



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(SETUP BY AN ACT OF PARLIAMENT)

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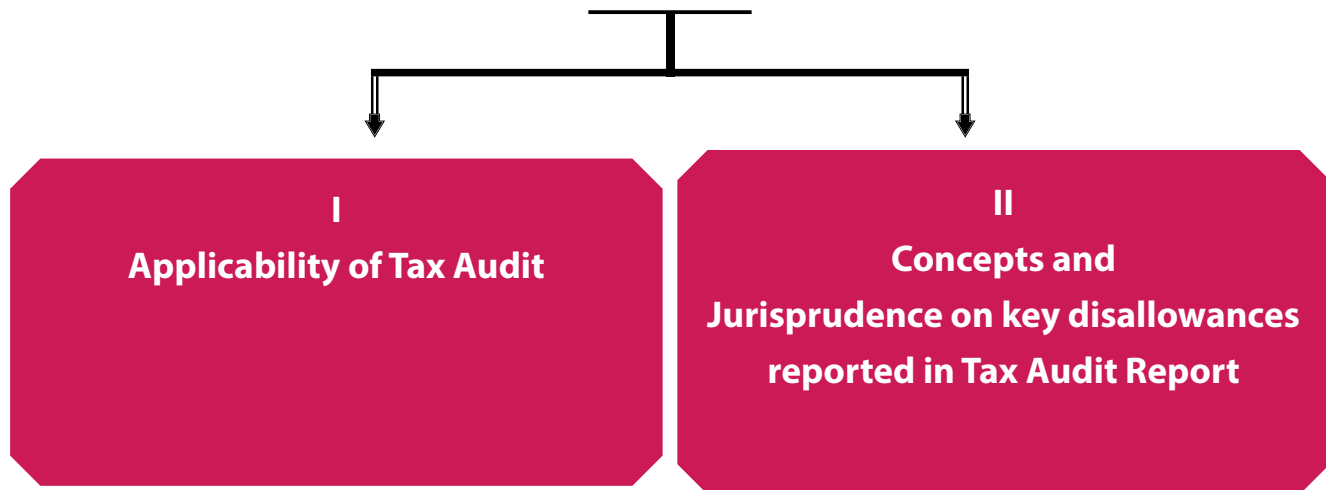
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TAX AUDIT – KEY CONCEPTS

- Adv. (CA) Santosh Sagar



I. Applicability of Tax Audit

- Genesis and Objectives of Tax Audit
- Categories
- Section 44AA – Maintenance of Books
- Section 44AB – Audit of accounts
- Section 44AD – Presumptive Taxation for Specified Business
- Section 44ADA – Presumptive Taxation for Specified Profession
- Case studies

1. Genesis of Tax audit

- ✦ Recommended by the Direct Taxes Enquiry Committee chaired by Sri. Justice K.N. Wanchoo (Retd. CJI) (1971)
 - ▶ Malpractices like **presentation of false and misleading accounts** could be checked to a great extent
 - ▶ Not to cast legal obligation on all taxpayers to maintain accounts
 - ▶ **Compulsory audit** for businesses/ professions where income or property exceeds **specified limits**



+ Tax Audit

- ▶ Section 44AB introduced vide Finance Act, 1984
- ▶ Effective Date - 1st April 1985.

+ Objectives - Explanatory Notes (CBDT Circular No. 387, dt. 6th July 1984)

- ▶ A proper Tax Audit for taxpayers would ensure:
 - Books of account and other records are properly maintained
 - Records faithfully reflect the income and claims for deductions are correctly made
 - Checking fraudulent practices
 - Facilitate administration of tax laws by a proper presentation of the accounts before the tax authorities and considerable saving in the time of AOs in carrying out routine verification like checking the correctness of totals and verifying if purchases and sales are properly vouched or not
 - Time of AO saved could be utilised in investigation of more important aspects of a case

2. Key Definitions

Business – Section 2(13)

“business” includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture;

Profession – Section 2(36)

