



# ISSUES IN TAX AUDIT

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# CONTENTS

- Tax Audit Limits & Due Dates
- Valuation of Closing Stock
- Conversion of Capital Asset into Stock-in-Trade
- Stamp Duty Value
- Income to be included under Sections 56(2)(viib), 56(2)(ix) & 56(2)(x) of the Income Tax Act, 1961 (the Act)
- Impact of COVID on Audit Matters
  - Residential Status
  - Valuation of Closing Stock
  - Subsequent Events
  - Going Concern
  - Deferred Taxes

# CONTENTS

- Tax Deducted/ Collected at Source
- Disallowance/ Deemed Income under sections 40A(3) & 40A(3A) of the Act
- Payments/ Receipts under Sections 269SS, 269ST & 269T of the Act
- Incomes not credited to P&L Account - Taxability
- Expenses debited to P&L Account - Allowability
- Chapter VI-A or Chapter III Deductions/ Exemptions
- Expenditure/ Payments under sections 43B, 14A, 32 of the Act
- Transfer Pricing Disclosures – Sections 92CE & 94B(1) of the Act
- General Issues
- ICDS

## Tax Audit Limits & Due Dates

- **Business** – Sales/ Turnover/ Gross Receipts exceed Rs. 1 Crore in PY
- **Profession** – Gross Receipts exceed Rs. 50 Lakhs in PY
- **Business** – Deemed Profits u/s 44AE, 44BB, 44BBB – Profits lesser than prescribed limits
- **Business** – Deemed Profits u/s 44AD
  - Declares profit lesser than 8% (or 6%) of Turnover + Income exceeding basic threshold limit + Total Sales **do not exceed Rs. 2 Crores**
- **Profession** – Deemed Profits u/s 44ADA
  - Declares profit lesser than 50% of Gross Receipts + Income exceeding basic threshold limit + Total Gross Receipts **do not exceed Rs. 50 Lakhs**

## Tax Audit Limits & Due Dates

- If assessee **opts out of 44AD** during lock-in period of 5 consecutive years from the first year of opting in, then any of the next 5 consecutive years during which income exceeds basic threshold limit
- If taxpayer's **cash receipts are limited to 5% of the gross receipts or turnover** and if the taxpayer's **cash payments are limited to 5% of the aggregate payments** – Then tax audit limit is increased to Rs. 5 Crores
- W.e.f. 01.04.2020 – Amendment in Finance Act, 2020

## Due date for filing audit report

- Tax audit report u/s 44AB shall be furnished by the assessee **atleast one month prior to the due date of filing of return of income u/s 139(1)**
- **W.e.f. 01.04.2020 – Amendment in Finance Act, 2020**
- **Due date for furnishing the report of the accountant**
- The report of the accountant as specified under sections 10, 10A, 12A, 32AB, 33AB, 33ABA, 35D, 35E, 44DA, 50B, 80-IA, 80-IB, 80JJA, 92F, 115JB, 115JC & 115VW should be furnished on or before the specified date referred under section 44AB of the Act.  
**i.e. one month prior to the date of furnishing the return of income.**

## Clause 14 -Valuation of Closing Stock

- Excess stock as a result of incorrect accounting entries - **Tax neutral entry**, hence no concealment
- Where revenue had **modified method of valuation of closing stock** in particular year, same methodology would also have to be applied for valuation of opening stock for that year? – Yes

*Veera Exports vs. ACIT, 248 Taxman 478 (Guj. HC)*

- Undervaluation of closing stock/ material/ finished goods - Covered within the definition of undisclosed income?

## Clause 14 - Valuation of Closing Stock

- Replacement Cost of Raw Materials
- Opening and Closing balance of stock to be considered from same source – One from stock register and another from bank statement **improper**
- For adopting an incorrect method of valuation, books of account could not be rejected - *Paramount Impex vs. ACIT, 117 taxmann.com 802 (Chand. Trib.)*
- **Unpaid excise duty on goods in stock which have not left the premises – Can it be added to Closing Stock value?**



## Clause 15 - Conversion of Capital Asset into Stock-in-Trade

- Assessee received land on partition of HUF which was held as stock-in-trade by the joint family HUF – Provisions of Section 45(2) - Is there any conversion of capital asset?

*CIT vs. C Ramaiah Reddy, [2020] 117 Taxmann.com 540 (Kar HC)*

- Agricultural Land held as stock-in-trade - Non-refundable deposit received from builder for construction – Capital Gains ?
- **Date of conversion of capital asset into stock-in-trade** – To be determined either on entry in Books or intention of assessee to convert capital asset into stock
- **Land held as Asset converted to Stock-in-trade** - Given as security for commercial expediency to sister concern -Subsequent sale of land in enforcement of security – No amount received by assessee - Taxability?
- **Conversion of Stock-in-Trade into Capital Asset - Amendment to Section 45 by Finance Act, 2018 – Disclosure Requirements in Form 3CD?**

