

Guidance Note
on
Tax Audit under Section 44AB
of the Income-tax Act, 1961

Revised 2013 Edition



The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

GUIDANCE NOTE ON TAX AUDIT UNDER SECTION 44AB OF THE INCOME-TAX ACT, 1961

(Revised 2013 Edition)



The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

© The Institute of Chartered Accountants of India

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic mechanical, photocopying, recording, or otherwise, without prior permission, in writing, from the publisher.

First Edition : 1985
Second Edition : 1989
Third Edition : 1998
Fourth Edition : 1999
Fifth Edition : 2005
Reprinted : 2012
Sixth Edition : 2013

Committee/ Department : Direct Taxes Committee

E-mail : dtc@icai.in

Website : www.icai.org

Price : ₹ 250/-

ISBN : 978-81-87080-65-7

Published by : The Publication Department on behalf of the Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002.

Printed by : Sahitya Bhawan Publications, Hospital Road, Agra 282 003
July/2013/5,000 Copies

Foreword to the Sixth Edition

The first edition of the Guidance Note on Tax audit u/s 44AB of the Income-tax Act, 1961 was brought out in the year 1985 immediately after the introduction of tax audit provision to guide members in discharging their responsibility efficiently and effectively. Subsequently, significant amendments were made in the relevant statutory provisions and accordingly the said Guidance Note was revised from time to time.

The last edition of this Guidance Note was brought out in the year 2005. Thereafter, a number of amendments were made in the Income-tax Act, 1961 which had a great bearing on tax audit reporting requirements and was followed by the issuance of supplementary guidance a couple of times. Also, due to unstinted efforts of ICAI, the Government has permitted uploading of tax audit report in the e-filing portal. In order to update and guide the members about the developments taken place in past few year, the Direct Taxes Committee of the Institute of Chartered Accountants of India has revised the said Guidance Note.

I earnestly appreciate the efforts of Direct Taxes Committee, particularly of CA. Manoj Fadnis, Chairman, and CA. G. Sekar, Vice-Chairman, for responsibly undertaking this revision and fulfilling this onerous task in time.

I am sure that this edition of the Guidance Note will be useful to our members in discharging their arduous responsibility

Date: 01.07.2013
Place: New Delhi

CA. Subodh K. Agrawal
President

Preface to the Sixth Edition

The very purpose of introduction of the provisions of audit under section 44AB was to ensure that the books of account and other records are properly maintained, that they faithfully reflect the income of the taxpayer and claims for deduction are correctly made by him and accordingly this responsibility was posed on chartered accountants.

Since then several times the law changed and consequently the guidance so provided. The year 2008 dispensed off the requirement of furnishing tax audit reports along with the return of income. Thereafter, in the year 2011, e-filing of income tax returns of assesseees liable to tax audit was made mandatory. However, the assesseees were still not required to furnish the tax audit reports. This is when cases of quoting fake membership numbers came to light. In order to find a remedy to fake audits conducted by unscrupulous people, the ICAI persistently followed up with the Government. As a result, the year 2013 witnessed a major change, requiring a chartered accountant to upload the tax audit report along with his digital signatures, which when digitally cross signed by the assessee will be considered to be furnished as per requirements of section 44AB.

Considering the fact that the responsibilities of chartered accountants has increased manifold vis-à-vis the scope of tax audit, the Direct Taxes Committee felt the need of bringing out this sixth edition of the Guidance Note. Since 2005, when the last revision of the Guidance Note on Tax audit under section 44AB of the Income-tax Act, 1961 was done by the erstwhile Fiscal Laws Committee, various supplementary guidance have been issued from time to time. This revised sixth version of the Guidance Note has consolidated the guidance issued so far and more importantly has incorporated all the recent changes that have taken place in tax laws. With this revision, an effort was made to embrace all such changes including the requirements of mandatory e-filing of tax audit reports.

I am extremely thankful to CA. Subodh K. Agrawal, President and CA. K. Raghu, Vice President of the Institute of Chartered Accountants of India who have been the guiding force behind the integration and revision of the Guidance Note. I am also thankful to past Chairman of the Committee CA. Sanjay Agarwal whose efforts have made the much awaited e-filing of tax audit reports a reality.

In order to revise this important Guidance Note, the Committee formed various study groups all over India under the convenorship of various Central Council Members. I express my sincere thanks to the Convenors of various study groups, CA. G. Sekar, Chennai study group, CA. Naveen N.D. Gupta, Delhi study group, CA. Babu Abraham Kallivayalil, Kochi study group, CA. Nihar Niranjana Jambusaria, Mumbai study group, CA. Dhinal A. Shah, Ahmedabad study group, CA. M. Devaraja Reddy, Hyderabad study group, CA. S.B. Zaware, Pune study group, CA. Mukesh Singh Kushwah, Ghaziabad study group & Lucknow study group and CA. Shyam Lal Agarwal, Jaipur study group. Further, I wish to place on record my sincere appreciation to the members of the said groups who spared their valuable time for providing valuable inputs based upon which the revised draft of the Guidance Note has been prepared.

