

Issues on 44AB debated in Appeal

PPT by

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SILVER JUBILEE YEAR OF THE PROVISION

Section 44AB was first introduced by Finance Act, 1984 and this provision will be celebrating its SILVER JUBILEE very soon.

In this span of 25 yrs, there have been 22 major amendments in sections relating to Tax Audits.

Audit expectations & Audit Report

155 ITR 81 in T.S. Natraj & Others vs Union of India, (KAR)

Importance of reporting

Maintaining audit independence

155 ITR 81contd

in T.S. Natraj & Others vs Union of India,

This judgement takes into consideration a dissent note given by one scholarly person by name Rangnekar who was member of Wanchoo Committee on whose recommendations this provision was enacted.

Rangnekar goes very critical about the way tax audits are being carried out and its an eye opener to all of us.

155 ITR 81contd in T.S. Natraj & Others vs Union of India

- Scope of examination-whether full-check,test-check or mere reconciliation-in order to satisfy that purchases,sales,income and expenses are properly accounted for and balance sheet is properly drawn up
- Nature of security offered for obtaining secured loans.Particulars of security not recorded or accounted for in the books to be stated.
- Computation of admissible allowance by way of depreciation.

155 ITR 81contd in T.S. Natraj & Others vs Union of India

- Brief particulars of expenditure on entertainment,advertisement,guesthouse, etc and the amount,if any,disallowable under section 37 of the I.T Act,1961
- Particulars of expenses in respect of which payments have been made to directors,partners or persons substantially interested in the concern and their relatives. The amount, if any, not deductible under section 40 and 40A of the IT Act,1961
- Particulars of amounts,if any, chargeable as profits under section 41 of the IT Act,1961.
- Particulars of payments in respect of which income tax has not been deducted at source and paid in accordance with the requirements of ss.192-200 of the IT Act,1961

Form 3CD Point No 8

Section2(13) defines BUSINESS AS

‘business’ includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture ;

Relevant case laws:

Narain Swadeshivg. Mills vs CEPT 26 ITR 765(SC): - Systematic or organised course of activity with set purpose.

Senairam Doongarmally vs CIT 42 ITR 390 (SC): -The intent has to be profit earning but the outcome could be loss.

An assessee acquired an asset with an expectation to sell it at a profit. Whether business? Janakiram Bahadurram vs CIT 57 ITR 21 (SC)

CIT vs Dharma Reddy 73 ITR 75(SC): - Continuous exercise of an activity.

Sarojkumar Mujumdar vs CIT 37 ITR 242: - Onus on department to prove adventure in nature of trade.

Form 3CD Point No 8contd

Section2(36) defines PROFESSION AS

‘Profession’ includes vocation.”

Relevant case laws:

C Rajgopalchariar vs CIT 50 ITR 196(Mad): - A motive for making a profit is not essential requisite of profession. Also see 113 ITR 462 Delhi CIT vs Ramparshad

CIT v. P. V. G. Raju [1975] 101 ITR 465 Politics is a profession

In this case

Krishna Iyer J., speaking for the court, said :

“It is thus clear, without reference to the wealth of case-law relied on by the High Court, that politics has been a profession and, indeed, under modern conditions in India, perhaps the most popular and uninhibited occupation _ with its perils, of course. Law cannot take leave of realities and, therefore, section 5(a) of the Expenditure-tax Act, 1958, must bear the construction that politics is a profession or occupation.”

Politics is a profession

- What constitutes Turnover for politicians?
- Are they duty bound to get their accounts audited?

Form 3CD Point No 9.....contd

Books of Accounts prescribed u/s 44AA: -

Professions covered under the proviso of Rule 6F: -

- A Keshva Bhat vs ITO 247 ITR 83(Kar): -If in any one of the preceeding 3 yrs the gross receipts are less than Rs.1,50,000- no need to maintain books.
- AO cannot direct additional books of accounts. CIT vs Rajanikant Dave 150 Taxman 387 (All)
- Stock record not mandatory under law. CIT vs Gajanan Traders(Panji)

Form 3CD Point No 11

Method of Accounting

- Different Systems of accounting in respect of different sources-
J K Bankers vs CIT Allahabad HC 94 ITR 107
- Regular does not mean permanent system of accounting-
CIT vs Punjab State Industrial Co-op Ltd 255 ITR 351
- Method of Accounting- Assesses Choice
CIT vs Macmillan & Co 33 ITR 182 SC

