

# **TAX AUDIT**

## **Introduction and Applicability**

What You Need to Know?



## FAQ 1. What is a Tax Audit?

A tax audit is an examination to ensure that a taxpayer's financial records accurately adhere to generally accepted accounting principles and the Income-tax Act's requirements. This process helps verify that all records are properly maintained and accurately reflect the taxpayer's actual income. It also aids in detecting any fraudulent activities. However, undergoing a tax audit does not protect the assessee from further scrutiny assessments or potential disallowances of expenses<sup>1</sup>. Only a practising Chartered Accountant can conduct a tax audit.

## FAQ 2. What Forms are Required for the Tax Audit Report?

The tax audit report must be submitted using the forms specified below:

Category of Taxpayer	Form for Audit Report	Annexure to Audit Report
Books of account are audited under another law	Form 3CA	Form 3CD
All other cases	Form 3CB	Form 3CD

Forms 3CA and 3CB serve as the audit report formats. Form 3CD is a detailed statement of particulars required under Section 44AB of the Income-tax Act, which must be attached to either Form 3CA or Form 3CB.

If the assessee's books of accounts are subject to audit under any other law, it suffices to conduct the audit as per that law and submit both the audit report and the statement of particulars (Form 3CD) prepared by a Chartered Accountant. These documents should be furnished by the specified due date.

## FAQ 3. Who Must Have Their Books of Accounts Audited?

Section 44AB mandates the audit of books for any assessee engaged in business or profession under certain conditions outlined below:

Nature of Business or Profession	Category of Taxpayer	When is the Audit Mandatory?
Any professions (specified or non-specified)	Any	If gross receipts from the profession during the relevant previous year exceed Rs. 50 lakhs.

<sup>1</sup> Goodyear India Ltd. v. CIT [2009] 112 Taxman 419 (Delhi)

Nature of Business or Profession	Category of Taxpayer	When is the Audit Mandatory?
Business	Both payment and receipt in cash do not exceed 5% of the total receipts and payment, respectively.	If total sales, turnover or gross receipt from the business during the previous year exceeds Rs. 10 crores.
	Either payment or receipt in cash exceeds 5% of the total receipts and payment, respectively.	If total sales, turnover or gross receipt from the business during the previous year: <ul style="list-style-type: none"> <li>Exceeds Rs 1 crore, and the assessee is not carrying on any business eligible for presumptive taxation (e.g. commission/brokerage/agency business)</li> <li>Does not exceed Rs. 2 crore, and the assessee is carrying on eligible business as defined in Section 44AD and has not opted for presumptive taxation under Section 44AD</li> <li>Exceeds Rs. 2 crore but not Rs 3 crore, and his cash receipts do not exceed 5% of total turnover/gross receipts, and the assessee is carrying on eligible business as defined in Section 44AD and has not opted for presumptive taxation under Section 44AD</li> </ul>
Businesses eligible for presumptive tax scheme under Section 44AD	Resident Individual or HUF	If the assessee's income exceeds the maximum exemption limit and he has opted for the scheme in any of the last five previous years but does not opt for the same in the current year.
Businesses eligible for presumptive tax scheme under Section 44AD	Resident Partnership Firm (Excluding LLP)	The taxpayer has opted for the scheme in any of the last five previous years but does not opt for the same in the current year.
Profession eligible for presumptive tax scheme under Section 44ADA	Resident Individual or partnership firm (Excluding LLP)	The taxpayer claims that profits from the profession are lower than the profits computed under Section 44ADA, and the total income exceeds the maximum exemption limit.
Businesses eligible for presumptive tax scheme under Section 44AE	Any Assessee engaged in plying, hiring or leasing of goods carriage	The taxpayer claims that the profits from the business are lower than the profit computed under Section 44AE.
Businesses eligible for presumptive tax scheme under Section 44BB	Non-resident assessee engaged in the exploration of mineral oil	The taxpayer claims that his profits from the business are lower than the profit computed under Section 44BB.
Businesses eligible for presumptive tax scheme under Section 44BBB	Foreign Co. engaged in civil construction	The taxpayer claims that his profits from the business are lower than the profit computed under Section 44BBB.