Last but not the least, I appreciate the efforts of CA. Mukta Kathuria Verma, Secretary, Direct Taxes Committee and CA. Sheetal Ahuja, Executive Officer, Direct Taxes Committee for their technical and administrative assistance in bringing out this sixth edition of the Guidance Note.

I am sure that this edition would guide our members as the earlier edition and would be of great assistance to our members.

Date: 01.07.2013

Place: New Delhi

CA. Manoj Fadnis

Chairman

Direct Taxes Committee

Foreword to the First Edition

The introduction of the provisions regarding compulsory audit of accounts for tax purposes under Section 44AB of the Income Tax Act, 1961, signified a very healthy development in our tax laws. It fulfils a long felt need and seeks to rectify a weakness which was diagnosed long ago. The requirements of the provisions place a tremendous responsibility on the members of our profession in carrying out the audit and in furnishing the audit report setting forth the prescribed particulars.

I have no doubt that our profession would rise to the occasion, acquit itself well in discharging this responsibility and justify the confidence reposed by the Government in our profession.

I would like to compliment the Taxation Committee in bringing out this timely publication. I am sure this guide would be of help to our members and ensure their full contribution to the achievement of the objectives of this provision.

14-2-1985

New Delhi

A. C. Chakraborti

President

Preface to the First Edition

Section 44AB has been introduced in the Income-tax Act, 1961, by the Finance Act, 1984. This section provides for audit of accounts of assesseees having total sales, turnover or gross receipts exceeding the specified limits of Rs.40 lakhs for business and Rs.10 lakhs for profession. New Rule 6G, inserted in the Income-tax Rules, prescribes the Forms of Audit report for the above purpose. The requirements for the above audit will apply to accounts relating to previous year relevant to assessment year 1985-86 and subsequent years.

Audit of accounts in the corporate sector has been made compulsory by legislation over a period of years. Realising the importance of audit, in recent years, this requirement is being extended to non-corporate sector also.

The Income-tax Act already provides for audit of accounts of Public Charitable Trusts and non-corporate assessee establishing new industrial undertakings. Section 142(2A) gave wide powers to the tax authorities to get the accounts in certain specified circumstances audited by a chartered accountant. The new provision introduced by section 44AB has considerably widened the scope of audit.

The Taxation Committee of the Institute has published (i) Guide for Audit of Public Trusts under section 12A(b) and (ii) Guide to Special Audit under section 142(2A). A monograph on compulsory maintenance of accounts has also been published and the same has been updated.

Considering the fact that the scope of audit under the tax laws has considerably widened after the introduction of section 44AB, the Taxation Committee has prepared this Guidance Note on Tax Audit for the use of our members. In this guidance note an attempt has been made to explain the scope of Tax Audit requirements. It has been emphasised that in any audit assignment the general principles of audit have to be followed. The members accepting these assignments will have to use their professional skill and expertise while expressing their opinion on the financial statements and other particulars required to be stated.

I am happy that with the active co-operation of the members of the Taxation Committee, it has been possible to finalise this Guidance Note soon after the final publication of the audit report forms by CBDT. In particular, I must express my gratitude to Shri P.N. Shah, our past President, Sarvashri N.K.

Poddar, M.G. Patel and A.H. Dalal, members of the Taxation Committee and the Secretary of the Committee for the efforts put in by them in the finalisation of the guidance note. I am confident that this guidance note will be of great assistance to our members in industry or in public practice.

13th February, 1985

G. Narayanaswamy

Chairman

Taxation Committee

Contents

Foreword to the Sixth Edition		
Preface to the Sixth Edition		
Foreword to the First Edition		
Preface to the First Edition		
1.	Terms, abbreviations used in this Guidance Note	1
2.	Introduction	2
3.	Provisions of section 44AB	13
4.	'Profession' and 'business' explained	18
5.	Sales, turnover, gross receipts	19
6.	Liability to tax audit - special cases	29
7.	Specified date and tax audit	30
8.	Penalty	30
9.	Tax auditor	31
10.	Accounting Standards	39
11.	Audit procedures	51
12.	Professional misconduct	54
13.	Audit report	54
14.	Form No. 3CA	57
15.	Form No. 3CB	59
16.	Form No. 3CD	61
17.	Particulars of Assessee [<i>clauses 1-6</i>]	62
18.	Particulars of Members/Partners [<i>clause 7</i>]	63
19.	Nature of business or profession [<i>Clause 8</i>]	65
20.	Books of account [<i>Clause 9</i>]	66
21.	Presumptive Income [<i>clause 10</i>]	69
22.	Method of Accounting [<i>clause 11</i>]	72
23.	Valuation of Closing Stock [<i>clause 12</i>]	74
24.	Conversion of asset into stock-in-trade [<i>clause 12A</i>]	90
25.	Items of Income not credited [<i>clause 13</i>]	94
26.	Particulars of Depreciation [<i>clause 14</i>]	98

