAs now have to start their Tax Audit work little earlier than before because it will certainly take some amount of time to prepare/fill the entire Tax Audit Report in the Income Tax Utility (or the software used by concern CAs) and upload the same online as we do normally for the Income Tax Returns.

***CBDT (vide Notification No. 34/2013 [F.NO.142/5/2013-TPL/SO 1111(E), dated 1-5-2013) has made changes in Income Tax Rules by adding the clause as:***

in sub-rule(2), the following proviso shall be inserted, namely:-

***Provided that where an assessee is required to furnish a report of audit under sections 44AB, 92E or 115JB of the Act, he shall furnish the same electronically." And in sub-rule 4, after the words, brackets and figures "of sub-rule (3)", the words and figures" and the report of audit in the manner specified in proviso to sub-rule (2)" shall be inserted. (Only relevant matter of Tax Audit from the Notification is provided here.)***

It means that after the above notification, the department has not only made just a facility for CAs to upload the Tax Audit Reports in Form No. 3CA, 3CB, 3CD etc. but also it has now made mandatory as well by way of making appropriate rules under Income Tax (Third Amendment) Rules, 2013 - Amendment in Rule 12.

Many times, due to overload of work during September end or some other reason, the audit may be completed before 30<sup>th</sup> September itself but actual

audit report may be issued after 30<sup>th</sup> September. But CAs may not now be able to keep issuance of Tax audit Report pending. So this initiative taken from Income Tax Department should be welcomed.

Another plus point of this initiative is that earlier Tax Audit Reports were not required to be attached with the Income Tax Returns. As a result, it was not possible or I would say it was quite difficult for the for the Income Tax Department (ITD) to see whether Tax Auditor has noted some important and crucial points in their Audit Report or disallowed some amount of expenses etc. From 'expenses', let's recall the lines "*Few of us ever test our powers of deduction, except when filling out an income tax form.*"

— Laurence J. Peter, author. Assessee always seek for more and more deductions. On the other hand, we (CAs) always see whether any expenses were wrongly claimed by the assessee in order to perform our duty honestly and also to contribute to the Government by way of taxes, etc. CAs while performing the tax audit disallow such expenses in their audit report. As per the prevalent practice, the Income Tax Department would come to know of such disallowances only if the assessment proceedings i.e. scrutiny happens for the assessee in future. Hence, this initiative will certainly result into a successful implementation and beneficial for all of us including Indian economy.

Let's us recall a good line that is '*There is no such thing as a Good tax.* However, one can certainly say that this initiative regarding Tax Audit is quite good as taken up by the Department.

#### Maximum Allowable Number of Tax Audits:

A Chartered Accountant in full time practice can NOT accept more than 'specified number of Tax Audit Assignments' (i.e. 45 – Forty Five). Please note that the aforesaid limit of 45 does NOT include audits conducted under Section 44AD, 44AE of the Income-tax Act 1961. If a member is partner in more than one firm then total assignments taken by him/her in all the firms shall not exceed 45. Further, we, the CAs are supposed to maintain a record of the Tax Audit Assignments accepted in each financial year. In a nutshell, in a CA Firm, specified number of tax audit assignments i.e. 45 are reckoned partner wise and not firm wise. Further, Audit of one or more branches of the same concern/entity by one CA in practice shall be considered as ONE assignment only. Last but certainly not the least is that a CA

being a part time practicing or part time partner of a firm shall NOT be entitled for the audit assignments.

To illustrate the above provisions please go through this small example: A firm has 6 partners. Hence, the maximum no. of Tax Audits that can be taken by a firm would be  $45 \times 6 = 270$ . If the Firm undertakes all the 270 Tax Audit Assignments, then the partners would not be in a position to undertake any tax audit assignment in their personal capacity.

Now, going little back, as I just mentioned before while that the Income Tax Department has made such the facility for CAs so that they can upload the Tax Audit Report in Form No. 3CA, 3CB, 3CD etc. Further, it has made mandatory as well by issuing Notification by CBDT explained above.

As a result, ICAI/ITD shall be able to track the count of 45 Tax Audits. In fact, ICAI with the help of CBDT/ITD can also put control on this website so that only 45 Audit Reports u/s 44AB (i.e. not of under Section 44AD, 44AE) can get uploaded under the log in of one CA. Hence, the moment a CA tries to upload his/her 46<sup>th</sup> Tax Audit Report online, the system will not accept it and will through a message like 'Exceeding Maximum Audit Limits eligible..

#### Reporting Types of Tax Audit Report

- (i) *'Unqualified' Audit Report:* It simply means that 'All is well ...' It ensures that assessee has followed every provisions and compliances of the Income-tax Act, 1961 as far as Tax Audit is concerned.
- (ii) *Qualified Audit Report:* In simple words, it means that 'Something is well, but not everything...' Such reporting shows that assessee has followed many provisions and compliances but not all of them. For instance, non-filing of any of the E-TDS returns may result such as Tax Auditor qualifies his Tax Audit Report.
- (iii) *Adverse Audit Report:* It means that 'Nothing is well...' This is the rarest case as it is hardly possible to get such auditee who has not at all followed the provisions and compliances.
- (iv) *Disclaimer of Opinion:* In simple words, it denotes as "Tax Auditor does not know anything". According to me, this type of reporting came into the picture when Tax Auditor is unable to give his/her opinion on books of accounts may be due to improper/insufficient information and so on. ■