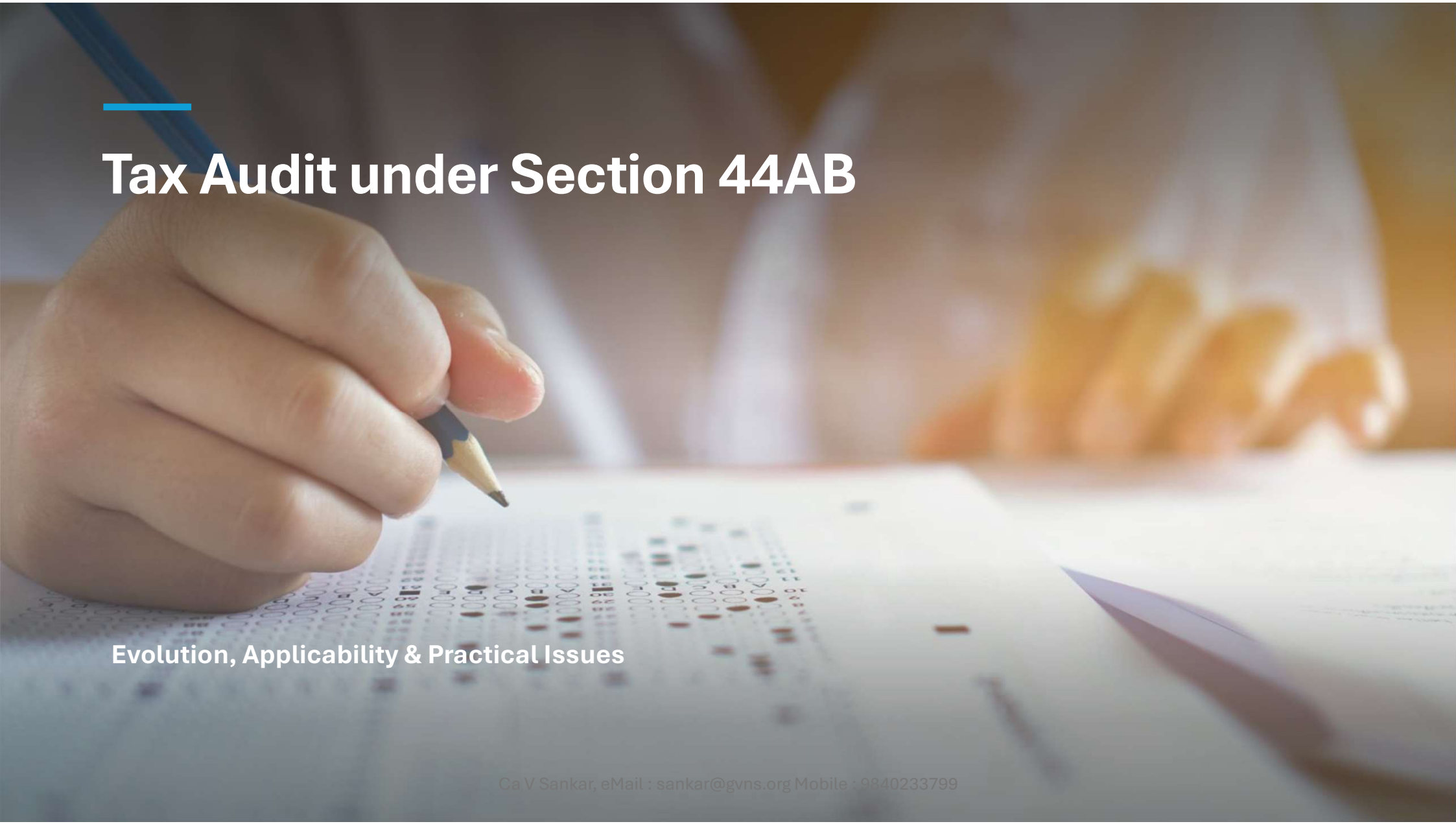


Tax Audit under Section 44AB

Evolution, Applicability & Practical Issues

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HISTORICAL BACKGROUND OF 44AB



INTRODUCED BY FINANCE ACT, 1984



EFFECTIVE AY 1985-86



ORIGINAL THRESHOLD: ₹40 LAKH (BUSINESS) & ₹10 LAKH (PROFESSION)



OBJECTIVE: PREVENT TAX EVASION & ENSURE ACCURATE REPORTING

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Relevant Sections

44AB: Tax Audit

44ADA: Presumptive taxation for professionals

44AD: Presumptive taxation for small businesses

44AE: Presumptive taxation for goods carriages

44AA: Books of accounts to be maintained

Interlinking of these provisions for applicability

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APPLICABILITY OF TAX AUDIT (AY 2025-26)