“profession” includes vocation

Books or books of account – Section 2(12A)

“books or books of account” includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form or in a floppy, disc, tape or any other form of electro-magnetic data storage device”



3. **44AA – Maintenance of Accounts**

Specified Professions

Gross receipts > INR 1,50,000 (PY or any of last 3 years) (Per Rule 6F)

Business or other professions (Individual/ HUF)

Income > INR 2,50,000

Sales/ turnover/ gross receipts > INR 25,00,000 (any of last 3 years)

Profits < Presumptive taxation rates (44AE, 44BB, 44BBB)

Transition out of 44AD (for 5 years) and Income > INR 2,50,000

Business or other professions (other than Individual/ HUF)

Income > INR 1,20,000

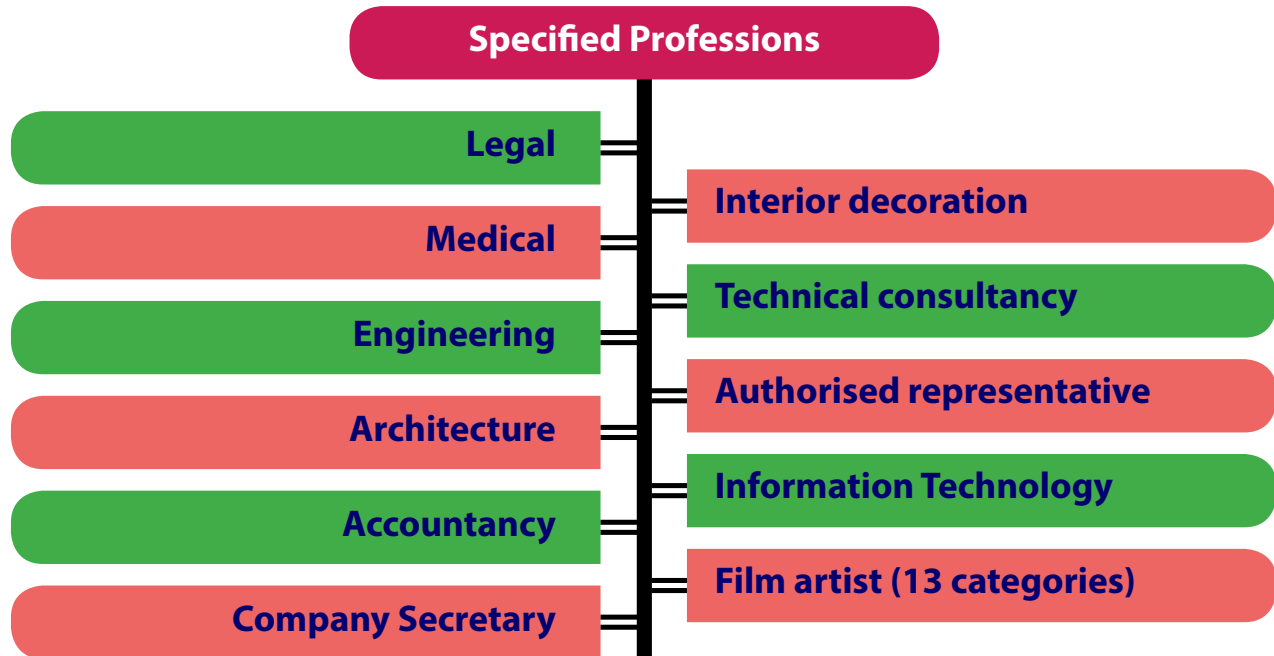
Sales/ turnover/ gross receipts > INR 10,00,000 (any of last 3 years)

Profits < Presumptive taxation rates (44AE, 44BB, 44BBB)