## Clause 17 - Sections 43CA & 50C : Stamp Duty Value = Full value of consideration

- Relevant date for application of section 50C – **Rates on date of agreement are to be adopted** instead of rates prevailing on date of registration of property
- Disclosure under this clause implies acceptance of undervaluation of property transferred – Practically feasible?
- What constitutes land/ building – whether leasehold right/ development rights/ FSI (Floor Space Index)/ TDR? – Professional judgement of Auditor
- Sale consideration is as per mutual family settlement approved by Civil Court – Value as per 50C not to be considered – No capital gains tax
- Reference to Valuation Officer by the assessing officer – Is it Mandatory? - *Sunil Kumar Agarwal vs. CIT, 372 ITR 83 (Cal HC)*

## Clause 17 - Sections 43CA & 50C : Stamp Duty Value = Full value of consideration

- Realization of **right in proportionate share of land on purchase of flat deferred** till formation of co-operative society by flat owners and transfer of entire property to co-operative society
- Mere execution of a development agreement is not a “transfer” if possession as per s. 53A of the Transfer of Property Act is not given – Meaning of Transfer
- Impact of Section 45(5A) on year of taxability
- Transfer by way of contribution of ‘development rights’ to an AOP – Section 50C not applicable
- Where assessee was provided with development rights in consideration to land surrendered, Section 50C is applicable? – No

## Clauses 29, 29A & 29B - Income from Other Sources

- Sections 56(2)(viib), 56(2)(ix) & 56(2)(x) - Disclosures
- Business Books viz-a-viz Personal Books - Audit of both set of books?
- COVID Impact - Economic downturn may force some **promoters to sell their shares at less than Rule 11UA value to genuine investors** either to repay debts borrowed on pledge of shares or to raise capital for future survival
- Provisions to apply only in abusive situations - *K P Varghese, [1981] 131 ITR 597 (SC)*
- Onus will be on the assessee to demonstrate **impact of Covid-19** on valuation assumptions made in the past – Scrutiny of assumptions by the Department
- Any compensation/ other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto – **COVID Impact?**

## Clauses 29, 29A & 29B - Income from Other Sources

### ➤ **Definition of Relative u/s 56(2)(vii)**

#### ➤ **For Individual**

- a. Spouse of Individual
- b. Sibling
- c. Sibling of Spouse
- d. Sibling of either of Parents
- e. Lineal ascendant/ descendant
- f. Lineal ascendant/ descendant of Spouse
- g. Spouse of persons from b to f

#### **Reciprocity for gifting purposes**

#### ➤ **For HUF** – Any member of HUF

## Clauses 29, 29A & 29B - Income from Other Sources

- Gift not defined in Income Tax Act, 1961
- Definition of Gift in Gift Tax Act, 1958 - *Voluntary transfer of existing movable or immovable property from one person to another without consideration in money or money's worth*
- Transfer of Property is essential for the purpose of gift as per Gift Tax Act, 1958
- Occasion to be proved in Income Tax Act, 1961 to accept a gift? - *Pendurthi Chandrasekhar vs. DCIT, 407 ITR 179 (AP HC)*

## Clauses 29, 29A & 29B - Income from Other Sources

- Closely-held company by Mother & Daughter – Shares issued to Mother at exorbitant premium – Benefit of investment has passed on to the daughter – Lifting of Corporate Veil – Taxability?
- Agricultural Land held a stock-in-trade – On sale, whether Section 56 can be invoked?
- Whether AO has power to change the method of valuation adopted by assessee from one method to another method provided under Rule 11UA?
- Prospective mother-in-law gifts the prospective daughter-in-law – Taxability?
- Ex-husband gifts ex-wife, not subject matter of the marriage settlement – Taxability?
- Genuine transaction and no deliberate under-declaration of FMV of paintings by parties – Sections 56(2)(vii) or Section 49(4) do not apply

## Clauses 29, 29A & 29B - Income from Other Sources

- Method of Valuation of Shares preferred by Startups – **Net Asset Method or DCF**
- Non-equity Shares & Preference Shares – **Rule 11UA(1)(c)(c) versus Department's contention**
- **Advance received for capital asset and forfeited** is taxable as Income from Other Sources - Advance received for personal assets which are not related to business and not recorded in books of accounts – Taxability?
- If a **notice of forfeiture** is contested by the party for prolonged duration – Need for disclosure?
- If a notice of forfeiture is contested by the party after the disclosure is made in the Form 3CD – **Treatment in books and disclosure?**



## Clauses 29, 29A & 29B - Income from Other Sources

- If the assessee contends that the **amount has not been forfeited as per section 56(2)(ix)** - Auditor to look at the totality of the development and examine the legality
- Where assessee has disputed stamp duty value before the stamp authorities and such **dispute is pending as on the date of finalisation of audit** - Tax auditor to disclose such fact, stating both stamp duty value adopted by the stamp authorities and that claimed by assessee.
- Where there is a dispute/ doubt on valuation of an asset - Advisable for tax auditor to request the assessee to obtain a **valuation report from a registered valuer**
- **Taxable Gifts exceeding Rs.50,000/-** May not be found in the business books of the entity – Auditor's responsibility?

