

Overview of Tax Audit Taxation of LLP / Partnerships



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LEGISLATION W.E.F. AY 2017-18

S. 44AB

- Business - exceeds Rs. 1 Crore
- Profession - exceeds Rs. 50 L
- Business u/s 44AE /44BB /44BBB; income < deemed profits;
- Profession u/s 44ADA; deemed profit < 50% & TI > ANCT
- Business u/s 44AD (4)

Rule 6G

- Prescribing the Forms for Report u/s 44AB

Form 3CA

- Report in case of a person who is required to get his A/cs audited under any law

Form 3CB

- Report in any other case

Form 3CD

- Particulars as required u/F 3CA or 3CB

S. 271B

- Penalty $\frac{1}{2}\%$ maximum Rs. 1.50 L

APPLICABILITY OF 44AD(44ADA) / 44AB

Mr. A started Mfg – 1st Yr - Turnover – 150L;
NP – 8 L; TI - 8.50 L

- AD - No
- AB - Yes

Mr. B - Trading - Turnover – 90L; NP - 10L;
Doctor- Fee – 45 L; NP- 25 L; TI -32L

- AD – No
- ADA - Yes
- AB - No

M/s. XYZ – Trading Turnover – 80L - NP – 4 L;
TI- 3 L

- AD – No
- AB - No

Mr. D - Trading; Turnover -95L; Commission –
6 L; NP- 15L; TI - 14L

- AD - No
- AB - Yes

FORM 3CB

- × Total 5 Paras
- × Same as Form 3CA except examination of books
- × Opinion subject to observations / qualifications to be given:
 - + Financial Statements – 3(a)
 - + Form 3CD – 5
- × SA 700?

SA 700 – PARA 3

- × **Assessee's Responsibility for the Financial Statements and the Statement of Particulars in Form 3CD**
 1. The **assessee is responsible for the preparation and fair presentation of the financial statements** in accordance with the Accounting Standards issued by the ICAI, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
 2. In preparing the financial statements, management is responsible for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.
 3. Those charged with governance are responsible for overseeing the entity's financial reporting process.

SA 700 PARA 3

- ✘ **Tax Auditor's Responsibility**
- ✘ Our objectives are to **obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement**, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is **not a guarantee** that an audit conducted in accordance with SAs will always **detect a material misstatement** when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these FS

SA 700 PARA 3

- × **As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit.**
- × **We also:**
 - + **Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.**

SA 700 PARA 3

- + Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.**
- + Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.**
- + Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.**

SA 700 PARA 3

- + Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- ✘ We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- ✘ We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

SA 700 – PARA 5

- 2. The assessee is responsible for the preparation of the statement of particulars required to be furnished under section 44AB of the Income-tax Act, 1961 annexed herewith in Form No. 3CD read with Rule 6G(1)(b) of Income Tax Rules, 1962 that give true and correct particulars as per the provisions of the Income-tax Act, 1961 read with Rules, Notifications, circulars etc that are to be included in the Statement.**

SA 700 – PARA 5

- × We are also **responsible for verifying the statement of particulars required to be furnished under section 44AB** of the Income-tax Act, 1961 annexed herewith in Form No. 3CD read with Rule 6G (1) (b) of Income-tax Rules, 1962. We have **conducted my/our verification of the statement in accordance with Guidance Note on Tax Audit** under section 44AB of the Income-tax Act, 1961, issued by the Institute of Chartered Accountants of India.

LLP TAXABLE AS FIRM

The Finance (No. 2) Act 2009 provided for taxation of LLP on same lines as that of Partnership firms

Firm

"firm" shall include a Limited Liability Partnership as defined in the LLP Act, 2008

Partner

"partner" shall include,—
a partner of a LLP as defined in the LLP Act, 2008;

Partnership Firm

“partnership” shall include a Limited Liability Partnership as defined in the LLP Act, 2008 [Sec 2(23)]

LLP VS. FIRM

- ✘ ***Firm is a separate person under Income Tax Laws***

- ✘ ***Firm is not a legal person distinct from its partners***
 - ✘ ***Malabar Fishers co vs. CIT (1979) 120 ITR 49 (SC)***

- ✘ ***LLP is a legal person distinct from its partners (LLP Act, 2008)***

BASIC TAXATION ASPECTS

- ✘ LLP assessable as Firm (184)
- ✘ Residential Status of LLP (6)
- ✘ Tax Rates of LLP
- ✘ Dividend Distribution Tax (DDT)
- ✘ Presumptive Taxation u/s 44AD
- ✘ Presumptive Taxation u/s 44ADA
- ✘ Presumptive Taxation u/s 44AE
- ✘ Verification of return by DP (in absence of DP by any partner) (140)



ALTERNATIVE MINIMUM TAX (AMT)

- ✘ Where the regular income-tax payable is less than the AMT payable, the **adjusted total income** shall be deemed to be the total income for such previous year and it shall be liable to pay income-tax on such total income at the rate of **18.5%**. (IFSC 9% w.e.f. AY 2019-20)
- ✘ $ATI = TI + \text{deduction U/C VIA} - C \text{ (other than 80P)} + \text{deduction u/s 10AA} + 35AD$
- ✘ AMT credit for **15 years**.
- ✘ Form 29C – to be certified by CA

AMT VS. MAT

Relating to	MAT	AMT
Applicability	Companies	Other than Cos
Based On	Book Profit	Adjusted Total Income
Rate of Tax w.e.f. AY 2020-21	15% plus surcharge & Cesses	18.5% plus surcharge & Cess
LTCG on invest. u/s 54EC	MAT payable	AMT not payable
Indexation	Benefit not available	Benefit available
Depreciation effect	Applicable	Not Applicable
B/f or unabsorbed depreciation	Allowed whichever is less	Both allowed