Assessee's choice Method of Accounting

Department cannot compel assessee to choose a particular method - The option is with the assessee and not with the department so that the department cannot compel an assessee to adopt the mercantile system of accounting, if the assessee chooses to adopt the cash system - **Juggilal Kamlatpat Bankers v. CIT [1975] 101 ITR 40 (All).**

Assessee's choice Method of Accounting

Change of method is not prohibited - Section 145(1) does not postulate any agreement or contract regarding the method of accounting to be employed by a taxpayer. This section also does not lay any embargo on him to alter his method of accounting. An assessee can change the method of accounting unilaterally in respect of a source of income - **Reform Flour Mills (P.) Ltd. v. CIT [1978] 114 ITR 227 (Cal).**

Assessee's choice Method of Accounting

Change of method does not require prior approval - A change in the method of accounting need not have the approval of the income-tax authorities, nor need it be supported by cogent reasons showing the *bona fides* of the assessee - **Snow White Food Products Co. Ltd. v. CIT [1983] 141 ITR 847 (Cal.) (Per contra).**

Form 3CD Point No 16

Production Incentive is not Bonus for purposes of Sec 36(1)(ii)
CIT vs Kasturi Mills 234 ITR 538 (Mad)

Form 3CD Point No 17

Capital Expenditure: - *CIT vs Wolkem Pvt Ltd 258 ITR 350(Raj)*

Capital Expenditure not defined in Act and has to take natural meaning: - *Mohantal Hargovind vs CIT 17 ITR 473*

The word 'expenditure' is itself not defined under the Act and in absence of statutory definition it has to take meaning in the manner it is understood generally. *Akash Films vs CIT 191 ITR 32 (Kar)*

Form 3CD Point No 17.....contd

Business Expenditure-Capital or Revenue: -

Nature and course of business and object behind expenditure are relevant factors- *Bombay Steam Navigation Co Pvt Ltd vs CIT (SC) 56 ITR 52*

Expenditure of Identical nature cannot be regarded differently for different purposes-*CIT vs Vallabh Glass Works Ltd 137 ITR 381 (Guj)*

Whether it is Revenue or Capital does not depend on the admission of the assessee.- *Avery India Ltd vs CIT 199 ITR 745*

It is misnomer to call expenses incurred by the assessee for maintenance of such branches as losses incurred by the assessee in such branches.- *Narayandas Kishandutt vs CIT 149 ITR 636(MP)*

Form 3CD Point No 17.....contd Disallowances u/s 40a

Two Disallowances under one Transaction

- M/s X Private Limited paid statutory audit fee of Rs.1,00,000/- in cash during the accounting year 2007 – 2008 with out deduction of tax at source.
- For Assessment year 2008 – 09
 - o Disallowance U/s 40(a)(ia) – Rs. 1,00,000
 - o Disallowance U/s 40A(3) – Rs.1,00,000

Form 3CD Point No 17.....contd Disallowance u/s 40b

Partner technically qualified and paid technical consultation fees- *CIT vs Packwell Industries 267 ITR 452* should be considered as remuneration only

Interest paid by one firm to another firm having common partners: - It is not interest within the meaning of section 40b- *CIT vs Nagpur Golden Transport Co 233 ITR 389 (Delhi)*

Form 3CD Point No 17.....contd Disallowance u/s 40A(3)

Return of paid cheques by bank to its constituents

Banks may now return the paid cheques to their constituents after obtaining a formal undertaking from them to the effect that they shall retain the returned paid cheques for a period of eight years and produce them before the ITO whenever called upon to do so.—*Circular : No. 33 [F. No. 9/50/69-IT(A-II)], dated 29-12-1969*

Form 3CD Point No 17.....contd Disallowance u/s 40A(3)

All outgoings, including purchase of stock-in-trade are covered: -Attar Singh Gurmukh Singh v. ITO [1991] 191 ITR 667 (SC).

Advance payments are also covered: - Kejriwal Iron Stores v. CIT [1988] 169 ITR 12 (Raj.).

Application of Monetary Limit of Rs.20,000/-

- Limit applies to payment to a party at one time
- Limit applies to cash portion of payment
- Limit applies to all items in a bill, and not to individual items
- Limit applies to each transaction

Limit applies to payment to a party at one time

The statutory limit applies to payment made to a party at one time and not to the aggregate of the payments made to a party in the course of the day as recorded in the cash book. The word 'sum' in section 40A(3) is used only to indicate an amount of money and does not refer to the totality of the expenditure. - *CIT v. Aloo Supply Co.* [1980] 121 ITR 680 (Ori.).

