Tax Audit Series - Version 4.0
Chapter 2 – Turnover

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In Chapter 2 of the Tax Audit Series – Version 4.0, we would discuss the meaning of the terms "Sales ", "Turnover" and "Gross Receipts".

The initial test for applicability of tax audit under section 44AB is to see if the 'sales', 'turnover' or 'gross receipts' as the case may be exceeds the limits specified u/s 44AB (a) or 44AB (b). In this series, we shall discuss what these terms means and what is to be included and / or excluded to determine the limits.

"Sales ", "Turnover" and "Gross Receipts" are commercial terms and they should be construed in accordance with the method of accounting regularly employed by the assessee. Section 145(1) of the income Tax Act, 1961 provides that income chargeable under the head "Profits and gains of business or profession" should be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. Mixed system of accounting is not allowed under Income Tax Law.

TURNOVER

The Term 'Turnover' has not been defined under the Income Tax Act, 1961. According to section 2(91) of Companies Act 2013:

> *"Turnover" means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year.*

The Central Sales Tax Act, 1956 defined the term turnover as

> *"Turnover" used in relation to any dealer liable to tax under this Act means the aggregate of the sale prices received and receivable by him in respect of sales of any goods in the course of inter-State trade or commerce made during any prescribed period and determined in accordance with the provisions of the Act and rules made there under.*

Further, section 8A (1) provides that sales tax should be deducted from aggregate of sales price to determine turnover.

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In "Glossary of Terms Used in Financial Statements" published by the ICAI in 2019, the expression "Sales Turnover" has been defined as under:

> *"The aggregate amount for which sales are effected or services rendered by an enterprise. The term `gross turnover' and `net turnover' (or `gross sales' and `net sales') are sometimes used to distinguish the sales aggregate before and after deduction of returns and trade discounts".*

The Central Goods and Services Act 2017 in section 2(112) defines turnover as:

> *"Turnover means the aggregate value of all taxable supplies (excluding the value of inward supplies on which tax is payable by a person on reverse charge basis), exempt supplies, exports of goods or services or both and inter-State supplies of persons having the same Permanent Account Number, to be computed on all India basis but excludes central tax, State tax, Union territory tax, integrated tax and cess"*

DOES TURNOVER INCLUDE INDIRECT TAXES SUCH AS GST?

A question has been raised a few times, that whether turnover for purposes of section 44AB includes indirect taxes like GST, Excise or VAT?

Normally indirect taxes are levied on the sales / turnover; hence turnover should not include such indirect taxes. Few relevant portions from Paras of ICAI Guidance Note on Division I – Non- Ind AS Schedule III to the Companies Act, 2013 (revised January 2022) reproduced below clarifying the disclosure in financial statements states that:

> *Para 9.1.3* - Indirect taxes such as Sales tax, Service tax, Purchase tax etc. are generally collected from the customer on behalf of the government in majority of the cases. However, this may not hold true in all cases and it is possible that a company may be acting as principal rather than as an agent in collecting these taxes. Whether revenue should be presented gross or net of taxes should depend on whether the company is acting as a principal and hence responsible for paying tax on its own account or, whether it is acting as an agent i.e. simply collecting and paying tax on behalf of government authorities. In the former case, revenue should also be grossed up for the tax billed to the customer and the tax payable should be shown as an

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expense. However, in cases, where a company collects tax only as an intermediary, revenue should be presented net of taxes

Para 9.1.4 - However, as per the Guidance Note on Value Added Tax, "Value Added Tax (VAT) is collected from the customers on behalf of the VAT authorities and, therefore, its collection from the customers is not an economic benefit for the enterprise and it does not result in any increase in the equity of the enterprise". Accordingly, VAT should not be recorded as revenue of the enterprise. At the same time, the payment of VAT should not be treated as an expense in the Financial Statements of the company.

Para 9.1.5 - Further, as per the definition of Revenue in the Guidance Note on Terms Used in Financial Statement, "It excludes amounts collected on behalf of third parties such as certain taxes". The Guidance Note on VAT further states, "Where the enterprise has not charged VAT separately but has made a composite charge, it should segregate the portion of sales which is attributable to tax and should credit the same to 'VAT Payable Account' at periodic intervals".

Para 9.1.6 - On the introduction of Goods & Services Tax from 1 July 2017 onwards, the collection of GST by an entity would not be an inflow on the entity's own account but it shall be made on behalf of the government authorities. Accordingly, the revenue should be presented net of GST collected.

Also, Para 5.5 of ICAI Guidance Note on u/s 44AB (Revised 2023) states that:

- If GST or any other tax is included in the sale price, no adjustment in respect thereof should be made for considering the quantum of turnover.
- If, however, GST or any other indirect tax recovered are credited separately to GST or any other tax Account (being separate accounts) and payments to the authority are debited in the same account, they would not be included in the turnover.

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Hence, indirect taxes should normally not be included to arrive at the limits of s. 44AB, except in the cases as stated above.

