

TAX AUDIT REPORT SERIES • FORM 3CD

Clauses 18 to 26

Reporting judgement, not just data entry

Why these nine clauses matter

- Clauses 18 to 26 are where the tax audit report stops describing the books and starts computing disallowances.
- Every clause in this block feeds a specific line of the ITR, or a specific adjustment the Assessing Officer can make without further enquiry.
- Departmental risk profiling now runs automated mismatch checks between 3CD figures and ITR schedules. A reporting error is no longer invisible.
- The auditor's real exposure is not the disallowance itself. It is Section 271J and the professional consequence of a wrong or evasive disclosure.



18 Depreciation

Particulars of depreciation allowable under the Income-tax Act, reported block-wise. Covers form fields, actual cost, the rate and put-to-use rules, and the goodwill adjustment under Rule 8AC.

Depreciation: what the form actually asks

- The clause requires depreciation allowable under the Income-tax Act, reported block-wise or asset-wise. This is not the same as depreciation under the Companies Act.
- The additions column requires sub-details: GST or CENVAT credit claimed, change in rate of foreign exchange, and subsidy, grant or reimbursement received.
- Separate depreciation numbers must be reconciled, and none of them will equal each other: book depreciation / Companies Act depreciation, and depreciation allowable under the Act.
- The block is a legal construct. Asset-wise fixed asset registers do not map to blocks without a separate mapping exercise.

REPORTED FIELDS

Description of block

Rate of depreciation

Opening actual cost or WDV

Adjustments to WDV

Additions and deductions with dates

Depreciation allowable

Closing WDV

The actual cost battleground

- **Section 43(1):** Actual cost includes the basic price plus all expenditure necessary to bring the asset to working condition, including freight, installation, erection and trial run costs.
- **Indirect taxes:** GST claimed as input credit is excluded from cost. GST not eligible for credit must be capitalised. The 3CD requires separate disclosure of this amount.
- **Section 43A:** Exchange rate difference on imported assets adjusts cost only on actual payment, not on mark-to-market restatement. The Ind AS position will not match the tax position.
- **Explanation 10:** Any subsidy, grant or reimbursement directly or indirectly attributable to an asset reduces the actual cost of that asset.
- **Borrowing cost:** The proviso to Section 36(1)(iii) capitalises interest for the period up to the date the asset is put to use. This links directly to Clause 21(i).
- Proviso to Section 43(1):** Any payment exceeding ₹10,000 to a person in a day, made otherwise than by banking channel or electronic mode, is permanently excluded from actual cost. No depreciation is ever allowable on that amount.

Rate, put-to-use, and the 180-day trap

- The rate is as per the New Appendix I to Rule 5, with a ceiling of 40 per cent from AY 2018-19. Anything above 40 per cent in the fixed asset register is a book rate, not a tax rate.
- The second proviso to Section 32(1) restricts depreciation to 50 per cent of the applicable rate only where the asset is both acquired and put to use in the same previous year for less than 180 days.
- A consequence often argued wrongly: an asset acquired in an earlier year and first put to use in the current year gets the full rate, not the half rate.
- Judicial support exists for allowing depreciation on passive or standby assets kept ready for use, but it is fact-dependent and needs documentation.
- Once inside the block, an individual asset not used during the year does not lose depreciation. The block concept, not asset-level use, governs.
- Depreciation is mandatory whether or not the assessee claims it (Explanation 5 to Section 32(1)). Additional depreciation under Section 32(1)(iia) is unavailable under the 115BAA, 115BAB or 115BAC regimes.

Goodwill and Rule 8AC

- The Finance Act 2021 removed goodwill of a business or profession from the definition of intangible assets with effect from AY 2021-22. Goodwill is no longer depreciable.
- Rule 8AC prescribes the computation for reducing the WDV of the intangible block where goodwill formed part of it and depreciation had been claimed previously. The 3CD carries a dedicated field for this adjustment.
- Where the reduction exceeds the block WDV, the excess is treated as a short-term capital gain. Verify that this amount has flowed to the capital gains schedule of the return.
- The 115BAA, 115BAC and 115BAD WDV adjustment fields are year-locked to AY 2020-21, 2021-22 and 2024-25. For the current year they are historical, but the carried-forward WDV they produced remains live.