## Clauses 29, 29A & 29B - Income from Other Sources

- **Double taxation** - Section 56(2)(x) taxes buyer/ investor for acquiring property at a price less than FMV; Sections 50C & 50CA impact seller for receiving consideration on sale of property at less than FMV value - So the **differential amount may get taxed in the hands of both the seller as well as the buyer.**
- **Bonus Shares** - As long as there is **no disproportionate allotment** - No scope for any property being received by shareholders on allotment of bonus shares - **Provisions of Sections 56(2)(vii) & 56(2)(x) do not apply**
- **Reciprocity of taxability in the case of HUF** - Gift by HUF to its member - Not taxable u/s 56(2)(vii) - *Pankil Garg vs. PCIT, 181 DTR 305 (Chandigarh Trib.)*
- HUF receives a gift from a relative of a member – Taxability?
- When all members of HUF (donor) are relatives of the assessee (donee), the gift received from HUF is a gift received from a "group of relatives" – **Exempt from tax**

## Clauses 29, 29A & 29B - Income from Other Sources

- **Prohibition of Benami Property Transactions Act, 1988 (Benami Act)** – Interplay between the two statutes in terms of Relative and Gift
- **Benami Transaction**
  - A transaction/ an arrangement where a property is transferred to/ held by a person; **and**
  - Consideration for such property has been provided/ paid by another person; **and**
  - The property is held for immediate/ future benefit, direct or indirect, of the person who has provided the consideration
- **Exceptions** – Spouse & Child ; Joint Owner
- **Payment Test and the Benefit Test**
- **Unknown source for payment** –
  - **Income Tax Act** – Individual will be proceeded against, property will be with wife/ child.
  - **Benami Act** – **Property will be confiscated.** This will over-ride Income Tax Act

## Impact of COVID on Audit Matters – ICAI (AASB)

### ➤ Determination of Residency for Financial Year 2019-2020

- Has been unable to leave India on or before 31st March, 2020, his period of stay in India from 22nd March, 2020 to 31st March, 2020 shall not be taken into account; or
- Has been quarantined in India on account of Novel Corona Virus (Covid-19) on or after 1st March, 2020 and has departed on an evacuation flight on or before 31st March, 2020; or
- Has been unable to leave India on or before 31st March, 2020, his period of stay from the beginning of his quarantine to his date of departure or 31st March, 2020, as the case may be, shall not be taken into account; or
- Has departed on an evacuation flight on or before 31st March, 2020, his period of stay in India from 22nd March, 2020 to his date of departure shall not be taken into account.
- CBDT Circular No. 11 of 2020 dated 8th May, 2020

# Impact of COVID on Audit Matters – ICAI (AASB)

## ➤ Valuation of Closing Stock :

- Different Date of Counting - Auditor to comply with procedures given in SA 501 – Audit Evidence – *Changes in inventory post counting to be recorded*
- Attendance is not possible - Auditor to comply with procedures given in SA 501 - *Roll-back of stock numbers backward/forward to the Balance Sheet Date*

## ➤ Subsequent Events : Examples of events and conditions that may be relevant now

- New commitments, borrowings or guarantees entered into now
- Invocation of force majeure clause after the year-end by any party
- Increase in capital/ issuance of debt instruments, such as issue of new shares or debentures, or an agreement to merge or liquidate
- Expected credit loss provisioning – Customers filing for liquidation
- Dishonour of payments / EMI received from debtors / borrowers at a date later than 31st March 2020

# Impact of COVID on Audit Matters – ICAI (AASB)

## ➤ SA 570 (Revised) – Going Concern

- Importance of exercising professional scepticism is amplified
- Significant implications for global economies and markets for certain industries such as restaurants, entertainment, hospitality, retail and travel especially aviation

## ➤ Suggestions for an Auditor by the ICAI

- I. Discuss impact of COVID-19 on entities with management and those charged with governance;*
- II. Obtain sufficient appropriate audit evidence to assess whether disclosures given by management about the COVID-19 events are appropriate; and*
- III. Document audit evidence and their considerations in such a way that, in line with SA 230-Audit Documentation*

# Impact of COVID on Audit Matters – ICAI (AASB)

- Ind AS 12 - Income Taxes & AS 22 – Accounting for Taxes on Income
- COVID 19 impact on future profits – Reduction in DTL or additional temporary differences
- Entities with DTA – Reassess forecasted profits & recoverability
- Impact on plans to distribute profits from subsidiaries
- Disclose any significant judgements and estimates made in assessing the recoverability of DTA
- Clauses 30C – GAAR & 44 – GST Compliance - Deferred till March 2021
- *Order under section 119 of the Income-tax Act, 1961 vide a Circular No. 10/2020 dated 24.04.2020*

## Clause 21(b) & Clause 34 - Tax Deducted at Source

- **COVID Impact** - Reduced TDS & TCS Rates from 14.05.2020 upto 31.03.2021
- Reduction by 25% in TDS rates - Non-salaried specified payments to Residents
- Reduction by 25% in TCS rates - Specified Payments
- No reduction in cases of non-furnishing of PAN
- ***CBDT Press Release dated 13.05.2020***