BUSINESS: TURNOVER > ₹1 CRORE (₹10 CRORE IF DIGITAL ≥95%)



PROFESSION: RECEIPTS > ₹50 LAKH



PRESUMPTIVE SCHEMES OPTED OUT – TAX AUDIT BECOMES MANDATORY



START-UPS/LLPS/COMPANIES – GENERAL APPLICABILITY

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Guidance Note on Tax Audit

ICAI issues Guidance Notes regularly

Latest Exposure Draft 2025: Covers practical clarifications for TAR filing【86832dtc-exp-draft-44ab.pdf】

ICAI website link: ICAI Guidance Note – Tax Audit

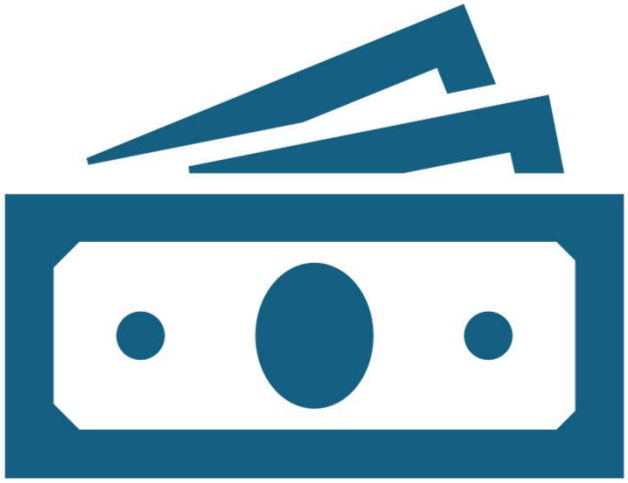
Clarifications on Clauses of Form 3CD



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Receent Notification

- INCOME-TAX (EIGHTH AMENDMENT) RULES, 2025 - AMENDMENT IN FORM NO. 3CD
- NOTIFICATION G.S.R. 207(E) [NO. 23/2025/F.NO. 370142/10/2025-TPL], DATED 28-3-2025
- Effective from 1st April, 2025



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Meaning of Sales, Turnover & Gross Receipts

Turnover = aggregate amount of sales effected or services rendered
(Para 5.4–5.7, pp. 14–15, ICAI GN)

Gross Receipts = all receipts from business/profession assessable under PGBP
(Para 5.13, p. 19, ICAI GN)

Inclusions: Commission, brokerage, scrap sales, lease rentals, insurance claims (except fixed assets), etc.
(Para 5.13, p. 19)

Exclusions: Sale proceeds of fixed assets/investments, rental income (unless business income), dividends, interest (unless business income), reimbursements
(Para 5.14, pp. 20–21)



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– Commission Agents & Petrol Bunk Dealers

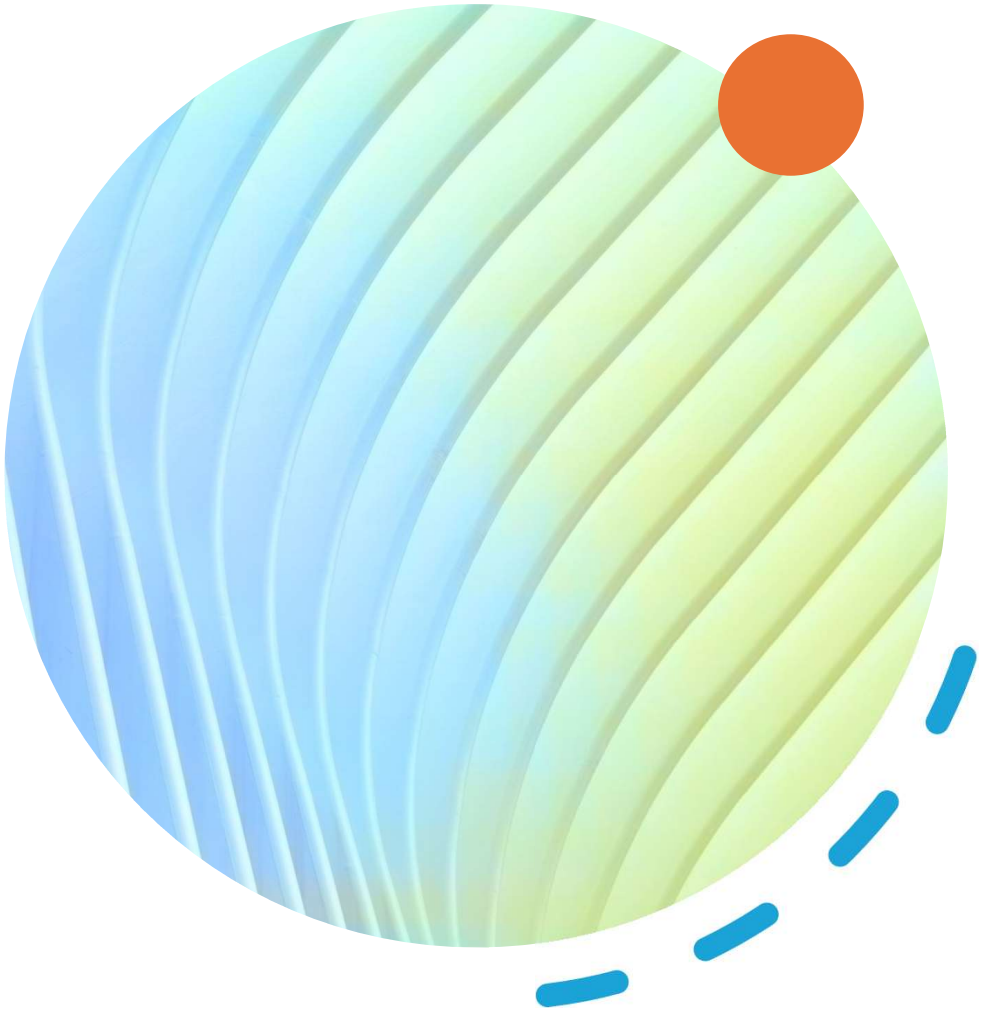
Principle *(Para 5.9–5.10, pp. 15–16, ICAI GN)*:

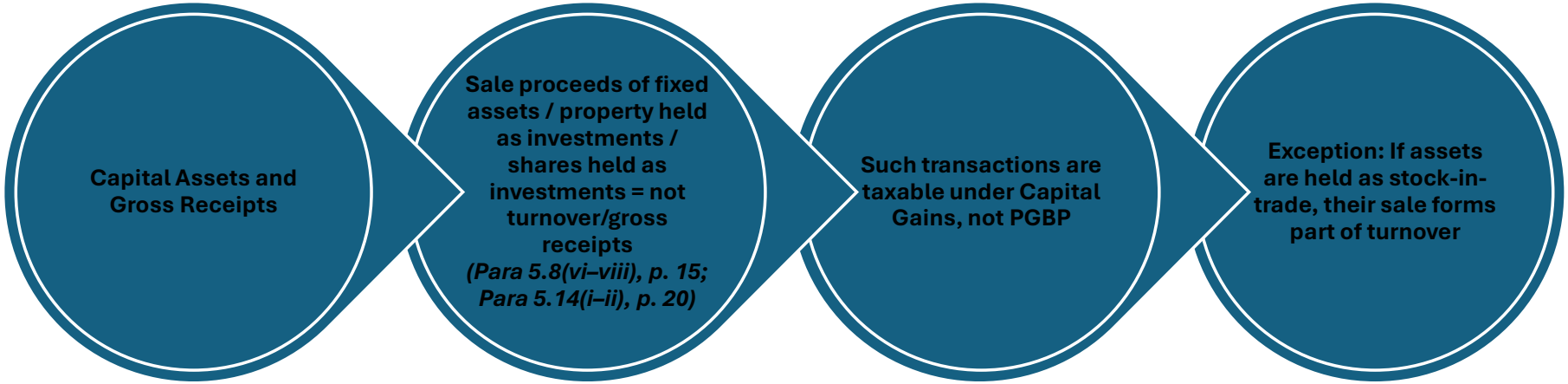
- If ownership/risk remains with principal → Only commission is turnover
- If ownership/risk passes to agent → Full sales value is turnover

CBDT Circular No. 452 (17.03.1986) supports this (Appendix IV, p. 382)

Petrol pumps:

- Commission/margin = turnover (when dealer acts as agent)
- Full sales = turnover (when dealer owns stock)




Capital Assets and Gross Receipts
Sale proceeds of fixed assets / property held as investments / shares held as investments = not turnover/gross receipts
(Para 5.8(vi–viii), p. 15; Para 5.14(i–ii), p. 20)
Such transactions are taxable under Capital Gains, not PGBP
Exception: If assets are held as stock-in-trade, their sale forms part of turnover



What are Form 3CA and 3CB?