Transition out of 44AD (for 5 years) and Income > INR 2,50,000

- **Specified Professions - 2(12A) read with Rule 6F**
- **Other Professions - 2(12A) read with Rule 6F**
- **Business - 2(12A)**

shall ***keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.***



+ **Rule 6F**

- Cash book
- Journal (Mercantile system)
- Ledger
- Carbon copies of bills issued and receipts issued with counterfoils (exceeding INR 25)
- Original bills/ receipts for expenses (expenses exceeding INR 50) and signed payment vouchers (payments upto INR 50)
- Additional requirements for a Doctor
- Maintenance of Books - 6 years or completion of pending reassessment proceedings

+ **Specified Profession vs Non-specified Profession - Discriminatory requirements?**

- Challenge to Constitutional Validity of Section 44AA
- Is there any discrimination between Specified Professions and other Professions for maintenance of Books of Accounts?
- Observations of the High Court:
 - ❑ Specified Professions definitely fall into a category of regulated professions - lawyers, chartered accountants, doctors, etc.
 - ❑ Organised professions or professions like interior decorators who charge considerable



fees for the services rendered, perhaps are not regulated by any enactment to subserve the object of bringing to tax their income.

- ❑ What falls outside the enumerated class, practicality is the guiding force to prescribe a monetary limit which will compel them to maintain accounts.
- ❑ It would be futile to call upon an **Ordinary Pan Seller/ Street Vendor/ Roadside Hawker/ Cabin Shop Owner or Vegetable Vendor** and persons like those who also carry on profession **to maintain books of account**.
- ❑ Professions such as street hawkers, ordinary pan sellers, etc., do not belong to the same category/ class as Advocates, doctors and engineers.
- ❑ Conclusion:
 - ★ No discrimination
 - ★ Reasonable classification permissible under Article 14
 - ★ No need to attract the equality assured under Article 14.
- ❑ **Karnataka High Court in H.A.K. Rao vs. UOI [(1991) 189 ITR 322]**

4. **Section 44AB - Audit of accounts of certain persons carrying on business or profession**

+ When is Tax Audit Applicable?

- **Scenario 1: Section 44AB(a)** - Business, where total sales/ turnover/ gross receipts > INR 1,00,00,000 in the PY
- **Scenario 2: Proviso to Section 44AB(a)** - Business, where total sales/ turnover/ gross receipts > INR 10,00,00,000 in the PY
 - ❑ Aggregate of cash received \leq 5% of Total sales/ turnover/ gross receipts; and
 - ❑ Aggregate of cash payments \leq 5% of Total payments
- **Scenario 3: Section 44AB(b)** – Profession, where Gross receipts > INR 50,00,000 in the PY and presumptive taxation under Section 44ADA(1) not opted for
- **Scenario 4: Section 44AB(c)** – Business (44AE, 44BB, 44BBB), where Actual income from



presumptive business < presumptive income

- **Scenario 5: Section 44AB(d)** – Profession, where Actual income < presumptive income u/s 44ADA in the PY
- **Scenario 6: Section 44AB(e)** – Transition out of 44AD (for 5 years) and Income > INR 2,50,000

5. Section 44AD - Special provision for computing profits and gains of business on presumptive basis

+ When is Tax Audit Applicable?

- **Scenario 1: Section 44AB(a)** – Business, where total sales/ turnover/ gross receipts > INR 1,00,00,000 in the PY
- **Scenario 2: Proviso to Section 44AB(a)** – Business, where total sales/ turnover/ gross receipts > INR 10,00,00,000 in the PY
 - ▣ Aggregate of cash received <= 5% of Total sales/ turnover/ gross receipts; and
 - ▣ Aggregate of cash payments <= 5% of Total payments
- **Scenario 3: Section 44AB(b)** – Profession, where Gross receipts > INR 50,00,000 in the PY and presumptive taxation under Section 44ADA(1) not opted for
- **Scenario 4: Section 44AB(c)** – Business (44AE, 44BB, 44BBB), where Actual income from presumptive business < presumptive income
- **Scenario 5: Section 44AB(d)** – Profession, where Actual income < presumptive income u/s 44ADA in the PY
- **Scenario 6: Section 44AB(e)** – Transition out of 44AD (for 5 years) and Income > INR 2,50,000