Mostly dormant, with three live items

- Clause 19 requires a two-column presentation: the amount debited to the profit and loss account, and the amount admissible as per the provisions of the Act subject to fulfilment of prescribed conditions.
- The weighted deduction era is over. Most rates were reduced to 100 per cent, and several sections have sunset entirely.
- **Section 35D:** Amortisation of preliminary expenditure now requires the prescribed statement to be furnished electronically before the due date, under Rule 6ABBB.
- **Section 35DD:** Amalgamation or demerger expenditure is amortised at one-fifth over five years. It is commonly claimed fully in year one in the books.
- **Section 35DDA:** Voluntary retirement scheme payments, one-fifth over five years. The book charge is usually 100 per cent in the first year.
- **Section 35(2AB):** The deduction for in-house R&D is limited to the expenditure approved by DSIR in Form 3CL. The auditor reports what is admissible, not what was incurred.

Bonus or commission in place of dividend

- Reports any sum paid to an employee as bonus or commission for services rendered, where that sum was otherwise payable to the employee as profits or dividend, under Section 36(1)(ii).
- The target is closely held companies routing distributable profit to shareholder-directors as commission, in order to escape dividend tax and obtain a deduction at the company level.
- Questions to ask: Is the recipient a shareholder? Is the payment proportionate to shareholding rather than to services? Is it a year-end appropriation of profit? Is there a board resolution and a service rationale?
- An amendment to the Income-tax Act now allows this payment to be made up to the due date of filing the income tax return.

Employee contributions: the due-date trap

- Reports contributions received from employees for the funds referred to in Section 36(1)(va), read with Section 2(24)(x). Five columns, and every one is a factual assertion: nature of fund, sum received from employees, due date, actual amount paid, actual date of payment.
- The Supreme Court in *Checkmate Services* settled the question: the employee contribution must be deposited by the due date under the respective labour statute. Section 43B(b) does not rescue a late deposit.
- This is the single most common source of a large, indefensible disallowance in a small company audit.

KEY DISTINCTION

Employee share (Clause 20(b), Section 36(1)(va)): Must be deposited by the labour-statute due date. No year-end cure.

Employer share (Clause 26, Section 43B(b)): Payment by the Section 139(1) due date suffices.

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Amounts Not Deductible

Prohibited expenditure, TDS defaults, partner remuneration, cash payments, and the five sub-clauses everyone skips.

CLAUSE 21(A)

Expenditure prohibited by law: the wider net

- Reports amounts debited to the profit and loss account that are capital expenditure, personal expenditure, political party advertisement, penalties or fines for violation of law, and expenditure for a purpose that is an offence or is prohibited by law.
- Section 37 itself contains no provision disallowing club expenses.
- Explanation 3 to Section 37(1) expanded this to expressly cover expenditure that is an offence under a foreign law, any benefit or perquisite given in violation of a law governing the recipient's conduct, and compounding of an offence.
- The benefit-or-perquisite limb has the widest reach: freebies and sponsorships to persons governed by a professional code, and gifts routed through distributors.
- CSR expenditure is expressly denied as business expenditure under Explanation 2 to Section 37(1). It is claimable under Section 80G, except for contributions to the Swachh Bharat Kosh under Section 80G(2)(a)(iiihk) and the Clean Ganga Fund under Section 80G(2)(a)(iiihl).
- Distinguish compensatory payments from penal ones. Interest for delayed payment of a statutory due is compensatory and allowable. The penalty component is not.

