New Tax Audit Report- Indirect Tax Impact

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Clauses in Tax Audit Report- AY- 14-15 and Connection to IDT

The tax audit under Income Tax has undergone a change. There are already a number of compliances which professionals felt was asking for too much. In this amendment additional disclosures/ duties of judgment/ reporting have been additional thrust on the auditor. Assessees may not be too concerned as they are of the view that it is the auditor’s headache. In the view of the paper writers this would add a few days more of work. We understand the ICAI is making representation to postpone to the next year or at least provide a few more months. We may have to wait for some time to get authentic information on what would happen. The guidance note by ICAI may also be issued by the end of this month.

However this is an opportunity to add value to the client who may till date not be aware and not complying, exposing himself to great risk. It could also ensure that the benefits available under the law are suggested for client to avail. Also an opportunity to make a difference and change in perception of the auditor from **cost to value**.

Background / Concept of IDT

Indirect Tax unlike direct tax is as the name suggests borne by somebody else. Normally the consumer of the goods or services bears the impact. In most contracts the burden is shifted to the consumer/ user unless contractually all taxes are included in the price agreed. [Not a very prudent method from the dealer/ manufacturer/ service providers point of view] Everybody rich or poor buying the goods or availing the services pays the same amount. It is directly inflationary as cost of goods/ services increases to extent of net tax payable.

The total direct tax is expected to be ₹ 7,45,000 Crores. indirect taxes for this year for the centre could be about:

Service Tax- ₹ 2,20,000 crores Central Excise – ₹ 2,00,000 crores

Customs Duties – ₹ 1,80,000 crores.

For the States

CST/ VAT – ₹ 700,000 Crores [All States together]

State Excise – Info not available.

Entry Tax (Octoroi – Maharastra) , Profession Tax, Entertainment Tax, Luxury Tax – maybe around 10-15% of VAT/CST. – ₹ 100,000 Crores for the Country as a whole.

Total Direct Taxes = 745,000 cr Vs IDT = 1400,000 Cr. Almost Double !!

We have examined based on the quantum and impact the relevant provisions under 10 major indirect tax Laws. Some important methods to determine the same are also discussed to enable the Tax Auditor to report as under:

1. VAT:
2. CST
3. Service Tax
4. Central Excise Duty
5. State Excise Duty
6. Customs Duty
7. Entry Tax
8. Luxury Tax
9. Entertainment Tax
10. Profession Tax

The changes made in the Forms 3CA, 3CB and 3CD are very significant move towards ensuring that there is no leakage of revenue by mismatch between compliances and disclosures under income tax and indirect taxation law. To this end, CBDT via Notification No. 33 dated 25th July 2014, had made some changes in Form 3CA, 3CB and3CD. Via these changes the compliances which a CA is required to ensure and disclosures which are required to be made by a Chartered Accountants has been increased. An effort has been made to compile and put in place all additions impacting indirect taxes below. Listed below are the modifications/ additions made in this notification.

Major Changes which are proposed to be made and impact:

3CA: Point 3.In the opinion part, now apart from mentioning that particulars in Form 3CD are true and correct, auditors have to mention observations/ qualifications if any.

Disclosure:

*Insertion of words "According to **examination** of books of account **including other relevant documents**" –this increases the verification Scope of the Auditor.*

FORM 3CB

Changes made are on similar lines as that in Form 3CA as mentioned above to extent observations/qualifications, if any to be listed out.

FORM 3CD

The important changes made in Form 3CD are addition of some new clauses thereby requiring more disclosures. The responsibility to arrive at the liability may not exist and the auditor could rely on assertion of client. Listed below are the modifications/ additions made relevant from indirect taxes perspective.

PART A

Point 4: Now have to mention whether the assessee is liable to pay Indirect tax like excise duty, service tax, sales tax, custom duty etc and furnish the registration number for the same. Part- I on this booklet provides information on different indirect taxes which maybe needed to be known for compliance.

Disclosure: *Where liable to pay indirect taxes such as excise duty, service tax, sales tax. If there is liability then give registration number or identification no allotted for same.*

Possible Value Additions at time of audit:

Indicate if

- Activity amounts to manufacture of excisable goods or provision of taxable services?
- Requirement to take registration under excise or service tax where wrongly claiming exemption, such as SSI exemption on branded goods.
- The excise duty/service tax/customs duties or VAT being paid at wrong rate.
- Imports made from related parties and possibility of referring to SVB.

Point 6: **Date of commencement of previous year for newly started business:**

Disclosure: Date of commencement of new business*: report dates when started new business activities and excise/service tax and excise/service tax/VAT registration details where liability to pay such taxes is there to be disclosed at 4.*

PART B

Point 11(b) and (c): Earlier only required to mention a list of books of account maintained; now also to mention the address at which the books of accounts are kept. Further if books of accounts are not kept at one location, now need to furnish the addresses of locations.