Form 3CA: Audit report where accounts of the assessee are audited under any other law (e.g., Companies Act)



Form 3CB: Audit report where accounts are not audited under any other law



Both forms are accompanied by Form 3CD (Statement of particulars)



Applicable under Rule 6G of the Income-tax Rules, 1962

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Evolution of 3CA/3CB

Initially, only Form 3CA existed for company audits

Form 3CB introduced to cover entities not subject to statutory audits

Regular amendments made to align with new disclosures (3CD clauses)

Latest revision reflects inclusion of 43B(h) MSME payments, GST reconciliations, TDS disclosures

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- **ICAI Clarifications on 3CA/3CB**
- **Auditor must carefully select appropriate form depending on statutory audit requirement**
- **Form 3CA: Attach statutory audit report and audited financials**
- **Form 3CB: Auditor provides independent audit opinion on financial statements**
- **ICAI Guidance Note clarifies reporting responsibilities in both cases**

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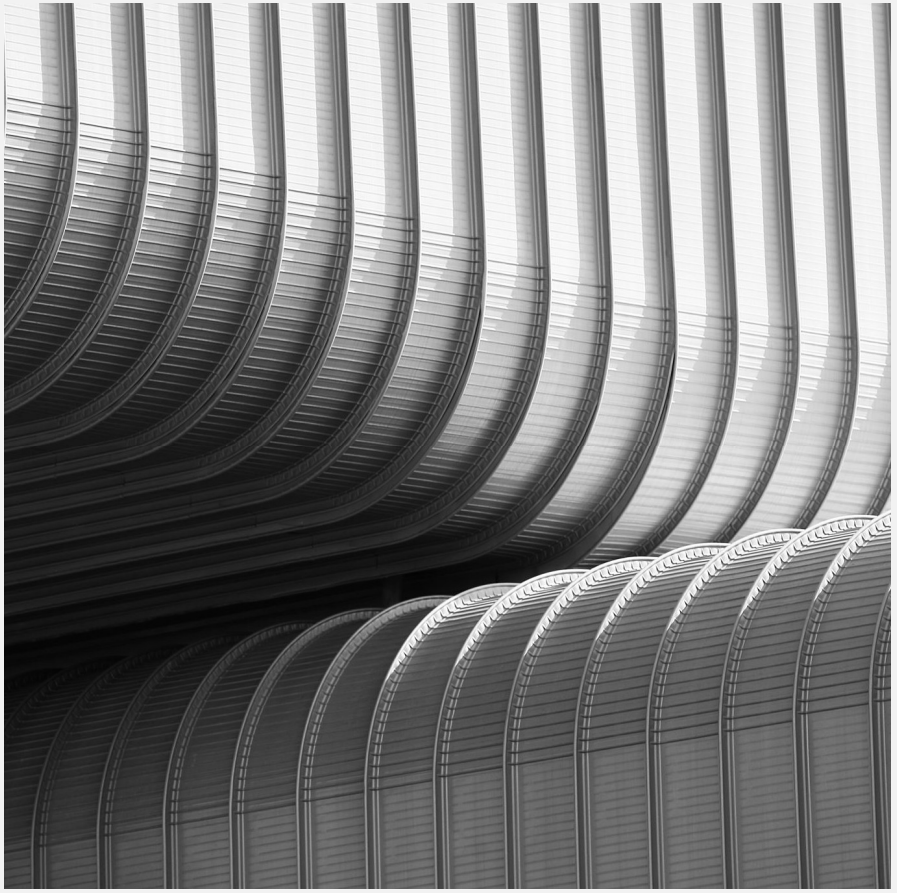
AY 2025-26: Key Focus Areas

Sec. 43B(h) MSME Payments – strict compliance

Reporting of disallowances under 43B clauses

Changes in reporting for TDS/TCS compliance (Clause 34)

Enhanced disclosures for GST reconciliations (Clause 44)



Section 43B(h) – MSME Payments

Introduced via Finance Act, 2023

Applies to Micro & Small Enterprises

Payment deadline: 15 days (as per contract) or 45 days (statutory maximum)

Non-compliance → Disallowance in same year (no relief till ROI date)

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Clause in Tax Audit Report

Clause 22 of Form 3CD – Disallowance under MSMED Act read with Sec. 43B(h)

Auditor’s duty: Report unpaid dues beyond permissible period

Special disclosure requirement different from other 43B clauses

Link: Form 3CD (Tax Audit Report) – Download

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Issues Identified by ICAI in Guidance Note

Ambiguity in determining MSME classification of creditors

Verification of written agreements for payment terms

Practical challenge: Identifying micro/small suppliers from large vendor lists

Suggestion: Obtain MRL + vendor confirmation for classification

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- **ICAI Clarifications on MSME Reporting**
- **Disclosure required even if payment made before ROI filing**
- **Reliance on MSME registration certificate/portal for verification**
- **Documentation essential for audit defence**
- **Auditor not expected to conduct external investigation beyond reasonable checks**