TDS default: an asymmetric disallowance

- Section 40(a)(i) disallows 100 per cent of payments to non-residents where TDS was not deducted. Section 40(a)(ia) disallows 30 per cent of payments to residents. The asymmetry is the teaching point: a non-resident default costs the entire payment.
- Reporting requires payee-level detail including PAN.
- No disallowance arises where tax was deducted and paid on or before the Section 139(1) due date. Where tax was never deducted, the second proviso to 40(a)(ia) and the Form 26A route can save the deduction if the payee has offered the income.
- Recurring dispute areas include reimbursements versus payments for services, and cross-border software and cloud payments.
- Cross-check the 3CD figure against Clause 34 quarterly TDS statements and against the Form 26Q defaults on TRACES. This reconciliation is the first thing a scrutiny officer runs.

Partner remuneration and cash payments

- Clause 21(c) reports interest, salary, bonus, commission or remuneration inadmissible under Section 40(b) or 40(ba). The Finance Act 2024 revised the remuneration slabs, so the ceiling computation has changed.
- The related development is Section 194T, which requires TDS on payments of salary, remuneration, commission, bonus or interest by a firm to a partner. A firm that missed this deduction now faces a Section 40(a)(ia) issue on partner payments as well.
- Also check that the partnership deed authorises the payment and that interest does not exceed 12 per cent simple. An unauthorised payment is disallowed regardless of quantum.
- Clause 21(d) reports disallowance under Section 40A(3) and deemed income under 40A(3A) for cash payments above ₹10,000, or ₹35,000 for payments for plying, hiring or leasing goods carriages.
- Rule 6DD exceptions are narrow and have been progressively pruned. Treat any claimed exception as requiring documentation, not assertion.

The five sub-clauses nobody rehearses

- **21(e), Section 40A(7):** A provision for gratuity is disallowed unless it is a contribution to an approved gratuity fund or a provision for a sum actually payable in the year.
- **21(f), Section 40A(9):** Contributions to any fund, trust or institution other than as required by law or to a recognised or approved fund. Staff welfare trusts are the usual catch.
- **21(g):** Particulars of any liability of a contingent nature debited to the profit and loss account.
- **21(h), Section 14A:** Expenditure relatable to exempt income, with Rule 8D. Note the amendment providing that Section 14A applies even where no exempt income accrued during the year. Judicial reception of its retrospective application has been mixed.
- **21(i), proviso to Section 36(1)(iii):** Interest on capital borrowed for acquisition of an asset, for the period up to the date the asset is put to use, is capitalised and not deductible. This must tie back to the Clause 18 actual cost figure.

Sub-clauses 21(g) and 21(h) are the two most commonly reported as "Nil" without any actual work performed behind that disclosure.

MSME interest: non-deductible by design

- Reports the amount of interest inadmissible under Section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.
- Section 15 of the Act requires payment within the agreed period, capped at 45 days. Section 16 mandates compound interest at three times the RBI notified bank rate. Section 23 makes that interest non-deductible for income-tax purposes.
- Identify micro and small enterprise vendors through the Udyam registration certificate, vendor master flags, and the MSME declaration in the vendor onboarding file.
- Corroborate against MCA Form MSME-1, the half-yearly return of outstanding dues, and against the Schedule III MSME ageing disclosure. All three should reconcile.

No year-end cure for MSME principal

- Section 43B(h), applicable from AY 2024-25, disallows the principal amount payable to a micro or small enterprise where payment is not made within the time limit under Section 15 of the MSMED Act.
- Unlike every other limb of Section 43B, the proviso allowing deduction on payment before the Section 139(1) due date does not apply to clause (h). Payment after the 15 or 45 day window shifts the deduction to the year of actual payment. There is no year-end cure.
- Clause 26 of Form 3CD is worded by reference to clauses (a) to (g) of Section 43B. Clause (h) sits outside that enumeration, as does clause (da) for interest payable to specified NBFCs.
- Scope: the disallowance covers micro and small enterprises only. Medium enterprises are outside it. Udyam-registered traders are generally treated as outside the benefit of Section 15.