## Clause 21(b) & Clause 34 - Tax Deducted at Source

- Assessee cannot be made to suffer because of non-deposit of tax deducted by the deductor - *Aricent Technologies Holdings Ltd. vs. Addl. CIT (Delhi) ITA. No. 5708/Del/2019 dated 23.12.2019*
- Does **non-appearance of tax credit in the Form 26AS** preclude the assessing officer from giving the TDS credit to the assessee? – No
- The word '**payable**' occurring in section 40(a)(ia) not only covers cases where amount is yet to be paid but also those cases where amount has actually been paid - *Palam Gas Service vs. CIT, 394 ITR 300 (SC)*
- Auditor to report if Statement of TDS & TCS filed contains all the required information to be reported by the assessee

## Clause 21(b) & Clause 34 - Tax Deducted at Source

- **Non-serving of Order u/s 200A**, electronically & physically – Valid notice? Appeal on such order possible?
- **Late filing Fee u/s 234E** for period prior to June 2015 – Invalid
- Reimbursement of expenses on deputation - Not liable to Sec 195 TDS
- Non – deduction of TDS due to oversight of assessee's accountant, then the same can be regarded as a 'reasonable cause'
- Whether initiation of proceedings u/s 201(1)/201(1A) after a lapse of 10 years in case of assessee company can be upheld as there was reasonable explanation for delay? – Yes
- Deductor can be permitted to correct PAN of deductee in the statement of TDS

## Clause 21(b) & Clause 34 - Tax Deducted at Source

- Contract with transporter to hire vehicles for transport of teachers and students to school and back – TDS u/s 194C or 194I? – 194C applies
- 194A not applicable for interest on delayed delivery of plots by Govt. owned undertaking – Not in nature of interest as per section 2(28A) – Interest in the nature of compensation for delay
- Payment by Jet Airways (assessee) for usage of lounge space at the airport is not rent liable for TDS u/s. 194-I - The real character of the service provided and for which the payment is made, would have to be judged

## Clause 21(d) - Sections 40A(3) & 40A(3A) - Disallowance/ Deemed Income

- Section 40A(3) - Is it within Auditor's rights to get details of account payee cheques issued by assessee from his banker?
- Provisions of TDS disallowance u/s 40(a)(ia) and cash expense disallowance u/s 40A(3) and 40A(3A) **applicable while computing the application of income in case of Charitable and Religious trusts and institutions** registered u/s 12A & 12AA - Violation of these sections will not be allowed as application of fund - **W.e.f. 01.04.2019 - Finance Act, 2018**
- **Presumptive Taxation** - No need to look into Section 40A(3) for presumptive taxation cases since the income is estimated and no deduction is allowed

## Clause 21(d) - Sections 40A(3) & 40A(3A) - Disallowance/ Deemed Income

- If in year 1, expense is allowed on mercantile basis and such expense is settled in cash, whereby it exceeds limit as prescribed in Section 40A(3)/ 40A(3A), then such expense shall be deemed to be the income of year 2.
- What happens if capital asset bought on accrual basis is settled in cash in next year, after claiming depreciation in year 1?
- Is depreciation to be adjusted in subsequent year?
- Responsibility of Auditor in year 2?
- Cost of asset to the extent of such cash payment to be considered as Nil - Finance Act, 2017
- **Expenditure – Not defined under the Act**

## Clause 21(d) - Sections 40A(3) & 40A(3A) - Disallowance/ Deemed Income

- **Business Exigencies** - Exceptions contained in Rule 6DD are not exhaustive and the said rule must be interpreted liberally - *Anupam Tele Services vs. ITO, 366 ITR 122 (Guj HC)*
- Expenditure includes advance payment
- **Cash paid on seller's insistence** - Assessee had placed proof of payment of consideration for its transaction to seller, admitted payment and there was no doubt about genuineness of payment, no disallowance could be made under section 40A(3)
- Cash payment only in excess of limit prescribed in Section 40A(3) needs to be disallowed and not the whole payment
- Partly in cash & Partly in cheque - Section applies only to the cash portion of the payment
- Assessing Officer has to take into account the surrounding circumstances, considerations of business expediency and the facts of each particular case in exercising his discretion in allowing or disallowing the payment
- Auditor to comment on the exigency of the situation in Form 3CD?