INCLUSIONS AND EXCLUSIONS FROM TURNOVER

The term 'turnover' for the purposes s. 44AB would mean the aggregate amount for which sales are affected or services rendered by an enterprise. The following should not be deducted from sales (if not included in sales) to arrive at turnover:

Inclusions (Not to be deducted from Turnover)

1. Sale of scrap / By product
2. Sale proceeds of shares, securities, debentures etc. held as stock in trade by the assessee.
3. Cash discount other than allowed in invoice is not to be deducted.
4. Commission on sales
5. If GST or any other indirect tax was included in sale price while accounting (Inclusive method), then the same shall form part of Turnover.

Exclusions (To be deducted from Turnover)

1. If GST or any other indirect tax was not included in sale price while accounting (Exclusive method), then the same shall not form part of Turnover.
2. Sale proceeds of Property Plant and Equipment (Fixed Assets).
3. Sale proceeds of Investment property.
4. Sale proceeds of shares, securities, debentures held as an investment.
5. Discounts (whatever nature) allowed in the Invoice.
6. Trade / Turnover discount (even if allowed by way of separate credit note).
7. Ancillary charges such as packing, freight and forwarding etc. provided they are separately mentioned in the Invoice. Otherwise, they will form part of Turnover.
8. Sales Returns
9. Price adjustments.
10. Special rebate (excluding commission on sales)

TURNOVER FOR SECURITIES & AGENCY

Share Brokers

Share Brokers buy and sell securities on behalf of their client. Thus, Brokerage income received on purchase and sale of such securities shall form part of Turnover.

Shares, Securities and Derivatives

Speculative Transactions

Aggregate of both positive (gains) and negative (losses) differences should be considered to determine turnover for purposes of tax audit. For example, where there is a gain of Rs. 10 lacs and loss of Rs. 8 Lacs resulting in net gain of Rs. 2 Lacs, the turnover would be Rs. 18 Lacs (10+8). Though the contract notes are issued for full value for purchases and sales, the accounting entries are made only for the differences.

Derivatives/ Futures & Options

Though the contract notes are issued for full value for purchases and sales, the accounting entries are made only for the differences. In case of Derivative transactions difference between purchase and sale is settled. Following is considered while determining turnover:

- Total of favourable and unfavourable differences in case of squared off transactions.
- Premium received on sale of options. However, if premium received is included to determine profit, then such profit should not be included.
- Differences in case of reverse trades.
- In case the transaction is not squared off at the end of year, the turnover (differences) would be considered on the date of squaring off i.e., in the year in which it is squared off.
- Case of delivery-based settlement, the difference in case of trade price and settlement price would be the turnover.

Delivery based transactions

Where the transaction for the purchase or sale of shares is delivery based whether intended or by default, the total value of the sales is to be considered as turnover, where shares are held as stock-in-trade (not investments).

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Agency Business

Amount of commission earned by the agent and not the aggregate amount for which sales are affected or services are rendered is considered as turnover / gross receipts.

If the property in the goods or all significant risks and rewards of ownership of goods continue to belong to the principal, the relevant sale price shall not form part of the sales/turnover of the commission agent and/or the consignee as the case may be. If, however, the property in the goods, significant risks and reward of ownership belongs to the commission agent and/or the consignee, as the case may be, the sale price received/receivable by him shall form part of his sales/turnover. Also, refer to the CBDT Circular No. 452 dated 17th March 1986, where CDBT has clarified related to commission agents, arhatias, etc. turnover for purposes of tax audit.

GROSS RECEIPTS

Gross Receipts would include all receipts whether in cash or in kind arising from carrying on of the business which will normally be assessable as business income under the Act. Apart from sales or turnover, the following stated hereafter are to be included or excluded to arrive at gross receipts.

Inclusions (To be included)

1. Sale proceeds of scrap, wastage etc. if it is not included in sale or turnover
2. Advance received and forfeited from customers
3. Cash assistance under the scheme of Government
4. Liquidated damages
5. Duty Drawbacks
6. Export incentives
7. Insurance claim (except relating to PPE (fixed assets))
8. Net Foreign exchange difference on export sales
9. Gross interest income (if forms part of business income)
10. Rental income (if forms part of business)
11. Dividend income (in case of dealer of shares and securities)

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12. Commission, brokerage, service and other incidental charges received in the business of chit funds
13. Reimbursement of expenses incurred (if credited to separate account then only to the extent of surplus)
14. Hire charges and instalments received
15. Finance income in case of lessor
16. Hire charges of cold storage
17. Value of any benefit or perquisite, whether convertible into money or not, arising from business or profession
18. Advertising charges by an advertising agent from the client, where books the advertisement space in bulk and recover charges from different clients
19. Amount received for conducting package tour

Exclusions (Not to be included):

1. Sale proceeds of asset held as investment.
2. Sale proceeds of PPE (fixed assets) including advance forfeited, if any
3. Interest income (if not forms part of business income)
4. Dividend income except in case of dealer in shares
5. Reimbursements of custom duty and other charges collected by clearing agent
6. Share of profit of a partner of a firm/LLP excluded from total income u/s10(2A)
7. Liabilities/ provisions of creditors, expenses or taxes written back
8. Rental income (if not forms part of business income)
9. Reimbursement of advertising charges by an advertising agent from the client
10. Agriculture receipts {as defined in section 2(1A) r.w.s 10(1)}
11. In case of travelling agent amount received from the clients for payment to airline, railways etc. as reimbursement.
12. Interest, remuneration received by partner from partnership firm.
13. In case of recruiting agent, the amount received from the clients by way of reimbursement for advertisement.