11(c) Apart from mentioning the list of books examined, also have to mention the nature of relevant documents examined.

Disclosure:

- *Obtain and give list of addresses where the books of account are kept.*
- *Details of books of account kept at each location.*

Possible Value Additions at time of audit:

- Bring to client attention locations where books kept, but not registered under service tax / excise/VAT and CST and taxes liability of excise duty/service tax/VAT and CST not being paid.

Point 16: Amounts not credited to PandL A/c, being(b) the pro forma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax where such credits, drawbacks or refunds are admitted as due by authorities concerned.

Disclosure:

Obtain from client and disclose amounts of the drawbacks, refund of duty of customs /excise or service tax, or refund of sales tax or VAT accepted as due by tax authorities.

Possible Value Additions at time of audit:

Mention where any drawbacks, refunds of indirect taxes received into bank account are not booked into accounts.

Point 18: Particulars of depreciation allowable as per Income Tax Act, 1961 in respect of each asset or block of assets in the following form……….(d)additions/deductions during the year with dates; in…..including adjustments on account of (i)Central value added tax credits claimed and allowed under Central Excise Rules 1944 in respect of assets acquired on or after 1.3.1994. This is to ensure that double benefit is not availed by the client.

Disclosure: *Cenvat credits availed on assets acquired.*

- *The terminology made contemporary. There is no substantive impact of this change.*

Possible value additions at time of audit:

- Reconcile credits availed on capital goods as per the financials with cenvat credits availed on capital goods as per the ST-3/ER-1.
- The depreciation claimed on the duty paid portion [either under sec 32 or 32AC] of capital goods which is restricted.
- If come across in vouching missed out input services credits related to capital goods then mention to client.
- Bring to client notice in case of differences.
- Check if (i) credits are being captured directly into accounts or (ii)there is separate Cenvat credits register being maintained to avail credits. This could be maintained in excel sheets.
- The first method would be best practice to ensure completeness of credits which were availed to ensure that there are no missed out credits.

Point 21: Details of amount debited to PandL A/c being in nature of capital, personal, advertisement expenditure etc, with nature, sl no, particulars, amount:

Expenditure incurred at clubs for club services and facilities, expenditure by way of penalty or fine for violation of any law for time being in force.

Expenditure by way of any other penalty or fine not covered above.

Expenditure incurred for any purpose which is an offence or prohibited by law.

Disclosure: *Details of such expenditure mentioned above.*

Possible value additions at time of audit:

- Differentiation between liquidated damages and penalties. First one allowed as deduction and next not.
- Differentiate from mandatory penalties which exist and those which indicate a mala fide.
- Mention there could be service tax on expenses by way of penalty or fine in some cases post 1.7.12.
- To be treated as a service, an activity has to be carried out for a consideration. The fines and penalties which are legal consequences of a person's actions are not in the nature of consideration for an activity. Not liable to service tax.
- The service tax may not be applicable on other fines, as there is no activity for a consideration.
- But in absence of any specific exclusion/exemption service tax could be demanded on

same.

Point 26: In respect of any sum referred to in clause(a),(b),(c),(d),(e),(f), of Section 43B, the liability for which:-

- (A) Pre-existed on first day of previous year but not allowed in assessment of any preceding previous year and was paid or not paid during previous year.
- (B) was incurred in the previous year and was paid on or before due date for furnishing return of income taxu/s139(1) or not paid before aforesaid date.

As per Section 43B

- Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of -

a) any sum payable by the assessee by way of tax, duty, cess or fee, (by whatever name called, under any law for the time being in force);…………………………

- State whether sales tax, customs duty, excise duty or any other indirect tax, levy, cess, impost passed through profit and loss account.
- **Disclosure:** *Details of Liability provided by assessee to auditor to be taken.*

Possible value additions at time of audit:

- Tax dues as per PandL and accounts
- Whether correct or not does not seem to be required.
- Broad checks could be put in place.
- Determine tax due as per books and in returns can be compared and differences reported with suggestions to reconcile.
- It is to be reconciled.
- If there is huge/material difference then observation or even qualify in the audit report in 3CA under point 3 or in 3CB in sl no.5

Similar to point 18 in point 27 where sets out now: (a) Amount of Central Value Added Tax credits availed of or utilised during the previous year and its treatment in the profit and loss account and treatment of outstanding Central Value Added Tax credits in the accounts.-earlier referred to Modified Value Added Tax Credits.