Tax audit provisions under Section 44AB do not apply to assessee covered by Section 44B, Section 44BBA, or Section 44BBC (effective from Assessment Year 2025-26).

**For More Details, Visit [Taxmann.com/Practice](https://www.taxmann.com/practice)**

#### FAQ 4. **Is a Tax Audit Required If Turnover Exceeds the Specified Limit But Total Income Is Below the Maximum Exemption Limit?**

Yes, a tax audit is required regardless of total income levels. Section 44AB mandates a tax audit even if the assessee's total income does not exceed the maximum exemption limit. The purpose of a tax audit under Section 44AB is to aid the Assessing Officer in accurately determining the total income of an assessee according to the provisions of the Act. Thus, if turnover exceeds the specified limits outlined in Section 44AB, a tax audit is obligatory, even if the total income falls below the exemption threshold.

#### FAQ 5. **Are Non-Residents Conducting Business in India Required to Get Their Accounts Audited Under Section 44AB?**

Section 44AB applies uniformly to both residents and non-residents. A non-resident is required to have their accounts audited if their turnover, sales, or gross receipts within India exceed the prescribed thresholds. The audit for a non-resident will focus solely on the business activities conducted within India.

#### FAQ 6. **How Can You Qualify for the Enhanced Tax Audit Limit of Rs. 10 Crores?**

To qualify for the enhanced tax audit threshold of Rs. 10 crores, a business must primarily conduct transactions through banking channels. Specifically, both cash receipts and cash payments during the financial year must not exceed 5% of total receipts and payments, respectively. This means that over 95% of all transactions should be executed through non-cash methods.

It is important to clarify that any transactions involving a cheque or bank draft, unless made as an 'account payee only', are considered cash transactions. This includes transactions using bearer or crossed cheques that are not marked 'account payee'.

Each condition concerning 'amounts received' and 'payments made' must be met independently. Failing to meet either condition disqualifies the business from the enhanced limit, meaning the standard audit thresholds apply.

The responsibility to demonstrate eligibility for this higher threshold lies with the taxpayer. If a taxpayer's cash transactions exceed the 5% limit, they risk a penalty under Section 271B for not auditing their accounts unless they can show a reasonable cause under Section 273B to avoid penalties.

**Illustrative Example:** Mr. A operates a readymade garments trading business. During the financial year 2022-23, he reports a turnover under Rs. 10 crores and the following transactions:

Particulars	Mode of Transaction	
	Cash (Rs. in Lakhs)	Bank (Rs. in Lakhs)
<b>Receipts</b>		
- Sales	20	480
- Advance from customers	10	20
- Unsecured loan	10	100
<b>Total receipts</b>	<b>40</b>	<b>600</b>
<b>Payments</b>		
- Purchase	15	400
- Rent	<i>Nil</i>	50
- Loan repayment	5	50
<b>Total Payments</b>	<b>20</b>	<b>500</b>

The turnover of Mr. A during the financial year 2022-23 is up to Rs. 10 crores. He shall not be liable for tax audit if his cash receipt and payment during the year do not exceed 5% of the total receipt or payment, as the case may be.

**Computation of Percentage of Cash Receipts & Payments:**

Particulars	Total (A)	Cash (B)	% in Cash (B/A*100)
Receipts	640	40	6.25%
Payments	520	20	3.85%

Although Mr. A's cash payments are within the permissible limit (under 5%), his cash receipts exceed the 5% threshold at 6.25%. Consequently, Mr. A does not qualify for the increased Rs. 10 crore threshold and must undergo a tax audit.

## FAQ 7. Are Professionals Eligible for the Enhanced Turnover Limit of Rs. 10 Crore for Tax Audits?

No, professionals do not have access to the enhanced turnover limit of Rs. 10 crores for tax audits. Section 44AB of the Income-tax Act distinguishes between business and profession: clause (a) addresses businesses, while clause (b) refers to professions. The provision that sets the enhanced turnover limit of Rs. 10 crores specifically under clause (a) applies solely to businesses. Therefore, professionals are not entitled to this increased threshold for tax audits.

