Namaste

In Chapter - 10 we would discuss the Particulars of Form 3CD – Part B – Clause 21.

Clause 21 (a) - Furnish the details of amounts debited to the profit and loss account, being in the nature of Capital, Personal, Advertisement Expenditure, etc.

- **Expenditure of Capital Nature**
  - Expenditure of capital nature which is debited to profit and loss account has to be reported.
  - The disclosure should include loss on sale of fixed assets, loss on sale of Investments, etc.
  - The tax auditor should keep the above principle in mind and if the same are not followed by the assessee, then the auditor should qualify the Tax Audit Report.

- **Expenditure of Personal Nature**
  - Personal expenses of the assessee are not allowable while computing Income from Business or Profession.
  - It should be noted that the word ‘Personal’ is confined to and attached with the “assessee” and not necessarily to and with persons other than the assessee.
  - The Tax Auditor should also collect information from Statutory Audit Report (In case of companies, statutory auditor is required to report if personal expenses are debited to profit & loss account) and also based on his audit procedures and report the same under clause.

- **Expenditure on advertisement being souvenir, brochure, tract, pamphlet, etc published by a Political Party**
  - The Tax Auditor should keep in mind that no deduction is allowed in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party as per s. 37(2B).
  - The expenditure of this nature should be segregated and reported under this clause. In case a trade union or labour union is promoted or formed by a political party but have a distinct legal entity, then expenditure incurred by way of advertisement given in the souvenir, brochure, tract, pamphlet or journal published by the trade union or the labour union is not required to be indicated in this clause.

- **Expenditure incurred at clubs**
  - Details should be verified for entrance fees and subscription as well as expenditure incurred for club services and facilities used.
  - If the expenditure incurred at club is of personal nature, then the same should be reported, as the same are not allowable.
Expenditure by way of penalty or fine for violation of law or otherwise or for offence or which is prohibited by law

- It must be borne in mind that the tax auditor while reporting under this clause is not required to express any opinion as to the allowability or otherwise of the amount of penalty or fine for violation of law. He is only required to give the details of such items as have been charged in the books of accounts.
- This clause covers only penalty or fine for violation of law and not the payment for contractual breach or liquidator damages.
- The tax auditor should keep in mind the difference between the amount prohibited by law and the amount paid which is compulsory in nature under the relevant statute.
- Details are to be given under this clause if the penalty, etc. are debited to profit & loss account, even if the assessee is contesting before the higher authorities. Where the assessee is required to pay an amount being purely compensatory in nature, then the same is allowable u/s 37(1) and is not reportable under this clause.

**Clause 21(b) - Amounts inadmissible u/s 40(a)**

This clause deals with amounts which are inadmissible as deductions u/s 40(a). Following are items which being not allowed as deductions is to be reported:

- **U/s 40(a)(i)**
  - Disclosure is of any interest, royalty, fees for technical services or other sum chargeable under the Income-tax Act which is payable outside India or in India to a non-resident or a foreign company on which tax is deductible at source and:
    - such tax has not been deducted, or
    - after deduction has not been paid during the previous year or in the subsequent year on or before the due date of filing return u/s 139(1).
  - The amount inadmissible is to be disclosed which in this case is 100% of the expenditure.
- **U/s 40(a)(ia)**
  - Disclosure is of any expenditure payable to any resident on which TDS is deductible under Chapter XVII-B and:
    - such tax has not been deducted, or
    - after deduction, has not been paid on or before the due date of filing return u/s 139(1).
  - The amount inadmissible is to be disclosed which in this case is 30% of the expenditure.
  - Payments for sums which are not claimed as expenditure (example, immovable property not being stock, capital payments, etc) are not to be disclosed in this clause.
In the details, name and address of the payee is also to be disclosed.

- U/s 40(a)(ic) - Fringe Benefit Tax (not applicable now though).
- U/s 40(a)(iia) – Wealth Tax (not applicable now though).
- U/s 40(a)(iib) - Any amount paid by way of a Royalty, License Fees, Service Fees, Privilege Fees, Service Charges or any other fees or charge by whatever name called, which is levied exclusively on or which is appropriated, directly or indirectly, from a State Government undertaking by the State Government.
- U/s 40(a)(iii) - Any payment towards ‘Salaries’, if it is payable outside India; or to a non-resident, and if the tax has not been paid thereon nor deducted therefrom.
- U/s 40(a)(iv) - Any payment to a provident or other fund established for the benefit of employees of the assessee.
- U/s 40(a)(v) - Any tax actually paid by an employer referred to in clause (10CC) of section 10.