+ **Eligible assessee:** Individual, HUF, Partnership Firm (excluding LLP), who has not claimed certain deductions (Section 19A, 10AA, 10B, 10BA, Chapter VIA)



✦ **Eligible business:** Any 'business' except 44AE

✦ **Ineligible business:** Specified Professions, Commission/brokerage receipts and Agency business

✦ **Expenses:** All deductions u/s 30 to 38 deemed to be allowed

✦ **Turnover cap:**

- INR 3,00,00,000 – Aggregate of cash received \leq 5% of Total sales/ turnover/ gross receipts; and
- INR 2,00,00,000 – All other cases

✦ **Presumptive income:** As a % of total turnover/ gross receipts

- 6% on non-cash transactions (Bank account, ECS, OEMs); and
- 8% on cash transactions; and

6. Section 44ADA - Special provision for computing profits and gains of profession on presumptive basis

✦ **Eligible assessee:** Individual, HUF, Partnership Firm (excluding LLP), who has not claimed certain deductions (Section 19A, 10AA, 10B, 10BA, Chapter VIA)

✦ **Eligible profession:** Specified Professions u/s 44AA(1)

✦ **Expenses:** All deductions u/s 30 to 38 deemed to be allowed

✦ **Turnover cap:**

- INR 75,00,000 – Aggregate of cash received \leq 5% of Total sales/ turnover/ gross receipts; and
- INR 50,00,000 – All other cases

✦ **Presumptive income:** 50% of gross receipts



✦ Is maintenance of Books of Accounts mandatory?

- Section 44AA(1) reads **Every person carrying on** legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the Official Gazette **shall keep and maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of this Act.**
- Section 44AA(3) reads The Board may, having regard to the nature of the business or profession carried on by any class of persons, **prescribe, by rules, the books of account and other documents (including inventories, wherever necessary) to be kept and maintained under sub-section (1) or sub-section (2),** the particulars to be contained therein and the form and the manner in which and the place at which they shall be kept and maintained.
- Rule 6F(1) reads Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist **shall keep and maintain the books of account and other documents** specified in sub-rule (2)
- Section 44ADA(4) reads **“Notwithstanding anything contained in the foregoing provisions of this section,** an assessee who **claims** that his profits and gains from the profession **are lower** than the profits and gains specified in sub-section (1) and whose total income exceeds the maximum amount which is not chargeable to income-tax, **shall be required to keep and maintain such books of account and other documents as required under sub-section (1) of section 44AA and get them audited and furnish a report of such audit as required under section 44AB.**

7. **Obligation to report income more than presumptive income in Section 44AD, 44ADA**

- ✦ Section 44AD(1) – “...., **a sum equal to eight per cent of the total turnover or gross receipts** of the assessee in the previous year on account of such business **or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the eligible assessee,**



shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession"

✦ Section 44ADA(1) – "... **a sum equal to fifty per cent of the total gross receipts of the assessee** in the previous year on account of such profession **or, as the case may be, a sum higher than the aforesaid sum claimed to have been earned by the assessee**, shall be deemed to be the profits and gains of such profession chargeable to tax under the head "Profits and gains of business or profession".

✦ Section 44AE(2) – "....., the profits and gains from each goods carriage,

(i) being a **heavy goods vehicle**, shall be an **amount equal to one thousand rupees per ton** of gross vehicle weight or unladen weight, as the case may be, **for every month** or part of a month during which the heavy goods vehicle is **owned** by the assessee in the previous year **or an amount claimed to have been actually earned from such vehicle, whichever is higher;**

(i) **other than heavy goods vehicle**, shall be an **amount equal to seven thousand five hundred rupees for every month** or part of a month during which the goods carriage is **owned** by the assessee in the previous year **or an amount claimed to have been actually earned from such goods carriage, whichever is higher.**

✦ Arguments in favour – No obligation to report higher income

- Objective to help small business and professions
- Use of the word "shall"
- No reference to "whichever is higher" in Section 44AD and 44ADA

✦ Arguments against - Obligation to report higher income

- Presumptive taxation is not a substitute for reporting 'real income'
- The Words, "a sum higher than the aforesaid sum claimed to have been earned by the assessee" indicate reporting of higher income earned
- Reporting of a higher income defeats the intent and objective of presumptive taxation



+ Point of caution!