## Clause 31 - Sections 269SS, 269ST & 269T – Payments & Receipts

- Loan/ deposit has been repaid by merely debiting account through journal entries – Contravention of Section 269T - *CIT vs. Triumph International Finance India Ltd.*, 345 ITR 270 (Bom HC)
- Object of S.269SS is to prevent transaction in currency – not intended to affect cases where a debt/ liability arises on account of book entries
- No monetary transaction between parties, by mere journal entry, liability was created – No loan or deposit in violation of S. 269SS
- Objective is to promote digital economy and discourage receipts/ payments in cash, not journal entries – Journal entries are not prohibited
- **Section 269ST does not distinguish between receipt on capital account and on revenue account, between receipts and payments** - Both disclosures to be made by Auditor

## Clause 31 - Sections 269SS, 269ST & 269T – Payments & Receipts

- Receipt in the nature of **repayment of loan by NBFCs or Housing Finance Companies (HFCs)**, the receipt of one instalment of loan repayment in respect of a loan shall constitute a 'single transaction' as specified in clause (b) of section 269ST of the Act
- The **tax auditor will have to exercise care and caution** - Link all receipts or payments, as the case may be, otherwise than by the modes specified in this section received/made in respect of a single transaction and verify if the aggregate amount exceeds the limits specified in section 269ST
- A **single invoice may relate to multiple transactions and vice-versa**, multiple bills may relate to a single transaction – Verify
- At a social event, the Catering contract may not exceed 2 Lakhs but if the same contractor providing flower decoration services, then the aggregate will have to be computed since it arises from the same event/ occasion.



## Clause 31 - Sections 269SS, 269ST & 269T – Payments & Receipts

- What happens if a person sells to and purchases from the same party where separate transactions do not exceed Rs. 2 Lakhs but together it exceeds? Even if the amounts are mutually set off
- **Only payee is restricted by this section, not payer**
- 'Reasonable cause' in penal proceedings u/s. 271DA
- **Payments/ receipts between family members? How does the Auditor track & report?**
- Monies received via Virtual Money/ Prepaid instruments like Airtel money, Paytm, Book Adjustment Entries, Perquisites given to Employees in other form [including ESOP], Advances given to Employees as imprest, Gift Deeds/ Will Deeds, Discount offered in mode other than cash like distribution of products free of cost – Whether covered u/s 269ST?

## Clause 31 - Sections 269SS, 269ST & 269T – Payments & Receipts

- ▶ Payments made for purchase of agricultural/ forest produce, animal husbandry/ dairy/ poultry produce, fish/ fish products, horticulture/ apiculture (beekeeping) products to the cultivators of such produce is an exception u/r 6DD.
- ▶ No disallowance u/s 40A(3) can be made if the trader makes cash purchases of **agricultural produce from the cultivator - Circular No. 27/2017 dated 03.11.2017**

## Clause 16 - Amounts not credited to P&L Account - Taxability

- Government Grants – **Purpose Test**
- True nature of receipts - Book-keeping entries are not decisive or determinative of the true nature of the entries - *Godhra Electricity Co. Ltd v. CIT, 225 ITR 746 (SC)*
- Excise refund, interest subsidy, etc. received in pursuance of industrial policy of Government for State would be capital receipt
- Additional consideration on sale of shares on open offer – Reason for increasing offer by said sum might be on account of delay in issuance of shares, nevertheless, same was nothing but part of sale price of share – Capital receipt
- Refund of excise duty paid prior to commencement of project - Results in reduction of cost of capital

## Clause 16 - Amounts not credited to P&L Account - Taxability

- Interest earned on bank deposits out of share capital before commencement of business – Not income
- Assessee-Company has floated various schemes which require subscribers to deposit certain amounts by way of subscriptions in its hands, and, depending upon scheme in question, these subscribed amounts at end of scheme are ultimately repaid with interest - *Peerless General Finance & Investment Co. Ltd. vs. CIT, 416 ITR 1 (SC)*
- **Carbon Credits** - Profits from sale of carbon credits **capital in nature** - Amount received on their transfer had **no element of profit or gain** - Prior to 01.04.2018
- **Section 115BBG** introduced w.e.f. 01.04.2018 - Income on transfer of Carbon Credits - Taxable at 10%

## Clause 21 - Amounts debited to P&L Account - Allowability

- **COVID Impact – CSR Expenditure w.r.t. COVID-19 – Allowability?**
- Explanation 2 to section 37(1) of the Act (CSR) is applicable to taxpayers covered u/s 135 of the Companies Act, 2013
- Factors like meeting social obligation, impact on goodwill on contribution to society, etc. meet the test of commercial expediency and deduction to be granted
- Branding of company on distribution of food and essential requirements, images of employees wearing company branded shirts and supporting larger cause, media reports, posting on social websites will all support the claim for such deduction.