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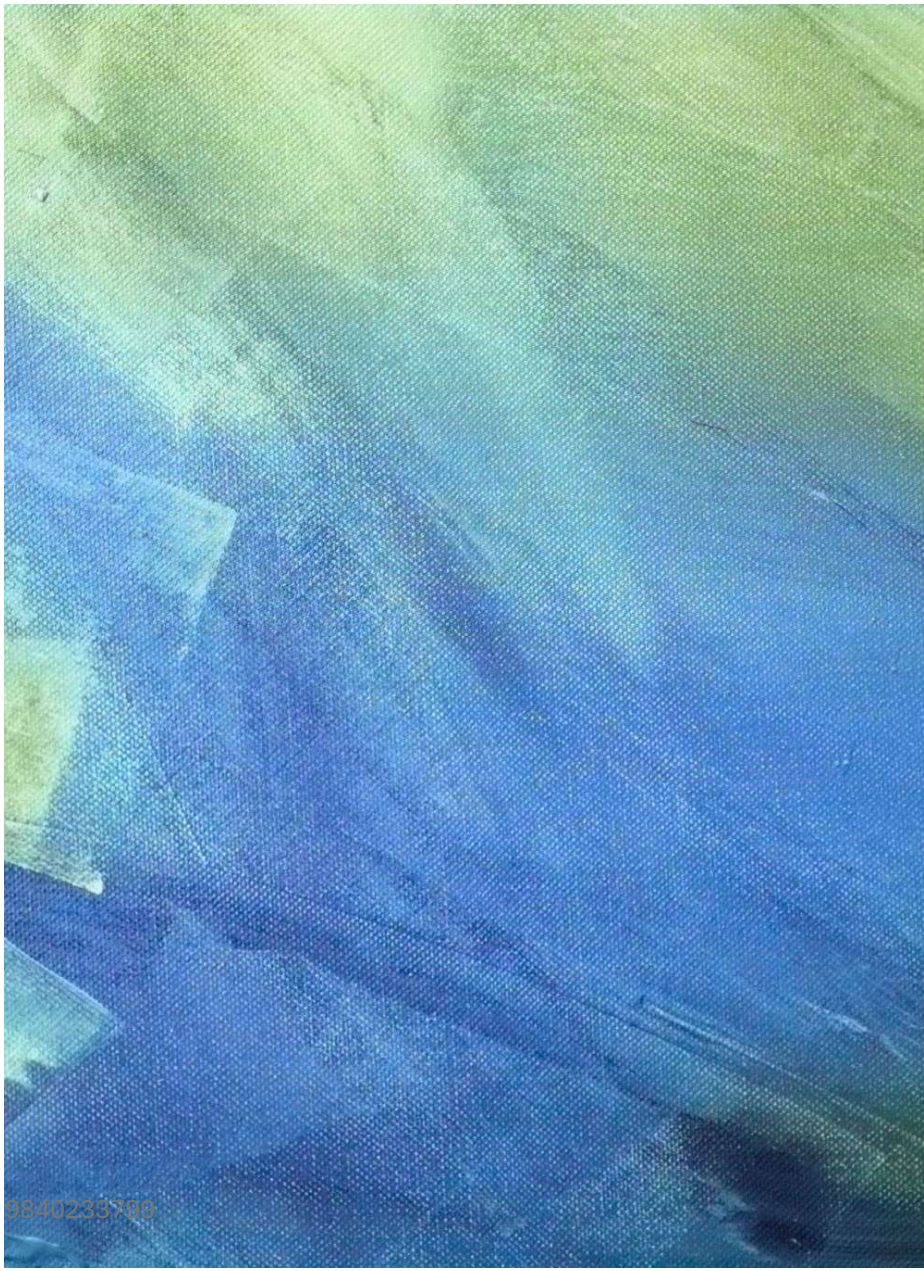


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Quality Review Board (QRB) Observations

Issues flagged in last 3 years:

- Non-reporting of disallowances u/s 43B & 40A
- Incorrect turnover computation
- Inadequate working papers
- Failure to report related party payments u/s 40A(2)(b)
- Lack of clarity in accounting method disclosure



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QRB – Suggestions for Improvement

- Strengthen audit documentation
- Clear mention of reliance on MRL
- Training on new reporting clauses
- Timely updation of audit checklists
- Ensure peer review compliance for tax audit engagements

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Revision of Tax Audit Reports

Allowed in following cases:

Clerical/mathematical errors

Retrospective amendments in law

CBDT/ICAI clarifications issued

Material misstatements detected post-filing

Must mention reason while revising TAR

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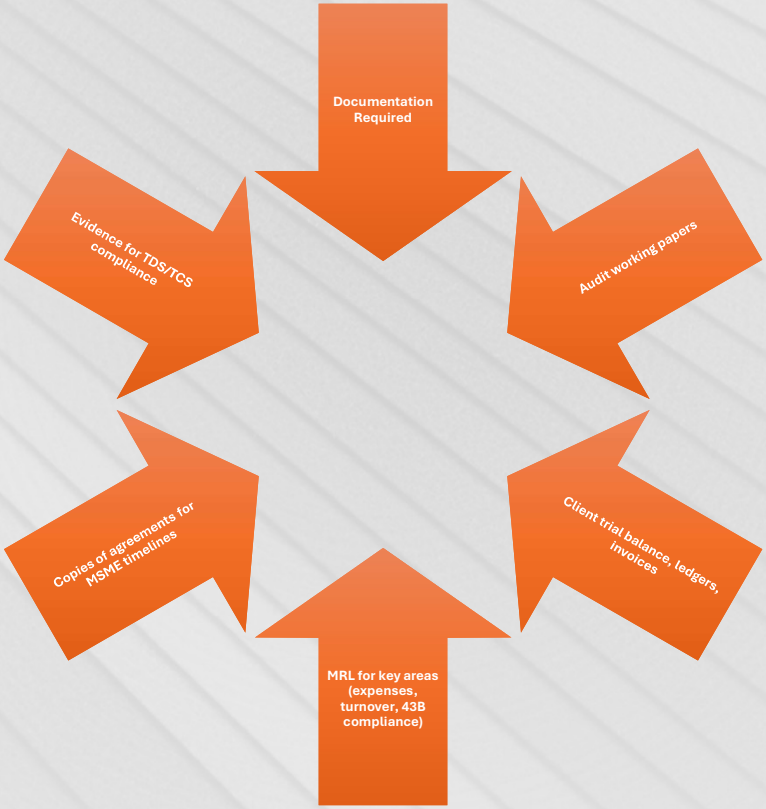
Peer Review Applicability

Mandatory for all CA firms conducting audits (including tax audit)

Ensures quality, compliance with ICAI standards

Benefits: strengthens credibility & reduces professional liability

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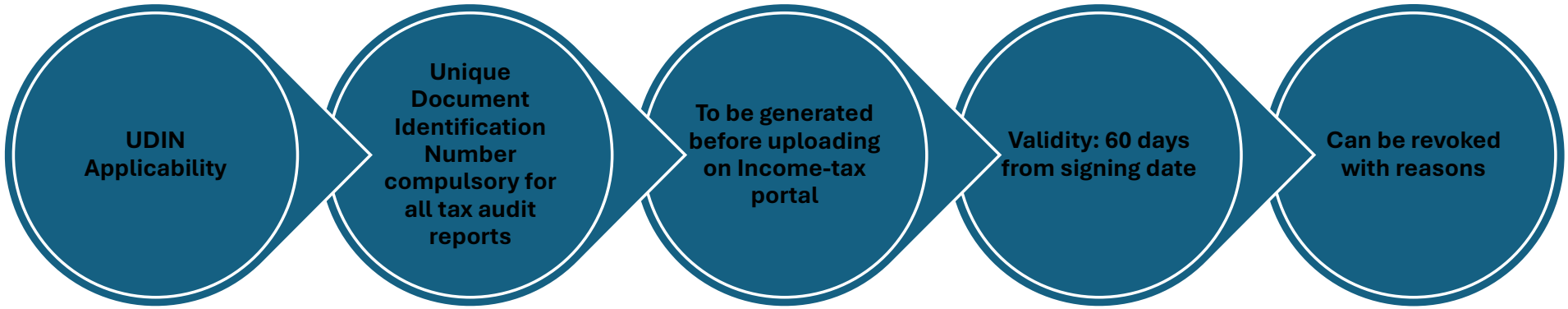
Management Representation Letter (MRL)

ICAI recommends MRL for:

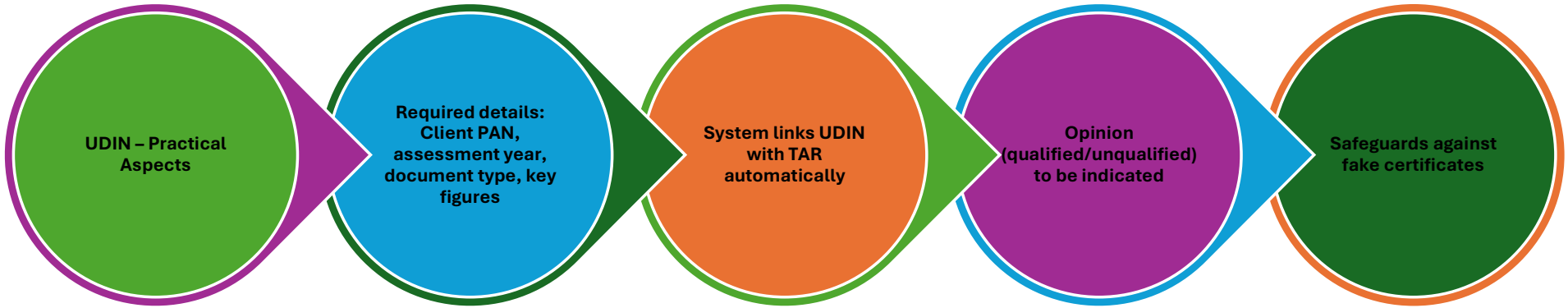
- Nature of business, turnover, accounting method
- MSME supplier classification
- Confirmation of PF/ESI/Bonus/Commission payments
- Related party disclosures

