

Chapter I: Introduction

1.1 Introduction

The Income Tax Act, 1961 (Act) contains several provisions¹ which mandate the assessee to furnish audit reports and certificates issued by the 'Accountant' in the prescribed Form for meeting the specific objectives. The Finance Minister in his Budget Speech in the year 1984 and Central Board of Direct Taxes (CBDT) vide its circular² of 1985 explained the rationale for introducing compulsory audit under Section 44AB of the Act as "intended to ensure that the books of account and other records 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). 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. The AO is expected to make an independent judgment while finalizing the assessment and can require the assessee to justify his claims with reference to records and evidences. The Delhi High Court³ has observed that tax audit does not provide any immunity from scrutiny or investigation by the ITD.

1.2 Organizational setup

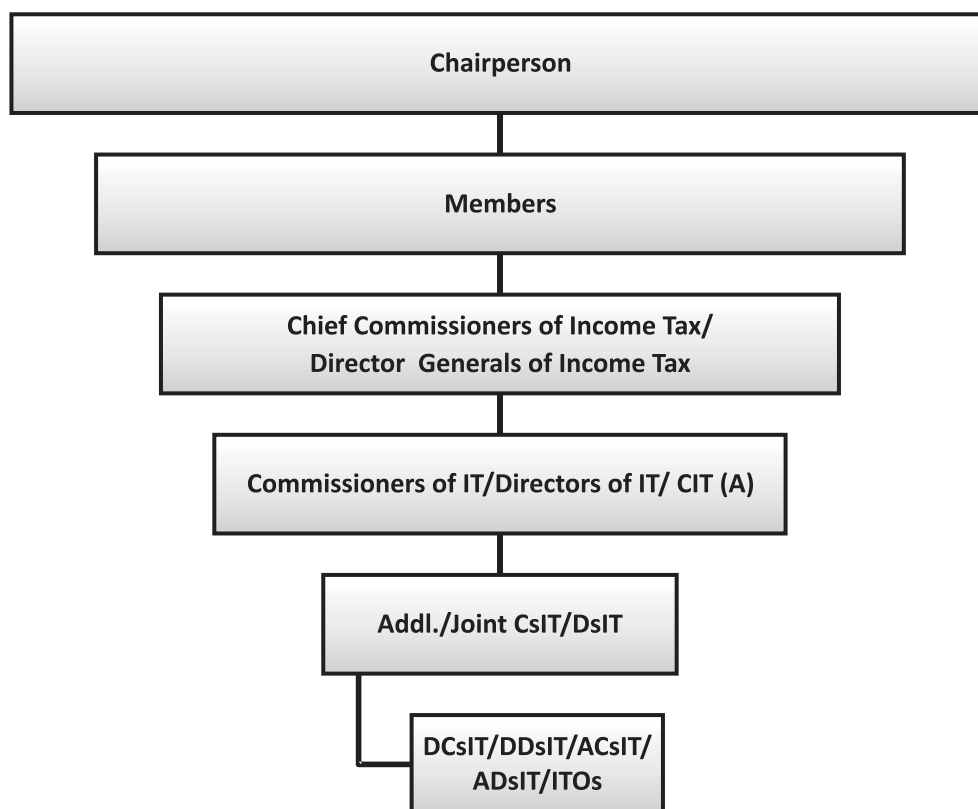
Central Board of Direct Taxes (CBDT), as a part of Department of Revenue, Ministry of Finance (Ministry), is the apex body charged with administration of Direct Taxes. CBDT is headed by the Chairperson and comprises of six Members. In addition to their functions and responsibilities, the Chairperson and Members are responsible for exercising supervisory control over field offices of the CBDT, known as Zones. Chief Commissioner of Income Tax (CCIT) heads the field office whose jurisdiction is generally co-terminus with the state. Commissioners/Directors of Income Tax head the assessment functions which are carried out through the Additional CIT/DIT, JCIT/JDIT and DDIT/DC/ADIT/AC/ITO.

1 Details of the provisions are discussed under para 1.3 of this Chapter.

2 Circular no. 387 of 06 July 1985.

3 Goodyear India Ltd. Vs. CIT [2000] {112 Taxman 419}-Delhi High Court.

Graph 1.1: Organogram of CBDT



The Institute of Chartered Accountants of India (ICAI) established under the Chartered Accountants Act, 1949 regulates the profession of Chartered Accountancy. The Chartered Accountants Act provides that only a member who holds a certificate of practice obtained from council of ICAI can practice the profession. Under the provisions of the Income Tax Act, 1961 (Act), assessee appoint Accountants as tax auditor. As per the instructions⁴ issued by CBDT, ITD may take up matter relating to professional negligence on part of CA for instituting disciplinary proceedings in terms of Section 288 of the Act. CAs are guided by Code of Ethics issued by ICAI. Central Vigilance Commission (CVC) has also issued Code of Ethics for Chartered Accountants⁵ in view of vital information contained in the Financial Statements prepared by CAs.

4 Instruction no. 1959 of 28 January 1999.

5 <http://cvc.nic.in/codeethics.pdf> accessed on 01 September 2014.