Disclosure:

- *Report on amount of Cenvat credits availed of or utilized during previous year and how it* *is treated in PandL and treatment of O/S Cenvat credits in accounts. Both availed and utilized to disclose.*

- *The terminology made contemporary. There is no substantive impact of this change.*

Possible Value Additions at time of audit:

- Reconcile credits availed on capital goods as per the financials with as per the ST-3/ER-1.
- Bring to client notice in case of differences.
- Check if (i)credits are being captured directly into accounts or (ii)there is separate Cenvat credits register being maintained to avail credits. This could be maintained in excel sheets.
- The first method would be best practice to ensure completeness of credits which were availed to ensure that there are no missed out credits.
- **Point 35(B) In case of manufacturing concern, give quantitative details of the principal items of raw materials, finished products and by-products**

Disclosure: *Raw materials: opening stock, purchases during previous year, consumption during previous year, sales during previous year, closing stock, yield of finished goods, percent of yield, shortage/excess if any.*

Possible Value Additions at time of audit:

- Abnormal shortage in the items could indicate missed out sales with corresponding shortfall in payment of excise duty which may need to be paid with interest and penalty at time of audit.
- Abnormal excess could mean trading goods are being cleared as manufactured goods on payment of excise duty. Could lead to demands at later date for reversal of credits.

Point 37. Disclosures on cost Audit to include disqualification or disagreement on any matter/ item/ value/ quantity as may be reported/ identified by the Cost Auditor. Earlier the requirement was to only state whether Cost Audit was carried out or not and to enclose copy of report.

Disclosure: *Report on details of disqualification or disagreement on any matter/item/value/quantity identified by cost auditor.*

Possible Value Additions at time of audit:

- Suggest there could be undervaluation of manufactured excisable goods removed for captive consumption not done as per CAS 4.
- Under-valuation of materials manufactured and consumed for providing services on which

service tax is paid.
- When CAS-4 certificate obtained very long ago, suggest taking on periodic basis such as quarterly, half yearly or annual.

Point 38: Similar disclosure as above point 37, to be made with respect to audit under Central excise Act as mentioned above. Disqualifications and disagreements to be reported.

Disclosure: *Comment if any audit was conducted, if yes report on details of disqualification or disagreement on any matter/ item/ value/quantity as reported/identified by the auditor.*

Possible Value Additions at time of audit:

- Suggest excise duty to be paid on intrinsic values of manufactured excisable goods.
- Suggest to check valuation of manufactured goods sold to related parties.
- Credits availed without receiving materials nor used for manufacturing processes.
- Irregular availment of restricted Cenvat credits as per definitions under Cenvat credit rules. Caution such credits could be demanded along with penalty.

The penal consequences under central excise are in annexure 2.

Point 39: Disclosure as above point 37, to be made with respect to audit under section 72A of Finance Act as mentioned above.

Disclosure: *Comment whether audit was conducted under the Central Excise Act, if yes give details of disqualification or disagreement on any matter/item/value/quantity as reported/identified by auditor.*

Possible value additions at time of audit:

- Part of the service charges could have been shifted in the expense account thereby suppressing the value of taxable service.
- At times checking of bank account with expenses and receipts could disclose the missed out value of taxable services.
- Any liability accrued for import of services should be examined as also the exchange rate fluctuations. Such services may not be reported as turnover in the financial statements.
- Auditors should obtain a list of foreign branches and branch accounts and try to scrutinize the same so as to ascertain the value of taxable services received on which service tax to be paid.
- The penal consequences under service tax are in annexure 2

Point 40: Details regarding turnover, gross profit etc for previous and preceding previous year.

Disclosure:

- *Details of total turnover, GP to turnover and NP to turnover, stock in trade to turnover and material consumed to finished goods produced.*

Possible Value Additions at time of audit:

- Under service tax and VAT [for a trader] if huge variance in turnover, could indicate that omitted to record some transactions.
- Under central excise, if there is huge variance from year to year for the material consumed to FG, could indicate clandestine removals.

Point 41: Details of demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth tax Act, 1957 along with details of proceedings:

Disclosure:

- *Details of demand raised or refund during previous year under any tax laws other than IT and Wealth Tax Act.*
- *The details not just to be disclosed under excise/service tax but also under other tax laws, which could be KVAT. The details may also relate to demand related to one of earlier assessment years but demand raised in the previous year.*
- *Whether mere disclosure suffices or statutory auditor needs to qualify his report, especially where a demand under other taxes is huge.*

Possible Value Additions

- Whether prima facie demand is sustainable or not.
- Advise to seek the legal opinion from indirect taxes professionals on the demand.

Conclusion

The new format contains more details to be given and leads to more reporting requirements on statutory auditor.**They may also need to get acquainted with indirect taxation laws to realize impact of the reported items and guide their clients accordingly.**