Protects auditor from future disputes

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– Adding CA in Income-tax Portal

Steps:

Client login → Authorised Representative → Add CA

Enter CA membership no. & PAN

Assign Form 3CA/3CB/3CD

CA accepts assignment

Implication: ensures digital linkage of audit responsibility

Case Study: MSME Payment Disallowance

TAR filed by 30 Sept 2025, ROI by 31 Oct 2025

Certain MSME dues paid in October

Department disallowed – reason: Sec. 43B(h) has no ROI relief

Lesson: Ensure timely payment within MSMED Act deadlines

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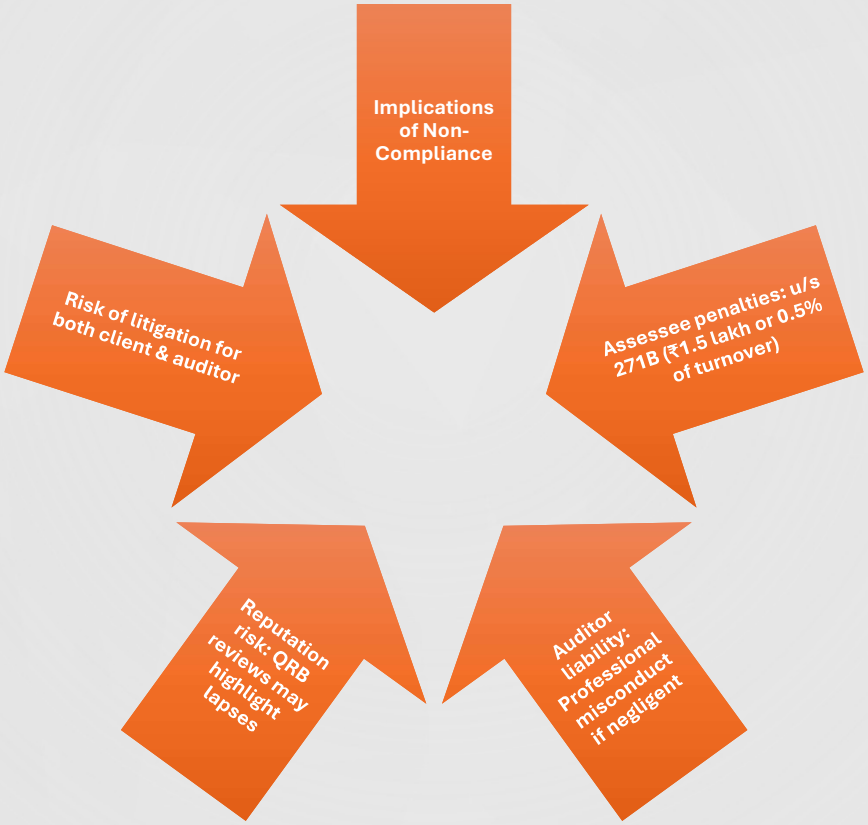
Issues in Current Practice

- Non-identification of MSMEs
- Over-reliance on client confirmations without audit evidence
- Wrong computation of turnover/receipts
- Late generation of UDIN
- Misclassification of expenses leading to reporting errors

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- Suggestions from ICAI Guidance Note
- Update audit checklists every year
- Use standardised MRL formats
- Train staff on new clauses (e.g., 43B(h))
- Integrate GST reconciliation with TAR review
- Review CBDT notifications periodically