1.3 Legal Framework

Section 44AB of the Act, introduced by Finance Act, 1984 provides for audit of accounts of assessees having total sales, turnover or gross receipts exceeding the specified limits. Further the Act makes it obligatory for a person to get his accounts audited before the specified date by an Accountant and furnish the report of such audit in the Forms prescribed under Rule 6G of Income Tax Rules, 1962 (Rules) duly signed and verified by such Accountants. In addition, Forms prescribed under various Sections of the Act/Rules, duly certified by an Accountant, are required to be submitted by an assessee for claiming exemptions, rebates and deductions. Some of the important Sections of the Act requiring such reports/certificates have been elaborated in **Appendix 1** and discussed in Chapters dealing with audit findings.

Penalty Provisions: Section 271B provides that if any person fails to get his accounts audited in respect of any previous year or years relevant to an assessment year or furnish a report of such audit as required under section 44AB, AO may direct that person to pay, by way of a penalty, a sum equal to one-half *per cent* of the total sales, turnover or gross receipts, as the case may be in case of a business, or of the gross receipt in case of a profession, in such previous year or ₹ 1,50,000, whichever is less. Section 271BA provides that if any person fails to furnish a report from an accountant as required by section 92E, the AO may direct that such person shall pay, by way of penalty, a prescribe sum of ₹ 1,00,000.

E-Filing: With the introduction of e-filing of income tax return (ITR) in 2008, requirement of filling of all the documents like Tax Deducted at Source (TDS) certificates, accounts, certificates/reports etc. were dispensed with by making provision in Rule 12(2) of the Rules. However, this provision has been changed by introducing a proviso to Rule 12(2) in June 2013 for compulsory e-filing of audit reports under Section 44AB (tax audit report along with financial statements), Section 92E (transfer pricing – international & domestic), Section 115JB (Form 29B for MAT), Form 10B (charitable trusts), Form 10BB (educational/medical institutions) and Form 10CCB (80IA/80IB/80IC/80ID/80JJAA/80LA). These reports have to be digitally signed by the CAs while uploading them to website maintained by ITD (<https://incometaxindiaefiling.gov.in>).

1.4 Why we chose the topic

Third party certification has a significant effect in allowance of deductions and exemptions and thereby assessment of income under the Act. During FY 2012-13, revenue forgone on account of corporate assesseees was ₹ 68,008 crore (19 *per cent* of Corporate Tax collection) which made the effective tax rate 22.85 *per cent*. Assesseees claim these deductions and exemptions based on certification by Accountant. The tax audit report/certificate is important as approximately 1.53⁶ *per cent* assessments are completed after scrutiny. It may be possible that vital information may remain outside the tax audit reports/certificates or may be incorrect; thus the very purpose of correct reflection of income and claims for deduction of the tax payer and thus checking the fraudulent practices is defeated. Therefore, it was felt necessary to undertake the review of the system to seek assurance in the system of tax audits/certification by Accountants.

Earlier we have commented upon the system of “Audit of Accounts under Section 44AB of Income Tax Act, 1961” in C&AG’s Compliance Audit Report No. 12 of 1997. We made number of observations on the lapses committed by the ITD in ensuring that assesseees comply with the provisions and the proper utilization of the information in the audit report by the AO in making assessment of income. The Public Accounts Committee (PAC) also expressed concern over the fact that due to inadequate attention to this aspect, the objectives of the introducing Section 44AB gets defeated. We again conducted a review on “Appreciation of Third Party Reporting/Certification in Assessment Proceedings” featured in C&AG’s Report No. PA 7 of 2008.

ICAI and CVC have issued code of ethics to be followed by CAs in carrying out their profession. This indicates the criticality of work done by CAs, based on which many stakeholders take vital decisions. Therefore, we decided to undertake the Performance Audit of Third Party Reporting/Certification in the Assessment Proceeding.

1.5 Audit objectives

The objective of the study was 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 Assessing Officer, thereby, aiding him in completing the assessment as required under the Act;

6 Average scrutiny assessments completed during FY 2010-11 and FY 2012-13

- c. the AO had evaluated and utilized the information provided in prescribed reports 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);
- e. there are lacunae or ambiguities in the provisions of the Act/Rules/forms of reports.

1.6 Audit scope

This Performance Audit covered assessments completed during the period of 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.

1.7 Sample selection

All cases of scrutiny assessments, appeal and rectification cases within the selected units were examined in audit. All circles/wards taken up for regular audit during the period from January to May 2014 were treated as selected units. We examined 98,078 scrutiny assessment cases in 546 circles/wards.

1.8 Acknowledgement

We acknowledge the co-operation of ITD in facilitating the audit by providing necessary records and information in connection with the conduct of this performance audit. An entry conference with CBDT was held on 06 February 2014 wherein audit objectives, scope of audit and main areas of audit examination were explained.

We issued draft Performance Report to the Ministry in September 2014 for their comments. After receipt of the Ministry's reply in October 2014, we held exit conference on 16 October 2014 to discuss our findings and recommendations vis-à-vis Ministry's comments. We again issued draft Performance Report in October 2014 containing Ministry's views and audit stand thereon for their further comments. We received further comments from the Ministry in October 2014 which have also been appropriately incorporated in the report together with audit comments thereon.