## Clause 21 - Amounts debited to P&L Account - Allowability

- Provision for leave encashment was made in the books on actuarial basis, therefore the same could not be held to be in the nature of a provision for an unascertained liability
- Company engaged in business of development of real estate made certain advance for purchase of land to construct commercial complex but same was **forfeited** – Applicability of Section 37(1) of the Act?
- Assessee having own interest-free surplus funds - Interest should be allowed if capital borrowed was used for purpose of business or profession
- **Copyright Expense** – Assessee only had licence to use copyright – Expenses deductible as revenue expenditure - **Licence to use the copyright viz-a-viz acquiring the copyright**

## Clause 21 - Amounts debited to P&L Account - Allowability

- **Penal in Nature** - Is **Speed Money** to be disallowed from business expenditure? No, expenditure incurred in the course of business – to be allowed u/s 37
- Complaint filed u/s 276C (1) of the Act – Wilful attempt to evade tax – Appeal pending before CIT(A) – Criminal proceedings kept in abeyance
- The levy of penalties and prosecution u/s 276C are simultaneous and, hence, once the penalties are cancelled on the ground that there is no concealment, the quashing of prosecution u/s 276C is automatic
- Prosecution in criminal law and proceedings arising under the Act are independent proceedings - **Wholesome rule to be adopted**
- **Mandatory Penal charges – Nomenclature – Compensation/ Penalty**

## Clause 26 - Allowability of Expenses - Section 43B

### **Liability covered u/s 43B which**

- Pre-existed at beginning of previous year, paid or unpaid
- Was incurred during the previous year, paid or unpaid
- Amounts to include payments to be made to the Indian Railways for the use of railway assets
- Excludes payments for basic rail freight
- Includes payments for hire of rail wagons, rail sidings, lease rent for use of railway land or buildings



## Clause 26 - Allowability of Expenses - Section 43B

- **Difference in treatment when payment made by Advertising Agency as against the Advertiser**
  - Payment by advertising agency included under this clause
  - Payment by advertiser not included since it is classified as payment for service of advertisement and not for use of railway assets
- **Conversion of interest o/s into shares – To be considered as actual payment since liability is settled and no more demand o/s with creditor - *CIT vs. Rathi Graphics Technologies Ltd., 378 ITR 107 (Del HC)***
- **Conversion of interest o/s into Debentures – Not actual payment - *CIT vs. MM Aqua Technologies Ltd., 386 ITR 441 (Del HC)***

## Clause 26 - Allowability of Expenses - Section 43B

- **Unpaid service tax** relates to consideration not received from parties to whom services were rendered; HC had ruled that when services are rendered, the **liability to pay the service tax** in respect of the consideration payable **will arise only upon the receipt of such consideration and not otherwise** – No disallowance u/s 43B
- *PCIT vs. Tops Security Ltd. in 262 Taxman 355 (SC)*
- *Confirming the decision of the Bombay HC in 415 ITR 212*
- **Consequence for GST provisions?**

## Clause 21(h) - Allowability of Expenses - Section 14A

- Addition on account of section 14A of the Act cannot exceed 100% of the exempt income earned -
- If an **expenditure incurred has no causal connection with the exempted income**, then such an expenditure would obviously be treated as **not related to the income** that is exempted from tax, and such expenditure would be allowed as business expenditure.
- *Maxopp Investment Ltd. vs. CIT, 402 ITR 640 (SC)*
- *Decision of Delhi High Court in 347 ITR 272 affirmed*

## Clause 21(h) - Allowability of Expenses - Section 14A

- If there are funds available, both interest-free and overdraft/ loans taken, then presumption would arise that investments would be out of interest-free funds generated or available with the company, if, the interest-free funds were sufficient to meet the investments
- Whether Section 14A would apply to dividend income on which tax is payable u/s 115-O? – Yes

## Clause 13 - Method of Accounting

- Section 5 of the Act – **Accrual of Income (Time of Accrual)**
- Where assessee sold a land during relevant assessment year and as per MOU part of sale consideration was payable by purchaser on completion of assessee's obligation under MOU
- **Assessee having not met conditions of MOU during relevant year, such amount was not taxable in relevant assessment year.**
- Income accrues only when it becomes due, i.e., it must also be **accompanied by corresponding liability of the other party to pay the amount - *Morvi Industries Ltd. vs. CIT [1971] 82 ITR 835 (SC)***
- **Revenue Recognition** - Postponement of recognition of such portion of sale proceeds which were not certain of being realised
- Real Income has to be considered for the purpose of revenue recognition

## Clause 18 - Depreciation

- Depreciation to be allowed even when the purchase of capital asset was considered as application of income
- *ACIT vs. Karnataka State Cricket Association, 50 CCH 77 (Bang. Trib.)/ Al-Ameen Charitable Fund Trust (67 taxmann.com 160) (Kar HC)*
- Ownership of asset for the purpose of claiming depreciation – Dominion over the asset and not mere deed of title
- *Build-Operate-Transfer - Right to operate toll roads and collect toll charges is an 'intangible asset'*
- Depreciation to be allowed for Infrastructure companies for toll roads built by them?
- Lessor leasing vehicles to customers is eligible for higher rate of depreciation available on commercial vehicles - *I.C.D.S. Ltd. vs. CIT, 350 ITR 527 (SC)*

## Clause 18 - Depreciation

- Assessee had recognized finance lease rent as part of business receipts and had also claimed depreciation on asset leased to lessee – Tribunal refers to the lease agreement which brings out fact that **assessee-lessor was the owner of the plant/asset** - assessee-lessor is entitled for depreciation on the asset leased under ‘**finance lease**’ arrangement.
- AS 19 – In finance lease, lessee to claim depreciation since all risks and rewards are transferred to lessee
- “When it comes to taxation, what is relevant is the provision of the Act which deals with taxability, but not guidelines issued by ICAI.”
- ICAI guidelines are only for its members to follow – Any deviation needs to be reported in the Audit Report
- Goodwill not specifically covered under section 32 – Covered under ‘any other business or commercial rights of similar nature, being intangible assets’ – The principle of **ejusdem generis** would strictly apply while interpreting the expression which finds place in Explanation 3(b) to Section 32(1).