## FAQ 8. **Is a Person Opting for the Presumptive Taxation Scheme Under Section 44AD Required to Get His Accounts Audited?**

Under the Income Tax Act, Section 44AB sets the criteria for when an assessee must have their accounts audited. One significant exception is for individuals who choose the presumptive taxation scheme under Section 44AD. Here's a breakdown:

- **Exemption from Audit** – *Individuals opting for the presumptive taxation under Section 44AD are not required to get their books audited, provided their business turnover does not exceed Rs. 2 crores.*
- **Conditions for Audit:**
  - **Clause (e) of Section 44AB** – If an individual has opted for the presumptive taxation scheme under Section 44AD in any of the previous five years but decides not to opt for it in the current year, they must have their accounts audited if their total income exceeds the maximum amount not chargeable to tax.
  - **Clause (a) of Section 44AB** – An audit is mandatory if a business's turnover exceeds Rs. 1 crore. However, this limit increases to Rs. 10 crores if cash receipts and payments constitute no more than 5% of total receipts and payments.
- **Overlap of Clauses:**
  - If an assessee is subject to both Clause (a) and Clause (e) of Section 44AB, they must have their books audited. For instance, if the turnover exceeds Rs. 1 crore and cash transactions are below 5%, the assessee is liable for an audit.

This structure clarifies the conditions under which an audit is required, aligning with the exemptions provided by the presumptive taxation scheme under Section 44AD.

Let's analyse the tax audit requirements for an assessee with different turnover scenarios and their choices regarding the presumptive taxation scheme under Section 44AD.

### **Example:**

If an assessee's turnover is more than Rs. 1 crore and cash transactions (both payments and receipts) are less than 5% of the total, does this subject them to a tax audit?

Here's a detailed breakdown in tabular form to clarify:

Situation	Turnover	Whether Liable for a Tax Audit?
<b>Assessee opted for Section 44AD in the last 5 years but not in the current year</b>	Up to Rs. 1 crore	No
	Up to Rs. 2 crores	Yes, if income is more than the maximum amount not chargeable to tax [Section 44AB(e)]
	More than Rs. 2 crores but up to Rs. 10 crores and the condition in the <i>Proviso</i> to Section 44AB(a) is complied with [i.e., cash payments and receipts do not exceed 5%]	No
	More than Rs. 2 crores but up to Rs. 10 crores and the condition in the <i>Proviso</i> to Section 44AB(a) is not complied with [i.e., cash payments and receipts exceed 5%]	Yes
	More than Rs. 10 crores	Yes
<b>Assessee has not opted for Section 44AD in the past five years and is not opting this year either</b>	Up to Rs. 10 crores	No [ <i>Proviso</i> to Section 44AB(a)]
	More than Rs. 10 crores	Yes

For More Details about Section 44AD, Visit [Taxmann.com/Practice](http://Taxmann.com/Practice)

## FAQ 9. Does a Salaried Employee Who Trades in Derivatives Need to Undergo a Tax Audit?

Income or losses from trading in futures and options (F&O) are treated as non-speculative business income and are taxable under the head 'Profits and Gains from Business or Profession', even if these transactions do not involve actual delivery of goods.

To determine whether a tax audit is necessary for a salaried employee engaged in F&O trading, one must first calculate the turnover from these activities. The need for a tax audit depends on this turnover figure. If the total sales, turnover, or gross receipts from trading exceed Rs. 1 crore during the financial year, a tax audit is mandatory. However, this threshold increases to Rs. 10 crores if more than 95% of transactions are conducted through banking channels, meaning cash transactions do not exceed 5% of total transactions.