- Presumptive taxation assumes that only those deductions u/s 30 to 38 and depreciation are deemed to have been allowed
- Presumptive taxation does not obliterate responsibility to prove source of investments, expenses and receipts (on a harmonious interpretation)
- Presumptive taxation does not provide a blanket immunity from penalty and prosecution

8. Interplay of Non-obstante clauses

44AD(1) - Notwithstanding anything to the contrary contained in sections 28 to 43C....

44ADA(1) - Notwithstanding anything contained in sections 28 to 43C.....

43B - Notwithstanding anything contained in any other provision of this Act.....

+ Can the provisions of Section 43B override 44AD and 44ADA and result in disallowance over and above presumptive income?

- The provisions u/s 28 to 43C are pertain to **computation of business income**.
- Provisions of Section 43B are **“restrictions”** on the allowance of a particular expenditure representing statutory liability and such other expenses/ payments unless same have been paid before the due date of filing the return.
- Non-obstante clause in Section 43B **has a far wider amplitude because** it uses the words “notwithstanding anything contained in any other provisions of this Act”.
- Therefore, even assuming that the deduction is permissible or the deduction is deemed to have been allowed under any other provisions of this Act, **still the control placed by the provisions of Sec. 43B in respect of the statutory liabilities still holds precedence over such allowance**.
- Dues to the crown have no limitation and have precedence over all other allowances and claims.
- Decision in the context of erstwhile Section 44F (similar wording to 44AD and 44ADA)
- **Hon’ble Panaji Tribunal in the case of Good Luck Kinetic vs. ITO [2015] 58 taxmann.com 267 (Panaji - Trib.)**



II. Concepts and Jurisprudence on key disallowances

- Impact of disallowances reported in Tax Audit Report
- Section 36(1)(va) - Contributions received from employees to various funds
- Section 40A(2) – Related Party transactions
- Section 40A(3) and 40A(3A) - Cash payments > INR 10,000

1. Impact of disallowances reported in Tax Audit Report

✚ 143. (1) Where a return, such return shall be processed in the following manner, namely:-

(a) the total income or loss shall be computed after making the following adjustments, namely:—

(i) to (iii)

(iv) disallowance of expenditure or increase in income ***indicated in the audit report but not taken into account in computing the total income in the return;***

(v) and (vi)

Provided that

Provided further that the ***response received from the assessee, if any, shall be considered before making any adjustment***, and in a case where no response is received within thirty days of the issue of such intimation, such adjustments shall be made

2. Section 36(1)(va) - Contributions received from employees to various funds

✚ Distinct treatment of Employee and Employer contribution (Section 43B)

✚ Legislative amendments effective from 01.04.2021

- Determination of 'due date' as per applicable statute
- Due date of deposit under Section 43B i.e., due date of filing Return u/s 139(1) not applicable
- Mandatory disallowance in case of delays – automatic determination in the Intimation

✚ Pre-amendment controversy

- Controversy settled by the Apex Court in the case of Checkmate Services SC decision



