



Direct Tax Committee of ICAI

Webinar on Clause 9 to 17 of the Tax Audit Report

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INTRODUCTION

Setting the Benchmark: Professional Audit Risk

Clauses 9 to 17 of Form 3CD represent the core bridge between financial accounting and statutory tax computation. The Taxation Audits Quality Review Board (TAQRB) of the ICAI has significantly increased scrutiny over tax audit reports.

Today's session goes beyond basic compliance to examine practical audit edge-cases, ICAI Guidance Note mandates, and landmark judicial rulings across Clauses 9–17.

WHY THIS MATTERS

- **SA 230**

Audit documentation must evidence every judgment call made under Clauses 9–17.

- **TAQRB Review**

ICAI's Quality Review Board actively scrutinises tax audit working papers.

- **CPC Scrutiny**

System-driven mismatches in these clauses trigger automated notices.

Clauses 9:

- a) If firm or Association of Persons, indicate names of partners/members and their profit sharing ratios.**
- b) If there is any change in the partners or members or in their profit sharing ratio since the last date of the preceding year, the particulars of such change.**

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CLAUSE 9 • TECHNICAL NUANCES

Partners, Members & Share Changes

- **Scope** Covers Partnership Firms, LLPs, Associations of Persons (AOPs), and Bodies of Individuals (BOIs).
- **Minor Admission** Minor admitted to profit benefits must be reported in 9(a). Since minors cannot bear losses, document how losses are reallocated among remaining partners.
- **Indeterminate Shares** For AOPs where profit shares are not fixed, select “Indeterminate” in the e-utility — this triggers the Section 167B maximum marginal rate.
- **Remuneration vs. PSR** Salary or interest restructuring that does not alter the underlying profit-sharing ratio does not trigger Clause 9(b).

Retrospective Partner Admission

SCENARIO

ABC & Co. admits a partner on 1 Jan 2026, via a deed executed in April 2026 with retrospective effect.

AUDIT ISSUE

Can a retrospective deed be relied upon for allocating profits to the new partner from 1 Jan 2026?

REPORTING & SOLUTION

- Under tax jurisprudence retrospective deeds are invalid for profit distribution.
- Report the actual execution date of the deed, not the stated retrospective date.
- Qualify the observation in Form 3CB accordingly.

Clauses 10:

- a) Nature of business or profession (if more than one business or profession is carried on during the previous year, nature of every business or profession)**
- b) If there is any change in the nature of business or profession, the particulars of such change.**

Nature of Business or Profession

- **Sector Code Accuracy**

Clause 10(a) requires the correct sector / sub-sector code reflecting each distinct business activity carried on during the year.

- **Temporary vs. Permanent Change**

Clause 10(b) distinguishes a temporary suspension of activity from a genuine, permanent segment closure.

- **Classification Impact**

Correct classification under Clause 10 determines the monetary thresholds applicable under Section 44AB.

Judicial Position on Business Continuity

CIT v. Maheshwari Enterprises (Madras HC)

Temporary stoppage of a production line due to raw material shortages does not constitute a “change in nature of business” under Clause 10(b).

Leasing of Idle Factory Space

SCENARIO

A manufacturing entity temporarily halts production on its main line due to supply chain disruptions, and leases out spare factory space for revenue.

AUDIT ISSUE

Does temporary disruption or short-term leasing constitute a “change in nature of business” under Clause 10(b)?

REPORTING & SOLUTION

- Temporary suspension does not amount to a change per ICAI Guidance.
- Leasing space is a distinct revenue stream — add the new sector code under Clause 10(a).
- Disclose the structural addition briefly in Clause 10(b) without treating it as a permanent change.

Discontinuation of Single Line of Business

SCENARIO

A manufacturing company operating two divisions—Textiles and Real Estate Construction—permanently shuts down its Textile division in August 2025 due to continuous losses.

AUDIT ISSUE

Is permanent closure of a single segment considered a reportable "change" under Clause 10(b)?

REPORTING & SOLUTION

- Yes. The permanent discontinuation of a business segment constitutes a structural change in the nature of business. Disclose the closure of the Textile segment explicitly under Clause 10(b).
- **Judicial Reference:** Contrast this with *CIT v. Maheshwari Enterprises (Madras HC)*, where *temporary* suspension was held as non-reportable.

03 **Clauses 11:**

- a) Whether books of account are prescribed under section 44AA, if yes, list of books so prescribed.**
- b) List of books of account maintained and the address at which the books of account are kept. (In case books of account are maintained in a computer system, mention the books of account generated by such computer system. If the books of accounts are not kept at one location, please furnish the addresses of locations along with the details of books of accounts maintained at each location.)**
- c) List of books of account and nature of relevant documents examined.**



Statutory Blueprint of Prescribed Books

SPECIFIED PROFESSIONS — RULE 6F

Criteria: Gross Receipts > ₹1.5 Lakhs in all 3 preceding years

- **Cash Book:** Daily record of all cash receipts/payments with absolute closing cash balances.
- **Journal & Ledger:** Structured log of transactions and systematic transaction classification.
- **Invoices & Vouchers:** Serialized copies of outgoing invoices (>₹25) and original expenditure vouchers (>₹50).
- **Medical Profession Mandate:** Daily Case Register (Form No. 25, replacing Form 3C) recording patient names, services, fees, plus an updated drug stock register.