## Clause 30A - Transfer Pricing - Section 92CE (Rule 10CB)

- 'Primary Adjustment' to a transfer price, means the determination of TP in accordance with ALP resulting in an **increase in the total income or reduction in the loss** of assessee.
- 'Secondary Adjustment' means an adjustment in the books of account of assessee and its AE to reflect that the actual allocation of profits between the assessee and its AE are **consistent with the transfer price determined as a result of primary adjustment**, thereby removing the imbalance between cash account and actual profit of the assessee
- Reporting of outcome of TP assessment, in case Primary Adjustment was made by A.O.
- Reporting even if there is no Secondary Adjustment to be made
- Duration of interest computation in case of delay in repatriation of funds to India? Interest upto March 31<sup>st</sup> or date of Form 3CD to be reported?



## Clause 30B - Transfer Pricing - Section 94B(1)

- Interest/ similar expenditure paid/ payable by Indian Company/ PE of Foreign Co. in India, exceeds Rs. 1 Crore to the **extent of excess interest** will not be allowed as expenditure under PGBP
- Excess Interest – Lower of
  - Total interest paid or payable in excess of 30% of EBITDA of borrower in PY; or
  - Interest paid or payable to AEs for that previous year.
- Interest disallowable u/s 14A, under the proviso to section 36(1)(iii), u/s 40A(i), section 40A(2), Section 92 should not be considered as interest for the purposes of section 92B(1).
- Two views for computing Rs. 1 Crore – Both allowed and accordingly, disclosure to be made:
- Aggregate of all interest paid or payable to **all non-resident AEs**
- Interest paid or payable to **each non-resident AE** is to be examined

## Clause 30B - Transfer Pricing - Section 94B(1)

- *Language of para 46.3 of CBDT's Circular No. 2 of 2018 containing Explanatory Notes to Provisions of Finance Act, 2017 (dated 15 February 2018) is similar to the format of reporting prescribed by CBDT in clause 30B of Form No. 3CD. The better view is to disclose interest paid only to non-resident AE(s)*
- Can the method be changed each year? What is the impact of the change – should it be disclosed?
- Whether details that need to be given are of the total amount of interest and similar expenditure claimed as a deduction and not just the interest paid to non-resident AE(s)?

## Clause 36A - Section 2(22)(e) - Deemed Dividend

- Auditor to obtain a certificate from assessee a certificate containing list of closely held companies in which he is beneficial owner of shares carrying not less than 10% of the voting power and list of concerns in which he has substantial interest
- Tax auditor to obtain a certificate from assessee of particulars of any loans/ advances received by any concern in which he has substantial interest from any closely held company in which he is beneficial owner of shares carrying not less than 10% voting power
- To check Form 26AS to examine nature of payment considered by payer concern
- Tax auditor may not have access to the records of assessee/ accounts may not be made up at the time of payment - In such a case may arrive at the accumulated profits by **appropriating the profit for the year on a time basis.**

## Clause 36A - Section 2(22)(e) – Deemed Dividend

- Registered Shareholder vis-à-vis Beneficial Owner of Shares – ICAI suggests reference may be made to the decision of the Supreme Court in the following cases
  - *CIT vs. Madhur Housing & Development Co.*, 401 ITR 152 (SC)
  - *CIT vs. Ankitech (P) Ltd.* 340 ITR 14 (Delhi HC).
  - *CIT vs. Universal Medicare Pvt. Ltd.*, 324 ITR 263 (Bom HC)

*However, the decisions in Madhur Housing & Ankitech have been doubted by the SC in the decision of *National Travel Services vs. CIT*, reported in 401 ITR 154 and has requested that a larger bench decide the matter.*

- Current year's profits cannot be treated as part of accumulated profits for the purposes of dividend u/s 2(22)(e) - *DCIT Vs. Sunil Umashankar Rungta*, 94 TTJ 329 (Mum. Trib.)