⊙ SC Decision in the case of Checkmate Services (P.) Ltd. vs. CIT

- ▶ When Section 43B was introduced, there was no concept of Employer's contribution
- ▶ Employer's liability is to be paid out of income, whereas Employee's liability second is deemed an income, by definition, since it is the deduction from the employees' income and held in trust by the Employer.
- ▶ Non-obstante clause has to be understood in the context of ensuring timely payment before the returns are filed. The due date for such liabilities is as defined by the respective statutes.
- ▶ Taxpayers are given some leeway that even if deposits are made beyond the due date, but before the date of filing the Return of Income, the deduction is allowed.
- ▶ Benefit of delayed deposit cannot be extended and applied to Employee's contribution
- ▶ Employee's contribution represents amounts held in trust and are neither part of the Employer's income, nor are they heads of deduction per se in the form of statutory pay out.
- ▶ Employee's contributions are others' income, monies, only deemed to be income, with the object of ensuring that they are paid within the due date specified in the particular law. They have to be deposited in terms of such welfare enactments.
- ▶ It is upon deposit, in terms of those enactments and on or before the due dates mandated by such concerned law, that the amount which is otherwise retained, and deemed an income, is treated as a deduction.
- ▶ **Conclusion**
 - Deduction u/s 36(1)(v) allowable only of Employee's contribution amounts are deposited on or before the due date prescribed in applicable statutes.
 - If any other interpretation were to be adopted, the non obstante clause under section 43B or anything contained in that provision would not absolve the assessee from its liability to deposit the employee's contribution on or before the due date as a condition for deduction.



3. **Section 40A(2) - Related Party transactions**

40A(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction

+ Transaction

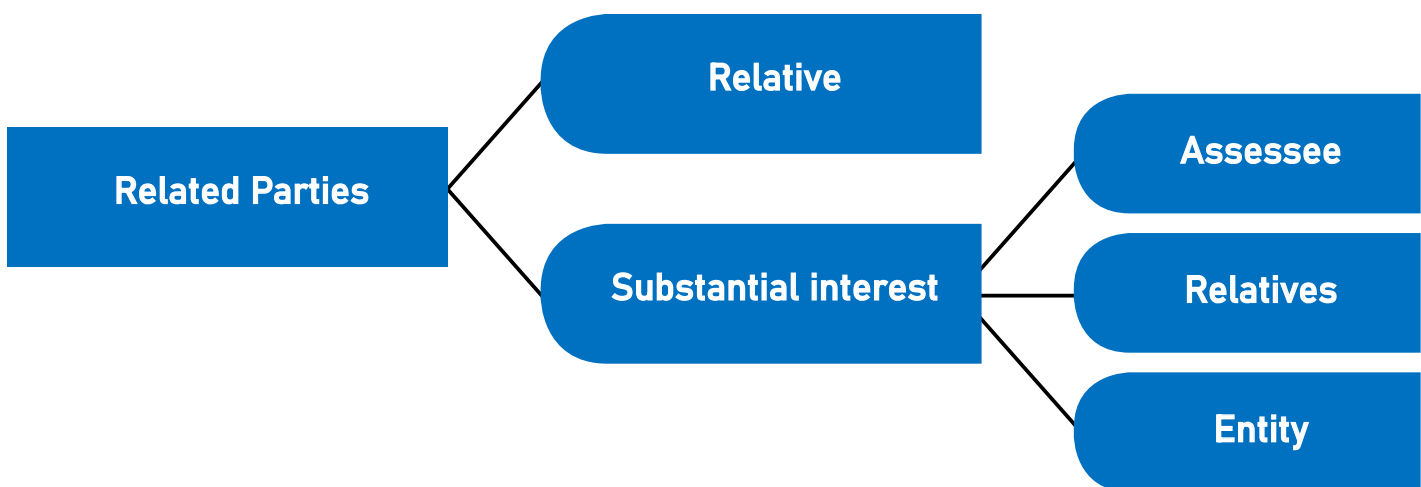
- Assessee incurs any expenditure
- Payment has been or is to be made
- Payment made to Related Person

+ Assessing Officer is of opinion that the expenditure is excessive or unreasonable

- Fair market value of the goods, services or facilities for which the payment is made or
- Legitimate needs of the business or profession of the assessee or
- Benefit derived by or accruing therefrom

+ Disallowance of expenditure considered to be excessive or unreasonable

+ Related Parties





- + Assessee's responsibility to demonstrate reasonableness of expenditure
- + Only a Reporting requirement in TAR
- + Tax Auditor not required to give any opinion
- + AO's prerogative to ascertain unreasonability/ excessiveness of payments

4. Section 40A(3) and 40A(3A) - Cash payments > INR 10,000

- + 40A(3) Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, exceeds ten thousand rupees, no deduction shall be allowed in respect of such expenditure.

