

Tax Audit Series - 1 – Turnover



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Namaste

We are starting a series on Tax Audit u/s 44AB, taking into account practical aspects to be taken care of to certify the Tax Audit Reports. It would also cover the amendments as made by CBDT on 20th July 2018. In series -1 we would discuss what is the meaning of the terms "Sales ", "Turnover" and "Gross Receipts".

The initial test is to see if the 'sales', 'turnover' or 'gross receipts' exceeds the limits specified u/s 44AB (a) or 44AB (b). In this series, we shall discuss what these terms means and what are to be included and 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" or "Income from other sources" should be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

TURNOVER

The Term 'Turnover' has not been defined under the Income Tax Act, 1961. According to section 2(91) of Companies Act 2013 as amended by the Companies (Amendment) Act, 2017

"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 GST law also do not define the term turnover. However, 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

In “Guidance Note on Terms Used in Financial Statements” published by the ICAI, 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”.

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Should Turnover include indirect taxes such as GST / VAT / Excise Duty?

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

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 Revised Schedule VI (reproduced below) 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 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”.

Also Para 5.9 of ICAI Guidance Note on u/s 44AB (Revised 2014) states that:

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

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

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Inclusions & Exclusions from Turnover

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

Inclusions (Not to be deducted from Turnover)

1. Sale of scrap/ By product
2. Sales proceeds of shares, securities, debentures etc. held as stock in trade by the assessee.
3. Cash discount other than allowed in invoice
4. Commission on sales
5. If sales tax/ Excise duty 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 sales tax/ Excise duty was not included in sale price while accounting (Exclusive method), then the same shall not form part of Turnover.
2. Sale proceeds of Fixed Assets.
3. Sale proceeds of Investment property.
4. Sale proceeds of shares, securities, debentures held as an Investment.
5. Discounts allowed in the Invoice.
6. 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)

In case of 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.

In case of Shares, Securities & Derivatives

Speculative Transactions

Aggregate of both positive and negative differences arising from the difference between purchase and sale transactions should be considered as Turnover.

Derivatives/ Futures & Options

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In case of Derivative transactions difference between purchase and sale is settled. Following are considered while determining turnover:

- Total of favourable and unfavourable differences.
- Premium received on sale of options.
- Differences in case of reverse trades.

Delivery based transactions

Where the transaction for the purchase or sale of any commodity including stocks and shares is delivery based whether intended or by default, the total value of the sales is to be considered as turnover.

In agency business

Amount of commission earned by the agent and not the aggregate amount for which sales are effected or services are rendered.

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

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.

Inclusions (To be included):

1. Sale proceeds of scrap, wastage etc. if it is 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 fixed assets)
8. Profit on sale of import license
9. Foreign exchange fluctuations on export sales
10. Interest income (if it forms part of business income)
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. Gross receipts including lease rent in the business of operating lease
17. Hire charges of cold storage

Exclusions (Not to be included):

1. Sale proceeds of asset held as investment.
2. Interest income (if not included as business income)
3. Dividend income except in case of dealer in shares
4. Reimbursements of custom duty and other charges collected by clearing agent
5. Share of profit of a partner of a firm/LLP excluded from total income u/s10(2A)
6. Liabilities/ provisions of creditors, expenses or taxes written back
7. Rental income (if not included as business income)
8. Reimbursement of advertising charges by an advertising agent from the client

Gross Receipts in case of Profession

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

Re-imburement 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 *Ms. Diksha Plaha* in assisting me to compile this part of the series. Your suggestions and comments would be highly appreciated

Best Regards

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