**Example:** Mr. A, besides earning a salary, has traded in futures and options throughout the year. Below are the details of his transactions:

Transaction	Buy Value	Sell Value	Realised P&L	Computation of Turnover
1	40,00,000	50,00,000	10,00,000	10,00,000
2	60,00,000	30,00,000	(30,00,000)	30,00,000
3	75,00,000	60,00,000	(15,00,000)	15,00,000
4	3,20,00,000	2,00,00,000	(1,20,00,000)	1,20,00,000
5	2,30,00,000	1,30,00,000	1,00,00,000	1,00,00,000
<b>Total</b>	<b>7,25,00,000</b>	<b>4,70,00,000</b>	<b>(55,00,000)</b>	<b>2,75,00,000</b>

Mr. A's turnover from futures and options (F&O) trading amounts to Rs. 2,75,00,000, resulting in a net loss of Rs. 55,00,000. As F&O transactions are typically conducted digitally through banking channels, the higher threshold of Rs. 10 crores for a tax audit is applicable. Consequently, Mr. A does not require a tax audit since his business turnover falls below the stipulated limit for the increased threshold.

## FAQ 10. What Are the Scenarios Under Which a Tax Audit Is Applicable for Professionals?

Section 44ADA allows professionals to opt for presumptive taxation if their gross receipts do not exceed Rs. 50 lakhs during the relevant previous year. This limit can be increased to Rs. 75 lakhs if cash transactions do not exceed 5% of the total gross receipts for the year.

Here's a breakdown of when a tax audit is applicable based on different scenarios:

Case	Gross Receipts	Profit	Whether Tax Audit Applicable?	Reason
<b>Case 1</b>	Rs. 40 lakhs	Rs. 25 lakhs	No	Gross receipts are less than Rs. 50 lakhs, and profit is more than 50% of the gross receipts.
<b>Case 3</b>	Rs. 40 lakhs	Rs. 10 lakhs	Yes	Profits are lower than 50% of total gross receipts, and total income exceeds the maximum exemption limit.
<b>Case 4</b>	Rs. 40 lakhs	Rs. 2 lakhs	No	Although profits are less than 50% of total gross receipts, but the total income is less than the maximum exemption limit.
<b>Case 5 (cash received during the previous year exceeds 5% of the total gross receipts)</b>	Rs. 70 lakhs	Rs. 50 lakhs	Yes	Gross receipts exceed Rs. 50 lakhs.

Case	Gross Receipts	Profit	Whether Tax Audit Applicable?	Reason
<b>Case 6 (cash received during the previous year does not exceed 5% of the total gross receipts)</b>	Rs. 70 lakhs	Rs. 50 lakhs	Yes	Gross receipts are less than Rs. 75 lakhs, and profit is more than 50% of the gross receipts.
<b>Case 7 (cash received during the previous year exceeds 5% of the total gross receipts)</b>	Rs. 80 lakhs	Rs. 15 lakhs	Yes	Gross receipts exceed Rs. 75 lakhs. The profit percentage is irrelevant here.

These examples illustrate how the tax audit applicability for professionals varies based on their gross receipts, the percentage of cash receipts, and their profit margins relative to those receipts.

## FAQ 11. **Does the Tax Audit Under Section 44AB Apply to the Business Income of Charitable or Religious Trusts Registered Under Section 12AB?**

Charitable and religious institutions are governed by special provisions outlined in Sections 11 to 13 of the Income Tax Act. To claim exemptions under these sections, trusts or institutions must meet certain conditions, including registration, maintaining books of account, undergoing audits, and filing income returns as specified under Section 12A. Once these conditions are met, the income of such institutions is calculated according to Sections 11 and 12, not by the usual commercial principles.

For entities registered under Section 12AB, the income defined under Section 11(1) should be computed following these special provisions rather than the standard provisions of the Act. Specifically, Section 14 and the five heads of income do not apply. The audit requirement under Section 44AB pertains to the 'Profit & Gain from Business' head, meaning it is mandated only when the income is assessed under this category or when a tax audit under Section 44AB is explicitly required.