27.	Deduction under sections 35AB - 35E [clause 15]	106
28.	Bonus, Commission, PF recoveries, etc. [clause 16]	111
29.	Amount debited to Profit & Loss Account [clause 17]	114
30.	Capital expenditure [clause 17(a)]	114
31.	Personal expenses [clause 17(b)]	116
32.	Advertisement expenses [clause 17(c)]	116
33.	Payments to clubs [clause 17(d)]	117
34.	Penalty, fine, etc. [clause 17(e)]	118
35.	Amounts inadmissible u/s 40(a) [clause 17(f)]	121
36.	Interest, salary, bonus, etc. to partners [clause 17(g)]	125
37.	Amounts inadmissible u/s 40A(3) [clause 17(h)]	127
38.	Amounts inadmissible u/s 40A(7) [clause 17(i)]	129
39.	Amounts inadmissible u/s 40A(9) [clause 17(j)]	129
40.	Contingent liabilities [clause 17(k)]	129
41.	Amount inadmissible in term of section 14A [clause 17(l)]	130
42.	Amount inadmissible under proviso to section 36(1)(iii) [clause 17(m)]	134
43.	Amount inadmissible u/s 23 of MSME Act, 2006 [clause 17A]	135
44.	Payments to relatives under section 40A(2)(b) [clause 18]	138
45.	Deemed profits under section 33AB/33ABA/33AC [clause 19]	140
46.	Profits chargeable under section 41 [clause 20]	141
47.	Payments under section 43B [clause 21]	144
48.	MODVAT credits [clause 22(a)]	148
49.	Prior period expenditure [clause 22(b)]	150
50.	Hundi loans [clause 23]	152
51.	Loans/Deposits accepted [clause 24(a)]	153
52.	Loans/Deposits repaid [clause 24(b)]	157
53.	Certificate for loan taken or repayment [clause 24(c)]	159
54.	Brought forward loss/depreciation [clause 25(a)]	160
55.	Change in shareholding [clause 25(b)]	162
56.	Deductions under Chapter VIA [clause 26]	163
57.	Tax Deducted at Source [clause 27]	166

58.	Quantitative details of a trading concern <i>[clause 28(a)]</i>	170
59.	Quantitative details of a manufacturing concern <i>[clause 28(b)]</i>	171
60.	Tax on distributed profits <i>[clause 29]</i>	171
61.	Cost Audit Report <i>[clause 30]</i>	173
62.	Excise Audit Report <i>[clause 31]</i>	173
63.	Accounting ratios <i>[clause 32]</i>	174
64.	Statement of particulars to be annexed to Form No. 3CD	176
65.	Signature	181
66.	Code of Ethics and other matters	181
67.	Format of Financial Statements	182
APPENDICES		
I	Circular No. 452 dated 17.3.1986 <i>(Para 5.10)</i>	187
II	Circular No. 4/2007, dated 15 th June, 2007 <i>(Para 5.13)</i>	191
III	Mandatory Communication - Relevant Extracts from the Code of Ethics <i>(Para 9.8)</i>	194
IV	Council Guidelines No.1-CA(7)/02/2008, dated 8 th August,2008 <i>(Para 9.8, 9.9, 9.10, 9.23)</i>	200
V	Relevant extracts from the Code of Ethics <i>(Para 9.18)</i>	211
VI	Form of tax audit particulars to be furnished by members/ firm <i>(Para 9.26)</i>	216
VII	Revision of recommended scale of fees chargeable for the work done by the members of the Institute <i>(Para 9.27)</i>	217
VIII	Criteria for classification of non-corporate entities as decided by the Institute of Chartered Accountants of India & Criteria for classification of companies under the Companies (Accounting Standards) Rules, 2006 <i>(Para 10.3 & 10.8)</i>	219
IX	Circular No. 561, dated 22 nd May, 1990 <i>(Para 13.12)</i>	232
X	Circular No. 739, dated 25-3-1996 <i>(Para 18.1 & 36.7)</i>	233
XI	The relevant extracts of the Micro, Small and Medium Enterprises Development Act, 2006 <i>(Para 43.9)</i>	234
XII	Chart of persons specified in Section 40A(2)(b) <i>(Para 44.1)</i>	236

XIII	Circular No. 208, dated 15 th November, 1976 & Circular No. 221, dated 6-6-1977 (<i>Para 50.1</i>)	238
XIV	Recommended form of financial statements for non-corporate manufacturing entities (<i>Para 13.8 & 67.3</i>)	241
XV	Recommended form of financial statements for non-corporate trading entities (<i>Para 13.8 & 67.3</i>)	249
XVI	Form No. 3CA, 3CB and 3CD	257