Subject to exceptions prescribed in Rule 6DD

- + 40A(3A) Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, or use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds ten thousand rupees

Subject to exceptions prescribed in Rule 6DD

+ Section 40A(3) and 40A(3A) - Precedents

- Purchase of agricultural products
- Payments where banking facilities are not available
- Insistence on payment of cash supported by Affidavits
- Adjustments towards liability
- Payment to agent

ACTIVITIES - JULY, 2023



**CA Day 2023 celebrations held at Hotel Malabar Palace, Kozhikode
 Chief Guest - Sri. P V. Chandran, Managing Editor, Mathrubhui.
 Senior Member CA. Sankaran Kutty P. was honoured at the function. - 01.07.2023**



Kozhikode Branch of ICAI in association with department of Income Tax, Kozhikode hosted, Tax Clinic programme for handling queries of the taxpayers w.r.t filing of return of Income Tax. Inauguration - Sri. Mr. Darzakhum Songate IRS, Principal Commissioner of Income Tax - 13.07.2023 & 14.07.2023



**Walkathon - in Connection with CA Day 2023,
Kozhikode Branch of ICAI organized a walkthon of Members and Students.
Sri. Sabu G. Superintendent, State Special Branch, Kozhikode Range flagged off the programme.**



Blood Donation Camp - Kozhikode Branch of ICAI in association with Rotary Calicut Sunrise Club was held at ICAI Bhawan, Kozhikode. 04.07.2023



**Sustainable Futures - As a part of sustainable future initiatives Kozhikode Branch of SIRC decided to reduce the usage of plastic bottles in branch activities and started using glass bottles.
Inauguration - CA. Satheesan P., Regional Council Member.
Members and students took sustainability pledge during the programme. 15.07.2023**



Unlocking Financial Freedom, Empowering Minds - financial literacy programme for students of St. Mary's English Medium School, Chevarambalam, Kozhikode. 15.07.2023



15.07.2023 - One Day Seminar on Professional Development organised by Professional Development Committee of ICAI
Speakers : CA Rajendra Kumar P., Central Council Member, ICAI ,
CA Nitin N., Ernakulam, CA Balaji K., Kottayam.



Seminar on Response to Notice U/S 133(6) - E-Verification and Related Matters
Inauguration - Sri. K Rajesh, Income Tax Officer (I & CI), Kozhikode
Speaker - CA. Rajednran KA, Calicut - 18.07.2023



Empowering Excellence, Inspiring Leadership – My ICAI-My Pride and Know your member.
Membership drive for (inactive members) and getting back our semi qualified students in fold of ICAI.
Members working in Malabar Group, Thai Group, Indian Institute of Management . 22.07.2023

UPCOMING PROGRAMMES AUGUST, 2023

12

One Day Seminar

**Organised by : Direct Taxes and International Taxation Committee of
SIRC of ICAI**

Time : 9:30 AM

Location : Hotel Paramount Tower, Town Hall Road

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Onam Celebration2023

Felicitation programme for the members newly qualified in May 2023

HOLIDAYS - AUGUST, 2023

| Date & Day | Particulars |
|------------------------|----------------------------|
| 15.08.2023 - Tuesday | Independence Day |
| 28.08.2023 - Monday | First Onam |
| 29.08.2023 - Tuesday | Thiruvonam |
| 30.08.2023 - Wednesday | Moonnam Onam |
| 31.08.2023 - Thursday | Sree Narayana Guru Jayanti |

Contributions to e-newsletter

Contributions in the form of articles, poems, jokes, travelogues etc. are invited from members for consideration in the monthly e-Newsletter. Interested members may email their contribution to icaikoznewsletter@gmail.com along with name, membership number and mobile number.