Limit applies to cash portion of payment

Where the payment was made partly in cash and partly by way of post-dated cheques, section 40A(3) will apply only if the cash payment exceeded the prescribed limit - *H.A. Nek Mohd. & Sons v. CIT* [1982] 135 ITR 501 (All.).

Limit applies to all items in a bill, and not to individual items

Section 40A(3) concentrates on the size of the payment and the manner of the payment. If different items are included in a single bill, it would not be right to dissect the bill and find out whether each item of expenditure is above Rs. 10,000; the proper way is to read the entries in a wholesome fashion - *Addl. CIT v. Shree Shanmuga Gunny Stores* [1984] 146 ITR 600 (Mad.).

Limit applies to each transaction

The words used are 'in a sum', *i.e.*, single sum. Therefore, irrespective of any number of transactions, where the amount does not exceed the above amount in each transaction, the rigours of section 40A(3) will not apply - *CIT v. Triveniprasad Pannalal* [1997] 94 Taxman 381 (MP).

Form 3CD Point No 17.....contd Section 40A (7) Gratuity

Provision in Accounts must and Deduction cannot be claimed on general principles.: - *Shri Sajan Mills Ltd vs CIT* 156 ITR 585(SC)

Form 3CD Point No 17.....contd Section 36(1)(iii)

Capital borrowed : - Reporting requirements only on proviso

Proviso deals with acquisition of an asset for extension of an existing business.

Not applicable to setting up of new business.

Tests of such asset first put to use

Trial Run of Machinery will not suffice

Mere installation of machinery was not sufficient in order to decide whether the business of an assessee was set up during the relevant assessment year –

Commissioner of Income-tax vs. Forging and Stamping Pvt. Ltd. 119 ITR 616 (BOM.)

For Section 36 (1)(iii)

Date of purchase of Raw Material is held relevant

Form 3CD Point No 17.....contd Section 36(1)(iii)

- Unit must be ready to start functioning for the purpose for which it is being setup-Simply because assessee had given banquet hall on lease in an incomplete building, it cannot be said that hotel business as such had been setup and could not be allowed as business expenditure.-*Held In CIT vs Piem Hotel Pvt Ltd 209 ITR 616(Bom)*

Form 3CD Point No 18 Payments to specified persons

Co-operative Societies not covered: - *CIT vs Manjara Shetkari Sakhar Karakhana Ltd 166 Taxman 287 (Bom)*

Expenditure must first be proved as excessive or unreasonable- *CIT vs Upper India 117 ITR 569 (SC)*

Interest paid to directors @ 15% and 12% to other creditors, correct way to ascertain whether payment was higher the market rate and not comparable rate: - *Hynoup Food & Oil Industry vs ACIT 47 TTJ 556 (Ahm)*

Appreciation of Audit Report/Certification in assessment proceedings

INSTRUCTION NO. 9/2008, DATED 31-7-2008

Kindly refer to above.

C&AG carried out a systems review of Third Party certification under the Income-tax Act. This has brought out that in many cases the information available in the tax audit reports is not being properly analyzed during assessment proceedings thereby defeating,

the very purpose of providing for audit of accounts in the Income-tax Act i.e., to ensure that correct deductions are claimed by the assessee.

It is, therefore, re-iterated that the tax audit reports as well as other statutory audit reports should be critically examined along with connected records and other available evidence and the information as available in these reports should be effectively utilized while finalizing assessment of cases selected under scrutiny.

In case of e-filed returns as well as annexure-less returns, tax audit reports and other statutory audit reports should be requisitioned and thoroughly examined during assessment proceedings in cases under scrutiny.

With effect from 10th August, 2006, the 'Accountants' are required to indicate in Form 3CD as to whether a certificate has been obtained from the respective assessees regarding payment relating to any expenditure/taking or accepting of loans or deposits or repayment of the same through account payee cheque/bank draft (refer points 17(h) and 24(c) of Form No. 3CD).

Instead of simply relying on the said certificates given by the assessees, the assessing officers should undertake a test check of such transactions while completing the assessments under scrutiny. Results of such test check should also be kept on record. In case, any violation is noticed, follow up action as per the Income-tax Act including invoking of penal provisions should be taken.

In cases where any factual misrepresentation by the Accountants is observed, suitable action should be taken against them as provided under section 288 of the Income-tax Act, 1961.

This may be brought to the notice of all concerned for strict compliance

Thank you