## Clause 36A - Section 2(22)(e) - Deemed Dividend

- Unpaid price of flat sold by company to director-shareholder [holding 20% shareholding in the company], taxable as 'deemed dividend' - The company had sold the flat to assessee of which a major portion of price remained unpaid by him at the end of the previous year
- Company involved in the business of money- lending – loan to substantial shareholder not to be treated as Deemed Dividend

# GENERAL ISSUES

## ➤ Two Views Possible

- When two views are possible then **one in favour of the assessee should be adopted** - When the language of the taxing provision is ambiguous, the meaning favourable to the assessee to be adopted, more particularly so when the provision relates to imposition of penalty - *CIT vs. Vegetable Products Ltd, 88 ITR 192 (SC)*
- **Contradictory View** - Above view **disapproved by the Constitution Bench in *Dilip Kumar (2018) 9 SCC 1 (FB)***

The burden is on the assessee to prove eligibility to an incentive or exemption provision and it is subject to strict interpretation. If there is ambiguity, the benefit of the ambiguity has to go to the Revenue. However, if the assessee proves eligibility, a wide and liberal construction of the provision has to be done

## GENERAL ISSUES

- Whether notional profit addition on sale of property constituting assessee's 'stock-in-trade' can be deleted where AO merely relied on DVO valuation and did not produce any other evidence to prove that assessee earned more than the stated consideration? – **Yes**
- Additional Sales declared during search- Tax Audit applicable? – No
- Whether the limit prescribed for applicability of tax audit is as per books of accounts only? What if incriminating material found during search to indicate the assessee was liable for tax audit? Penalty in such case?
- Turnover as per books of accounts for tax audit & GST returns – Should they match?
- Year of Search – Any disclosure in Form 3CD? Seizure of assets/ stocks/ books of accounts?

## Clause 13 - Method of Accounting Employed in Previous Year – ICDS

- ICDS I - Accounting Policies - No concept of prudence & Materiality in selection and application of accounting policies. - *Chamber of Tax Consultants vs. UOI, 400 ITR 178 (Delhi HC)*
- Accounting Policy shall not be changed without 'Reasonable Cause' – Not defined under ICDS – reliance to be placed on Judicial Pronouncements
- ICDS II - Valuation of Inventories - Valuation of inventory shall be at lower of actual cost or net realizable value (NRV) as provided in ICDS
- Inventories being unlisted securities - Actual cost
- Inventories being listed securities - Lower of actual cost & NRV



## Clause 13 - Method of Accounting Employed in Previous Year – ICDS

- ICDS III – Construction Contracts - Section 43CB – Income from Construction & Service Contracts - Profits to be computed on Percentage Completion Method as per ICDS
- **Contract for Services** : If duration of contract < than 90 days – Project Completion Method; If indeterminate number of acts over a specific period of time, profits to be determined on SLM.
- Contract revenue shall include retention money.
- AS 7 & IND AS 11 dealing with Construction Contracts do not prescribe inclusion of Retention Money in contract revenue ; ICDS – Reasonable certainty of ultimate collection
- ICDS IV – Revenue Recognition - Permits only one method – Proportionate completion method - Contrary to Supreme Court cases
- Sale of goods - If there is a reasonable certainty of its collection; Providing services – As per principles of ICDS 3; “Completed contract method” is not recognized.
- Interest income shall accrue on time basis determined by o/s amount & the rate applicable; Dividend income is recognized as per provisions of the Act

## Clause 13 - Method of Accounting Employed in Previous Year – ICDS

- **ICDS V - Tangible Fixed Assets** - Exchange of assets will incur equal FMV of the acquired asset.
- If several assets are purchased for consolidated price, total consideration remitted to be ascertained to various assets in a fair manner.
- Exp. incurred till plant has begun commercial production (production for captive consumption) is capital expenditure
- **ICDS VI - Changes in Foreign Exchange Rates**
- MTM Gain/ Loss in case of foreign currency derivatives held for trading/ speculation not to be allowed
- **Section 43AA** - Gain or loss arising on account of effects of change in forex rates shall be in respect of all foreign currency transactions, including *Monetary items and non-monetary items, Translation of financial statements of foreign operations, Forward exchange contract, Foreign currency translation reserves*

Gain/ loss on change of Forex rates to be treated as income/ loss – Computed as per ICDS

## Clause 13 - Method of Accounting Employed in Previous Year – ICDS

- ICDS VII - Government Grants - Recognition of Government Grants cannot be postponed beyond date of receipt – **In conflict with accrual system of accounting**
- Subsidy - Fundamental principles distinguishing capital and revenue subsidy, while also referring to AS-12, relating to Accounting for Government Grants.
- ICDS VIII - Securities - A security on acquisition is recognized at actual cost (purchase price and acquisition charges)
- Security acquired in exchange for other security/ asset, cost of acquisition is fair value of security/ asset acquired; For cum-interest securities, accrued interest is deducted from actual cost of securities.

## Clause 13 - Method of Accounting Employed in Previous Year – ICDS

- ICDS IX – Borrowing Costs - ICDS considers all assets as qualifying assets; Borrowing costs attributable to acquisition, construction/ production of qualifying asset.
- **Formula for capitalization of borrowing costs specified** ; Capitalization of borrowing costs should begin with the date of borrowing (If it is a specific borrowing), and the date of utilization of funds (if it is a general borrowing).
- ICDS X – Provisions, Contingent liabilities and Contingent Assets ; Excludes
  - *Arising out of financial instruments, whether the same is carried at fair value or not.*
  - *Arising out of executory contracts.*
  - *Arising in insurance business from contracts with policy holders.*
  - *Covered by other ICDS.*



# *Thank You*

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