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Notifications by Government

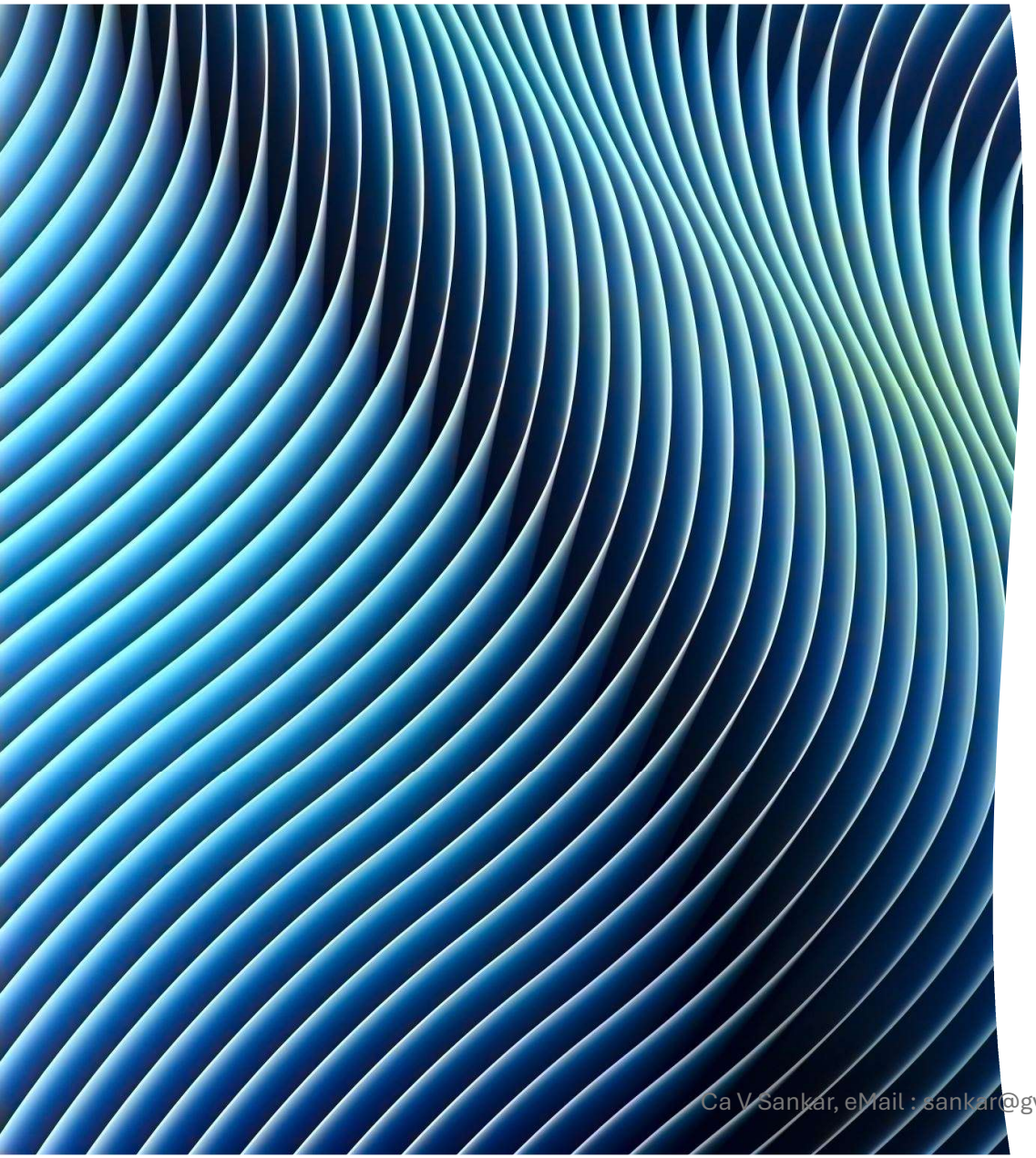
CBDT Circular No. 452 dated 17.03.1986 – initial guidance

Circular No. 4/2007 dated 15.06.2007 – clarification on turnover limits

Circular No. 6/2008 dated 24.09.2008 – revised TAR filing requirements

Finance Act 2025 amendments: Strengthened 43B compliance

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Practical Tips for Tax Auditors

Early engagement with client for data readiness

Maintain audit trail for all adjustments

Use software tools for clause-wise TAR review

Obtain third-party confirmations where possible

Cross-check consistency with GST returns & TDS statements

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Clause-wise Risk Areas (3CD)

Clause 13: Method of accounting

Clause 21(b): Sec. 40(a) – TDS disallowances

Clause 26: Sec. 43B – statutory payments

Clause 34: TDS/TCS compliance reporting

Clause 44: GST reconciliation

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- Recent Judicial Developments
- Case laws on method of accounting changes
- MSME payment disputes in tax litigation
- TDS mismatch cases leading to disallowances
- Implications of Supreme Court rulings on Sec. 43B

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Coordination with Clients

Educate clients about timelines for payments

Share audit checklists before year-end

Conduct pre-audit meetings

Stress importance of MSME classification & disclosures

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Future of Tax Audits

- Increasing digitisation & AI scrutiny by IT Dept.
- Greater integration with GST, MCA & TDS data
- Possible rationalisation of thresholds under new Income-tax Act, 2025
- Enhanced auditor responsibility

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Role of ICAI Direct Taxes Committee

Issues Guidance Notes & publications【Terms of Reference - Direct Taxes Committee.docx】

Conducts awareness & training for members

Represents issues before CBDT/MOF

Ensures members adhere to professional standards

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Key Takeaways

- Sec. 44AB has evolved to meet modern compliance needs
- AY 2025-26 critical focus: MSME payment reporting
- ICAI GN & QRB reviews are guiding tools
- Proper documentation, UDIN, peer review are non-negotiable
- CAs must balance compliance & professional responsibility

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- Thank You

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