**Clause 21(c) - Amount debited to profit and loss account being, interest, salary, bonus, commission or remuneration inadmissible under section 40(b)/40(ba) and computation thereof**

- The tax auditor should ensure that the inadmissible amount under section 40(b)/40(ba) and such information is disclosed in respect of interest/ remuneration paid to partner of partnership firm / LLP or a member of an Association of persons (AOP)/Body of individuals (BOI).
- The word "inadmissible" implies that the tax auditor will have to examine the facts, apply the conditions for allowance or disallowance and accordingly determine the prima facie inadmissibility of the deduction and also quantify the same.
- Salary, bonus, commission or remuneration or interest are not admissible, unless the following conditions are satisfied:
  - Remuneration is paid to working partner(s).
  - Remuneration or interest is authorised by the partnership deed / LLP Agreement and is in accordance with the partnership deed / LLP Agreement.
  - Remuneration or interest does not pertain to a period prior to the date of execution of partnership deed / LLP Agreement.
  - Remuneration does not exceed the limits prescribed under section 40(b).
  - Interest does not exceed the simple interest calculated at the rate of 12%.

**Clause 21(d) – Disallowance / deemed income u/s 40A(3)/ 40A(3A)**

- Disallowance u/s 40A(3) / deemed income u/s 40A(3A) is to be disclosed under this clause where payments are made other than by account payee cheque / draft exceeding the specified limits.
• It should be noted that expenditure limit per person per day has been decreased from AY 2018-19 from Rs. 20000/- to Rs. 10000/-. Expenditure includes purchases too.

• The Tax Auditor should obtain a list of all the payments exceeding Rs.10,000/- per person per day (Rs.35,000 in case of plying, hiring or leasing goods carriages) made by the assessee during the relevant year other than by account payee cheque / draft which should include the list of payments exempted in terms of Rule 6DD with reasons. This list should be verified by the tax auditor with the books of account in order to ascertain whether the conditions for specific exemption granted under clauses of Rule 6DD are satisfied. Details of payments which do not satisfy the above conditions should be stated under this clause.

• In case expenditure is incurred in earlier previous years, but payment is made in the previous year under tax audit, then also the limits discussed above needs to be verified and payments made in excess of the limits would be deemed to be income of current previous year u/s 40A(3A) and is to be reported in clause 21(d)(B).

• The tax auditor has to take into account the technological advancements in the field of banking and information technology. It may be noted if the payment is made by use of electronic clearing system through a bank account or through such other electronic mode as may be prescribed in rule 6ABBA, then as they are specifically excluded from the sections, itself, the such payments are not liable for disallowance as the main intention of provisions of sec. 40(3)/ (3A) and should not be reported.

• It is also to be verified that the payment was made by account payee cheque or account payee draft. Crossed cheques are not account payee as held in few cases.

• Along with nature of payment, name and PAN / Aadhar of the person is also to be disclosed.

• Where the assessee did not possess necessary evidence to enable the auditor to verify that the payment made was through account cheque or account payee draft, the same should be accordingly reported, which may be as under:
  • Though we have not observed any payment in excess of Rs.10000/- or Rs. 35000/- (in case of plying, hiring or leasing goods carriages) to have been made in contravention of section 40A(3) / 40(3A) read with rule 6DD, however the assessee did not possess necessary evidence to verify the same.

Clause 21(e) - Provision for gratuity not allowable u/s 40A(7)

• Details of provision made for gratuity but not paid would be disallowed u/s 40A(7) and is to be disclosed under this clause.

• It is to be noted that in case of provision for payment to approved gratuity fund, the same is not to be disclosed in this clause as the same is reportable u/s 43B i.e., in clause 26 of Form 3CD.
Clause 21(f) - Any sum paid by the assessee as an employer not allowable u/s 40A(9)

- Section 40A(9) disallows expenditure incurred on setting up or formation of, or as contribution to, any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860, or other institution for any purpose, except where such sum is so paid, for the purposes and to the extent provided by or under clause (iv) or clause (iva) or clause (v) of sub-section (1) of section 36, or as required by or under any other law for the time being in force.
- Under this clause, the Tax Auditor is required to ensure that details of payments which are not allowable under this section is disclosed.

Clause 21 (g) - Particulars of any liability of a Contingent nature

- The Tax Auditor should be mindful of distinction between the Contingent Liability and the Provision. The Tax Auditor should scrutinize the accounts relating to Provisions/Outstanding Liabilities to ensure that they do not contain any provision for contingent Liabilities.
- Though this clause requires only disclosure of contingent liability, yet in my view only the contingent liability for which provision has been made in the books should be disclosed in this clause as the same is not allowable as a deduction.
- The Tax Auditor should also refer the Accounting Policies adopted by the assessee as mentioned in the Financial Statements in this regard.
- Further, the Tax Auditor should check whether Contingent liability disclosed in earlier years have been provided in the books in the relevant previous year; if yes, then the basis for provision of the same.