Judicial precedents such as the Delhi Tribunal's decision in *United Educational Society v. Jt. CIT* [2019] and the Mumbai Tribunal's ruling in *Asstt. CIT v. India Magnum Fund* [2002] have clarified that Section 44AB does not extend to incomes covered under Chapter III, which are excluded from total income calculations. Consequently, charitable institutions whose income computation falls under Sections 11 and 12 are not subjected to tax audits under Section 44AB, unless specified otherwise.

Charitable trusts do undergo specific audits under Section 12A, with audit reports required to

be submitted in Forms 10B or 10BB. These sections operate independently of the five heads of income, thus preserving the exemptions granted under Section 12AB. For business operations within these trusts, the ICAI's "Guidance Note on Tax Audit" advises that if their business turnover exceeds certain thresholds (Rs. 1 crore or Rs. 10 crore in some cases), an audit under Section 44AB is necessary, notwithstanding the exemptions under various subsections of Section 10 and Section 11.

In summary, charitable or religious trusts generally do not require a tax audit under Section 44AB for income processed under Sections 11 and 12, unless their business activities surpass the prescribed turnover limits.

**For More Details about Taxation of Charitable Trusts, Visit [Taxmann.com/Practice](http://Taxmann.com/Practice)**

## FAQ 12. Who Must Maintain Books of Accounts According to Section 44AA?

Section 44AA of the Income-tax Act mandates the maintenance of books of accounts for various taxpayers. Below is a detailed table illustrating the requirements based on taxpayer categories, income thresholds, and gross turnover or receipts:

Nature of Business or Profession	Category of Taxpayer	Threshold Limits for Income	Threshold Limits for Gross Turnover or Receipts**
Specified Professions*	Any	N/A	Mandatory in every case except when presumptive taxation scheme under Sec. 44ADA is opted by the assessee.
Non-Specified Professions	Individual or HUF	Rs. 2,50,000	Rs. 25 lakhs in any 3 years immediately preceding the previous year.
Non-Specified Professions	Others	Rs. 1,20,000	Rs. 10 lakhs in any 3 years immediately preceding the previous year.
Business	Individual or HUF	Rs. 2,50,000	Rs. 25 lakhs in any 3 years immediately preceding the previous year.
Business	Others	Rs. 1,20,000	Rs. 10 lakhs in any 3 years immediately preceding the previous year.
Presumptive Tax Scheme under Sec. 44AD	Resident Individual or HUF	Rs. 2,50,000	Taxpayer opted for the scheme in any of the last 5 previous years but does not opt for it in the current year.
Presumptive Tax Scheme under Sec. 44AD	Resident Partnership Firm	N/A	Taxpayer opted for the scheme in any of the last 5 previous years but does not opt for it in the current year.

Nature of Business or Profession	Category of Taxpayer	Threshold Limits for Income	Threshold Limits for Gross Turnover or Receipts**
Presumptive tax scheme under Section 44ADA	Resident Assessee	N/A	Taxpayer claims that profits from his profession are lower than those computed under Section 44ADA and total income exceeds the maximum exemption limit.
Presumptive Tax Scheme under Sec. 44AE	Any Assessee engaged in plying, hiring, or leasing goods carriage	N/A	Taxpayer claims that his profits are lower than the deemed profits.
Presumptive Tax Scheme under Sec. 44BB	Non-resident assessee engaged in the exploration of mineral oil	N/A	Taxpayer claims that his profits are lower than the deemed profits.
Presumptive Tax Scheme under Sec. 44BBB	Foreign Co. engaged in civil construction	-	Taxpayer claims that his profits are lower than the deemed profits.

**\* Meaning of Specified Profession:**

- (a) Legal
- (b) Medical
- (c) Engineering
- (d) Architectural
- (e) Technical Consultancy
- (f) Interior decoration
- (g) Film artist<sup>2</sup>
- (h) Authorised Representative<sup>3</sup>
- (i) Accountancy Profession
- (j) Company Secretary<sup>4</sup>
- (k) Information Technology<sup>5</sup>

<sup>2</sup> Notification: No. SO 17(E), dated 12-1-1977

Film artist includes actor, cameraman, director, music director, art director, dance director, editor, singer, lyricist, story writer, screen play writer, dialogue writer, and dress designer.