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It is pertinent to note that there is a difference between gross receipts and total receipts referred to in section 44AB. Total receipts would include all receipts in cash or through bank, however, gross receipts would be as discussed above. For tax audit applicability under section 44AB gross receipts is to be considered and not total receipts. For example, M/s ABC & Co.'s gross receipts (nothing in cash) are Rs. 8 crores, but its total receipts are Rs. 25 crores which includes loans received, payments from past debtors, etc. In such case, it would not be subject to tax audit as its gross receipts is below the specified limits.

Gross Receipts in case of Profession

Gross receipts in case of profession would include all receipts arising from carrying on of the profession.

Re-imbursement of expenses if collected separately either in advance or otherwise, should not form part of the "gross receipts". If, however, such out of pocket expenses are not specifically collected but are included / collected by way of a consolidated fee, the whole of the amount so collected shall form part of gross receipts.

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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EARLIER CHAPTER

Chapter No.	*Title*	*Link*
1	Applicability	http://lunawat.com/Uploaded_Files/Attachments/F_20303.pdf

(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 / omissions)

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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 is qualified as an 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 Certificate Course on CSR of ICAI. 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 and post qualification certificate course on Valuation of ICAI.

He is elected as Central Council Member of ICAI for 2 consecutive terms from 2019 to 2025. Apart from being member in more than 25 committees / groups / directorates of ICAI, and other Bodies he is / was:

- Chairman of Accounting Standards Board (ASB) of ICAI for 3 years from 2022 to 2025
- Deputy Convenor of Centre for Audit Quality Directorate (CAQD) for 2024-25
- Convenor - Members & Students (Grievances Handling & e-Sahayata) Directorate for 2023-24
- Chairman of Accounting & Finance Services Sectional Committee SSD-12 under the Services Sector Division Council (SSDC) of Bureau of Indian Standards (BIS) for 2023-24
- Chairman of Expert Advisory Committee (EAC) of ICAI for Year 2022-23
- Co-Chairman of Corporate Affairs Committee of PHDCCI for the year 2022-23
- Chairman of Committee on International Taxation (CITAX) of ICAI for 2021-22
- Chairman of Taxation Audit Quality Review Board (TAQRB) of ICAI for 2021-22.
- Member of Quality Review Board (QRB) for 2 terms from 2020 to 2026.
- Member of the SME Implementation Group (SMEIG) of IFRS Foundation, UK for 3 years from 2023 to 2026.
- Chairman of Valuation Standards Board (VSB) of ICAI for the year 2020-21.
- Chairman of CSR Committee of ICAI for year 2020-21.
- Vice-Chairman of Committee on MSME & Start-up of ICAI for the year 2021-22.
- Vice-Chairman of Women Members Empowerment Committee (WMEC) of ICAI for 2021-22.
- Vice-Chairman of Direct Tax Committee (DTC) of ICAI for 2 years from 2019 to 2021.
- Vice-Chairman of Committee on International Taxation (CITAX) of ICAI for 2019-20.
- Member of ICAI Disciplinary Committee for the year 2020-21.

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He is the conceptualizer of the portal www.expertspanel.in which is a one stop solution for all professional queries which has given more than 36000 answers since its launch in mid of year 2018.

He has delivered more than 1700 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 also.

He is Senior Partner of **M/s LUNAWAT & CO**., Chartered Accountants. 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 Financial Reporting Review Board (FRRB) and Quality Review Board (QRB) and Peer Reviewer with Peer Review Board (PRB).

He has authored books on *"Chartered Accountant's Documentation and Compliance for Audits and Reviews", Limited liability Partnership – A Complete Resource Book",* "*Chartered Accountant's Documentation and Compliance for Audits and Reviews", "Importance of LLP after Companies Act, 2013",* "*Chartered Accountant's Documentation and compliance under Companies Act 2013, Peer Review and Quality Review",* "*Limited Liability Partnership – Law, Procedures and Taxation",* "*Documentation for Chartered Accountants",* "*Limited Liability Partnership – Law and Procedures with Ready Reckoner", "Fringe Benefit Tax & Banking Cash Transaction Tax"*, "*Documentation for Audits"* and "*Accounting Standards and CARO".*

He has written various articles on taxation, company law and audit in various journals. He has vast practical experience in income tax, audit, corporate laws and LLP.