Clause 21(h) - Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income.

- The Tax Auditor is required to report the amount of expenditure incurred by an assessee in relation to an income which is exempt under the Act.
- The tax auditor should examine the details of amount of inadmissible expenditure as furnished by the assessee. While carrying out such examination the tax auditor is entitled to rely on the management representation. However, Standard on Auditing (SA) 580, Written Representations may be referred to.
- The tax auditor should verify the amount of inadmissible expenditure as estimated by the assessee with reference to established principles of allocation of expenditure based on logical parameters like proportion of exempt and taxable income recorded, turnover, man-hours spent to earn the relevant income etc.
- The tax auditor should also verify the amount disallowable as per rule 8D.
Clause 21(i) - Amount inadmissible under the proviso to section 36(1) (iii).

- The said provision was amended by Finance Act 2015 and is in line with ICDS IX (Borrowing Costs), where interest paid in respect of amount borrowed for purpose of business is not allowed till the date asset was first put to use.
- The Tax Auditor while reporting under this sub clause should refer to the Accounting Policy adopted by the assessee in this regard. He should evaluate whether the Accounting Policy is in line with principles laid down in AS-16.

I hope this document is of use to you. I thank CA. Shreya Jain in assisting me to compile this part of the series. Your suggestions and comments would be highly appreciated.

Best Regards

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(Disclaimer: Though full efforts have been made to state the interpretations correctly, yet the author is not responsible / liable for any loss or damage caused to anyone due to any mistake / error / omission)
### ABOUT CA. PRAMOD JAIN

He is a commerce graduate [B. Com (H)] from Shri Ram College of Commerce (SRCC). He is a fellow member of the Institute of Chartered Accountants of India (FCA). He is a fellow member of the Institute of Companies Secretaries of India (FCS). He is a fellow member of the Institute of Cost Accountants of India (FCMA). He is a Bachelor of Law (LL.B). He has qualified Information System Auditor [DISA (ICAI)]. He is also a member of All India Management Association (MIMA). He is also an Insolvency Professional (IP). He has also passed the Proficiency Self-Assessment Test for Independent Director’s Databank. He has passed certification course NCFM of National Stock Exchange of India (NSE). He has also done certification course CAAT of ICAI. He has also done post qualification certificate course on Valuation of ICAI.

He has been elected as Central Council Member of ICAI for the period 2019 – 2022. Apart from being member in more than 25 committees / groups / directorates of ICAI, he is / was:

- Chairman of Committee on International Taxation (CITAX) for Year 2021-22
- Chairman of Taxation Audit Quality Review Board (TAQRB) for the year 2021-22.
- Chairman of Valuation Standards Board (VSB) for the year 2020-21.
- Chairman of CSR Committee of ICAI for year 2020-21.
- Vice-Chairman of Committee on MSME & Start-up for the year 2021-22.
- Vice-Chairman of Women Members Empowerment Committee (WMEC) - 2021-22.
- Vice-Chairman of Direct Tax Committee (DTC) for year 2019-20 and 2020-21.
- Vice-Chairman of Committee on International Taxation (CITAX) for Year 2019-20.
- Member of ICAI Disciplinary Committee Bench 1 for year 2020-21.
- Nominated as Member of Quality Review Board (QRB) for 3 years from 2020 to 2022.

He is the conceptualizer of the portal [www.expertspanel.in](http://www.expertspanel.in) which is a one stop solution for all professional queries which has given more than 31000 answers since its launch in mid of year 2018.

He is delivered more than 1400 lectures and articles on various topics of Income Tax, Corporate Laws, LLP, Audits, Peer Review, Quality Review, etc. at more than 200 forums throughout the country. Most of his presentations and articles since 2013 are available for free download from www.lunawat.com and from 2018 at [www.expertspanel.in](http://www.expertspanel.in) also.

He is president, founder convener and member of various Boards, Directorate, Committees, Study Circles, etc. of ICAI, ICSI and other prestigious bodies and associations. He has been a Technical Reviewer with FFRB and Quality Review Board and Peer Reviewer with Peer Review Board. He has authored books 13 books including “Chartered Accountant’s Documentation and Compliance for Audits and Reviews”, Limited liability Partnership – A Complete Resource Book”, and “Accounting Standards and CARO”.

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**Tax Audit Series v. 3.0 – Ch. 10 – Clause 21**