<sup>3</sup> Notification: No. SO 17(E), dated 12-1-1977

'Authorised Representative' means a person, who represents any other person, in lieu of fee or remuneration, before any Tribunal or statutory authority, but does not include an employee of the person so represented or a person carrying on legal profession or a person carrying on the profession of accountancy.

<sup>4</sup> Notification: No. SO 2675, dated 25-9-1992

<sup>5</sup> Notification: No. SO 385(E), dated 4-5-2001

\*\* For entities established during the previous year, the applicability of maintaining books of accounts will be determined based on whether the income or gross receipts for the current year are expected to exceed the prescribed thresholds. If not likely to exceed, the maintenance of books is not required.

For More Details about Section 44AA, Visit [Taxmann.com/Practice](http://Taxmann.com/Practice)

## FAQ 13. What Documents Are Required to Comply with Section 44AA for Maintaining Books of Accounts?

Taxpayers must maintain specific documents to fulfill the requirements of Section 44AA regarding the maintenance of books of accounts. Here's a breakdown based on the nature of the business or profession and applicable thresholds:

Nature of Business or Profession	Threshold Limits	Books of Accounts to be Maintained
Specified Professions other than company secretary and Information technology	Gross receipt exceeds Rs. 1,50,000 in any of 3 years immediately preceding the previous year	<ol style="list-style-type: none"> <li>Cash-book</li> <li>Journal, if books of accounts are maintained according to the mercantile system of accounting</li> <li>Ledgers</li> <li>Carbon copies of bills and carbon copies or counterfoil of receipts issued by the assessee of value exceeding Rs. 25 (must be machine numbered or serially numbered)</li> <li>Original bills issued to the assessee and receipts in respect of the expenditures incurred by him</li> <li>Signed vouchers, if bills and receipts are not issued, and the amount of expenditure does not exceed Rs. 50, if the cash book does not contain adequate particulars in respect of these expenditures</li> </ol>
Medical Professions	Gross receipt exceeds Rs. 1,50,000 in any of 3 years immediately preceding the previous year	<ol style="list-style-type: none"> <li>As specified above, for specified professions</li> <li>Daily case register in Form 3C</li> <li>Inventory under broad heads of stock of drugs, medicines, and other consumable accessories used for the purpose of profession, as on the first and last day of the previous year.</li> </ol>
Specified Professions	In every case, irrespective of gross receipts and Income	Such books of accounts which may enable the Assessing Officer to compute the taxable income.
Non-Specified Professions	Income and turnover do not exceed the threshold limit as specified above	Not required to maintain books of accounts

Nature of Business or Profession	Threshold Limits	Books of Accounts to be Maintained
Business	Income and turnover do not exceed the threshold limit as specified above	Not required to maintain books of accounts
Non-Specified Professions	Income and turnover exceed the threshold limit as specified above	Such books of accounts which may enable the Assessing Officer to compute the taxable income.
Business	Income and turnover exceed the threshold limit as specified above	Such books of accounts which may enable the Assessing Officer to compute the taxable income.

## FAQ 14. **Does the Audit Report Need to Include the Addresses of All Locations Where Mr. A Maintains Books of Accounts?**

According to Clause 11 of Form 3CD, auditors must list all books of accounts and the addresses where they are maintained. If books are kept at multiple locations, the auditor must specify each address along with the corresponding details of the books maintained there. For companies, it's also important for the auditor to check if Form AOC-5 has been filed with the Registrar of Companies. This form is necessary when books of accounts are held at a place other than the registered office.

Beyond listing the books under Clause 11(b), auditors have the responsibility to thoroughly examine these books. After such examination, they should confirm in Form No. 3CB whether the books maintained qualify as 'proper books of account' according to regulatory standards.