PARTNER'S REMUNERATION

- ✘ **It should not be disallowed u/s 37(1)**
- ✘ **It should not be disallowed u/s 40(a)(i)**
- ✘ **Should be paid to a working partner**
- ✘ **It is related to period falling on or after the date of such LLP Agreement**
- ✘ **Should comply with conditions u/s 184**
- ✘ **It should be within limits of s. 40(b)(v)**
- ✘ **Applicability of section 40A(2)(b)??**
- ✘ **Deduction of remuneration even if not claimed??**

PARTNER'S REMUNERATION - 2

- ✘ Such remuneration is **authorised by** and is **in accordance with** LLP Agreement

- ✘ *Circular no. 739 dt. 25.3.1996*

- ✘ *Sood Brij & Associates vs. CIT [2011-ITRV-HC-DEL-247] - FC*

- ✘ *Durga Das Devki Nandan vs. ITO [2011-ITRV-HC-HP-067] - AC*

- ✘ *CIT vs. Asian Marketing [2012-ITRV-HC-RAJ-131] - F*

- ✘ *Sood Bhandari & Co vs. CBDT (2012) 204 Taxman (P&H) - FC*

- ✘ *CIT vs. Vaish Associates [2016-ITRV-HC-DEL-003] - F*

- ✘ *GRK Agencies vs. ITO (2019) 55 CCH 0646 AsrTrib - A*

- ✘ **What if HUF is partner through its Karta?**

- ✘ *P Gautam & co. vs. JCIT (2011) 14 Taxman.com 79 (Ahd) ITAT*

- ✘ **Mutually decided by partners - Out of 4 working partners, salary payable to only 3 partners whereas bonus payable to all 4.**

- ✘ *ID. MOHD. NIZAMUDDIN vs.ACIT(2014) 39 CCH 0439 JaipurTrib*

PARTNER'S INTEREST

- ✘ It should not be disallowed u/s 37(1)
- ✘ It should not be disallowed u/s 36(1)(iii)
- ✘ It should not be disallowed u/s 40(a)(i)
- ✘ It should not be disallowed u/s 40(b) i.e.:
 - + Such interest is authorised by and is in accordance with LLP Agreement
 - + It is related to period falling on or after the date of such LLP Agreement
 - + It should be within limits specified in s. 40b(iv) which is currently 12% p.a. simple interest.
- ✘ LLP should comply with conditions u/s 184

PARTNER'S INTEREST - ?

- ✘ ABC & Co. has 1 property from which it receives rent, which is taxable u/h House property.
- ✘ Partner's Capital is used to acquire the property.
- ✘ Interest mentioned in P/D @ 12% was paid.
- ✘ Is the interest allowed u/s 40b?
- ✘ Is it allowed u/s 24(b)?
 - ✘ *Mata Vaishno Estates vs. ITO* [2011-TIOL-647-ITAT-DEL]
- ✘ Interest on revaluation of assets cr. to Partner A/c
 - ✘ *ACIT vs. Sant Shoe Store (2004) 88 ITD 524 (Chd)*
 - ✘ *ITO vs. Amar Garage (2004) 1 SOT 331 (Kol)*
- ✘ Depreciation not charged in books, higher Interest on Partner's A/c
 - ✘ *Swaraj Enterprises vs. ITO (2011) 132 ITD 488 (Visakha) – F*
 - ✘ *Arthi Nursing Home vs. ITO (2008) 119 TTJ (Visakha) 415 - A*

PARTNER'S INTEREST - ?

- ✘ XYZ & Co. has tax free incomes.
- ✘ It pays interest to its partners Rs. 2 Lacs.
- ✘ S. 40(b) complied with.
- ✘ AO makes disallowance of interest u/s 14A of interest Rs. 0.50 Lacs
- ✘ How much interest would be taxable in hands of the partners?

✘ *Shankar Chemicals Works vs. DCIT (2011) 47 SOT 121 (Ahd)*

OTHER ISSUES

✘ Book Profit – how to be determined?

- ✘ *Md. Serajuddin & Brothers vs. CIT* [2012-ITRV-HC-KOL-171] - F
- ✘ *CIT vs. Allen Career Institute* (2018) 403 ITR 0375 (Raj) - A
- ✘ Unabsorbed dep. – *Vikas Oil Mill vs. ITO* (2005) 95 TTJ (JP) 1126

✘ Taxability of amounts received by partners of LLP

✘ Applicability of s. 14A on share of profit received

- ✘ *Vishnu Anant Mahanjan vs. ACIT* [2012-ITRV-ITAT-AHD-115]
- ✘ *Hoshang D. Nanavati* [2011-ITRV-ITAT-MUM-082]

✘ Partner gives loan to firm in cash. S. 269SS?

- ✘ *CIT vs. M/s Muthoot Financiers* [2015-ITRV-HC-DEL-109]
- ✘ *CIT vs. V. Sivakumar* (2013) 354 ITR 9 (Mad)

✘ Contribution by partners to capital in cash > 2 L, Is 269ST applicable?

OTHER ISSUES - 2

- ✘ **Can a working partner earn remuneration from 2 Firms?**
 - ✘ *Yes - M/s sachi Sarees vs. ACIT (2019) 55 CCH 0553 KolTrib*
- ✘ **Survey in firm. Income surrendered. Can remuneration paid to partners from the surrendered income allowed u/s 40(b)?**
 - ✘ *Yes – Silver Place vs. DCIT (2018) 53 CCH 0300 PuneTrib*
- ✘ **Liability of partners for tax dues of LLP (167C)**
- ✘ **Applicability of Accounting Standards**
- ✘ **Carry forward and set off of losses**

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