Payments to specified persons under Section 40A(2)(b)

- Reports particulars of payments made to persons specified under Section 40A(2)(b). The clause requires the name, PAN, relationship, nature of transaction and amount.
- The net includes relatives; in the case of a company, any director and any relative of a director; partners and members of an AOP or HUF and their relatives; and any person in whose business the assessee or a specified person has a substantial interest, being 20 per cent of voting power or profits.

REPORTED FIELDS

Name of the specified person

PAN

Relationship with the assessee

Nature of transaction

Payment made or benefit granted

Clawbacks and deemed profits

- **Clause 24:** Reports amounts deemed to be profits and gains under Sections 32AC, 32AD, 33AB, 33ABA and 33AC. The claim provisions have largely sunset, but the clawback survives. The live risk is a lock-in breach: an asset on which investment allowance was claimed in an earlier year, sold or transferred within the specified period, triggers deemed income now.
- **Clause 25:** Reports profit chargeable to tax under Section 41. The heads are: remission or cessation of a trading liability (41(1)), balancing charge (41(2)), sale of a scientific research asset (41(3)), recovery of a bad debt previously allowed (41(4)), and withdrawal from the Section 36(1)(viii) special reserve (41(4A)).
- Practical sources: write-back of long-outstanding creditors, unclaimed balances transferred to income, statutory liabilities reversed, and settlement of a trade payable at a discount.
- Waiver of a loan is a standing dispute. Waiver of a trading liability falls within Section 41(1). Waiver of a loan taken for acquiring a capital asset has been held not to be a remission of a trading liability, though the reasoning turns on the use of the borrowing.

Section 43B: two buckets, one due date

- Covers tax, duty, cess or fee; employer contribution to a provident or other fund; bonus or commission to employees; interest to public financial institutions or scheduled banks; leave encashment; and payments to Indian Railways.
- Employer PF under clause (b) is allowable if paid by the Section 139(1) due date. Contrast this sharply with the employee contribution under Section 36(1)(va), where the labour law due date is mandatory.
- Explanations 3C and 3D: conversion of an outstanding interest liability into a funded interest term loan or into shares is not payment. A restructuring does not create a deduction.

REPORTING STRUCTURE

BUCKET A · PAID Liabilities from prior years, paid this year	BUCKET A · UNPAID Liabilities from prior years, still outstanding
BUCKET B · PAID Liabilities this year, paid by 139(1) due date	BUCKET B · UNPAID Liabilities this year, not paid by due date

Where the form lags the statute

- Section 43B has grown. Clause (da) covers interest payable on a loan or borrowing from a deposit-taking NBFC or a systemically important non-deposit-taking NBFC. Clause (h) covers payments to micro and small enterprises.
- Clause 26 of the form is drafted by reference to clauses (a) to (g). Clause (h) sits outside that reference, and the reporting treatment needs to be established from the current e-filing utility rather than assumed.
- Unpaid NBFC interest at year end is a disallowance the ledger will not flag on its own.
- The effect of clause (h) reaches the current computation and the deferred tax working, not merely a disclosure. The form lagging the statute is not a defence for the auditor. Report the substance and use Clause 3 where the fields do not accommodate it.

Cross-clause consistency checks

- Clause 18 additions and Clause 21(i) capitalised interest must tell the same story about the same borrowing.
- Clause 20(b) employee contributions and Clause 26 employer contributions must not be confused in either direction.
- Clause 21(b) TDS disallowance must reconcile with Clause 34 quarterly TDS statements and Form 26Q defaults on TRACES.
- Clause 22 MSME interest and Section 43B(h) principal disallowance must both be tested against the same vendor-wise ageing and Udyam status data.
- Clause 26, Bucket A requires knowing what was disallowed in earlier years. Without a carry-forward schedule, it cannot be reported correctly.

Section 271J

A penalty of ₹10,000 for each report or certificate containing incorrect information. It attaches to the accountant, not to the assessee.

Thank You

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