

Executive Summary

The Income Tax Act, 1961 (Act) contains several provisions which mandate the assesseees to furnish audit reports and certificates issued by the 'Accountant' in the prescribed Form for meeting the specific objectives. Tax audit under Section 44AB under the Act was introduced in 1984 in order to ensure that the books of account and other records of the assesseees are properly maintained and faithfully reflect the true income of the taxpayer. The objective of reporting/certification is to discourage tax avoidance and tax evasion.

The Act defines an 'Accountant' as a Chartered Accountant (CA) within the meaning of the Chartered Accountants Act, 1949 under explanation to Section 288(2) of the Act. Audit reporting and certification by CAs under the Act are thus Third Party Reporting. The CAs are regarded as facilitators for the Income Tax Department (ITD) in administering the provisions of the Act correctly. The Tax Audit Reports (TARs)/certificates issued by them serve as a valuable reference guide to the Assessing Officers (AOs) while making assessments.

We conducted Performance Audit on "Appreciation of Third Party (Chartered Accountant) Certification in Assessment Proceedings" with the objectives to see whether (a) all the requisite reports/certificates were obtained and kept on record at the time of assessments; (b) tax audit reports were complete to provide sufficient and requisite information to the AO, thereby, aiding him in completing the assessment as required under the Act; (c) the AO had evaluated and utilized the information while completing assessments, (d) in case of professional negligence of the Accountant, the matter has been taken up by the Commissioners with the Institute of Chartered Accountant of India (ICAI) and (e) there are lacunae or ambiguities in the provisions of the Act/reports.

This Performance Audit covered assessments completed during the period from financial years 2010-11 to 2012-13 and upto the date of audit. In case of major audit observations, assessment records of previous assessment years were also linked wherever found necessary. All circles/wards taken up for regular audit during the period from January to May 2014 were treated as selected units. All cases of scrutiny assessments, appeal and rectification cases within the selected units were examined in audit. We conducted entry meeting with CBDT in February 2014 in which audit objectives, scope and methodology were discussed.

We found cases (a) where the CAs failed to report full and correct information in 367 cases leading to short levy of taxes of ₹ 2,813.11 crore and (b) where the AOs failed to utilize the information available in 102 reports/certificates

submitted to them leading to short levy of taxes of ₹ 1,310.05 crore. Some of the important audit findings are as follows:

- a. Tax auditors failed to give correct information relating to allowance of depreciation in 66 cases involving short levy of tax of ₹ 457.79 crore (*Paragraph 2.3*).
- b. Tax auditors did not report correct information regarding brought forward loss/depreciation resulting in irregular brought forward loss/depreciation allowance in 46 cases involving short levy of tax of ₹ 557.79 crore (*Paragraph 2.4*).
- c. In 42 cases personal/capital expenditure was incorrectly allowed as the tax auditors did not report the amount in their tax audit reports which resulted in short levy of tax of ₹ 477.89 crore (*Paragraph 2.5*).
- d. CAs have certified wrong information/claims for various exemptions and deductions in 74 cases having tax effect of ₹ 259.72 crore (*Paragraph 2.7*).
- e. CAs gave incorrect/incomplete information in TARs/certificates in 132 cases having a revenue impact of ₹ 1,037.61 crore (*Paragraph 2.8*).

We also found in another 616 cases where CAs committed mistakes viz. in allowance of exemption/deductions, charging of tax on Book Profit under Section 115JB, adoption of Arm's Length Price and reporting on cash payments exceeding ₹ 20,000 per day (*Paragraphs 2.6 and 2.10-2.12*). In 109 cases, assesseees did not furnish requisite Form 3CEB on verification of ALP and Form 29B relating to certification for Book Profit (*Paragraphs 2.10-2.11*).

We have also commented on lacunae in the existing Forms which need modification in order to capture full information of the affairs of assesseees so that taxes are applied correctly (*Paragraph 3.2-3.4*). Regarding monitoring of work of CAs and ensuring quality tax audit, ICAI issued guidance to its members for limiting the tax audit assignments in a financial year. We found that 18.87 per cent of CAs (12,435 CAs) for AY 2013-14 issued more tax audit reports than prescribed by ICAI (*Paragraph 3.6*). We also got cases where CAs did not mention their membership numbers (*Paragraph 3.7*). ITD did not refer any case for professional negligence to ICAI for taking action against erring CAs in terms of Section 288 of the Act (*Paragraph 3.9*).

The audit findings on non-adherence to various provisions of the Act by CAs led to deny proper dues to the Government. AOs have also failed to utilize information available in Accountant's reports/certificates. CBDT have emphasized the use of information available in Accountant's reports/certificates by AOs at the time of assessments.

In our recommendations, we have suggested ITD to utilize information available in tax audit reports/certificates at the time of assessment proceedings. To improve the quality of work done by CAs, we recommend referring the cases of professional negligence to ICAI. Besides, we also recommended to make provisions in the Act to limit the number of tax audit, provide suitable controls in the ITD system and validating the membership of CAs at the time of e-filing (*Paragraph 3.11*).

Since the introduction of Section 44AB in the Act in 1984, we have evaluated the system of tax audit/certification by Accountants in 1997 (Para 3.2 of Audit Report No. 12 of 1997) and again in Audit Report No. PA 7 of 2008. In both the Audit Reports, we pointed out non-utilization of information by AOs in assessment proceedings and incorrect information furnished by CAs in TARs/Certificates. These irregularities are still persisting. Thus objective of introducing tax audit and certification by Accountants gets defeated. With growing revenue forgone every year and complex nature of business environments, Accountant's role in ensuring true picture of accounts and taxes due to the Government as per the Act is very crucial. It is joint responsibility of ITD and ICAI to ensure compliance to the Act. Necessary control mechanism over the third party certification in assessment proceedings must be ensured, by making suitable provisions in the Act, if necessary.