NON-SPECIFIED PROFESSIONS & BUSINESS — SEC 44AA(2)

- **Threshold Matrix:** Total income > ₹2.5 Lakhs or turnover > ₹25 Lakhs for Individuals/HUFs (₹1.2L / ₹10L for other corporate/firm structures).
- **Presumptive Link:** Assessee's opting out of 44AD/44ADA within the lock-in period, with income above the basic exemption, must maintain books under 44AA(2). Books must be preserved for a minimum of 6 years.

SA 580 — Management Representations

Where books and records are held on cloud infrastructure and across multiple physical sites, the auditor must obtain a comprehensive Management Representation Letter (MRL) before forming an opinion.

- 1 Obtain a Management Representation Letter specifying all storage locations.
- 2 Record regional godown registers for physical stock documentation.
- 3 Capture SaaS user access logs supporting the software audit trail.

CASE LAW FOCUS

Ghai Construction v. State of Maharashtra (Bombay HC): Section 44AB requirements apply strictly to business/professional transactions — non-business records of a sole proprietor fall outside Clause 11.

CIT v. Market Committee, Sirsa (P&H HC): Where income is exempt under Section 10 with no assessable profit or loss, non-maintenance of prescribed books does not automatically invite a Section 271B penalty.

Clauses 12:

Whether the profit and loss account includes any profits and gains assessable on presumptive basis, if yes, indicate the amount and the relevant sections (44AD, 44ADA, 44AE, 44AF, 44B, 44BB, 44BBA, 44BBB, 44BBC Chapter XII-G, First Schedule or any other relevant section).

Presumptive Taxation Interplay

● Dual-Activity Entities

Applies where an entity runs both a Section 44ADA presumptive unit and a regular Business which can be covered under Section 44AD audited under Section 44AB side by side.

● 5-Year Lock-In Rule

Under Section 44AD(4), opting out of the presumptive scheme within the lock-in period forces a mandatory audit under Section 44AB(e). Except exit on account of turnover breach.

Architect with a Dual-Income Structure

SCENARIO

An architect declares presumptive income under Section 44ADA. A separate trading business exceeds ₹1 Crore turnover and undergoes a Section 44AB audit.

AUDIT ISSUE

How should the presumptive income from the professional practice be reflected alongside the audited trading business?

REPORTING & SOLUTION

- Mark “Yes” under Clause 12 to disclose the presumptive-scheme unit.
- State the net profit credited to the P&L account from the Section 44ADA unit.
- This prevents double-counting of the same income during CPC processing.

Opting out of Section 44AD within the 5-year- Lock- In

SCENARIO

An assessee declared income on a presumptive basis u/s 44AD for FY 2023–24 and FY 2024–25. For FY 2025–26, profits fell below 6% of turnover, forcing the assessee to opt out, maintain books, and undergo a tax audit u/s 44AB(e)

AUDIT ISSUE

How should Clause 12 be handled when the entity opts out of Section 44AD?

REPORTING & SOLUTION

- Select "No" under Clause 12 for the current year, as the P&L account does not include income assessed presumptively.
- Mention in the audit observation space (Form 3CB Clause 5) that the assessee has opted out of 44AD within the 5-year lock-in period, triggering audit requirements under Section 44AB(e).

Clauses 13:

- a) **Method of accounting employed in the previous year.**
- b) **Whether there had been any change in the method of accounting employed vis-a-vis the method employed in the immediately preceding previous year.**
- c) **If answer to (b) above is in the affirmative, give details of such change, and the effect thereof on the profit or loss.**

Serial number	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)

Clauses 13:

d) Whether any adjustment is required to be made to the profits or loss for complying with the provisions of income computation and disclosure standards notified under section 145(2).

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Clauses 13:

e) If answer to (d) above is in the affirmative, give details of such adjustments:

		Increase in profit (Rs.)	Decrease in profit (Rs.)	Net Effect (Rs.)
ICDS I	Accounting Policies			
ICDS II	Valuation of Inventories			
ICDS III	Construction Contracts			
CDS IV	Revenue Recognition			
CDS V	Tangible Fixed Assets			
ICDS VI	Changes in Foreign Exchange Rates			
ICDS VII	Governments Grants			
ICDS VIII	Securities			
ICDS IX	Borrowing Costs			
ICDS X	Provisions, Contingent Liabilities and Contingent Assets			

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Clauses 13:

f) Disclosure as per ICDS:

(i)	ICDS I-Accounting Policies	
(ii)	ICDS II-Valuation of Inventories	
(iii)	ICDS III-Construction Contracts	
(iv)	ICDS IV-Revenue Recognition	
(v)	ICDS V-Tangible Fixed Assets	
(vi)	ICDS VII-Governments Grants	
(vii)	ICDS IX Borrowing Costs	
(viii)	ICDS X-Provisions, Contingent Liabilities and contingent Assets".	

Accounting Methods & ICDS Disclosures (13a to 13f)

● Method Identification

Clause 13(a) requires clear identification of the mercantile or cash system of accounting followed by the assessee.

● ICDS Adjustments

Clause 13(e) captures every increase or decrease in profit arising from the ten notified Income Computation and Disclosure Standards.

● Mandatory Disclosures

Clause 13(f) requires the specific disclosures mandated under each applicable ICDS, including accounting policy summaries.

Major ICDS Adjustments

ICDS Standard	Subject	Key Tax Conflict	Form 3CD Reporting
ICDS I	Accounting Policies	Disallow financial MTM and expected loss provisions. Concept of prudence is restricted.	Upward Adjustment (+)
ICDS II	Valuation of Inventory	Restate inventory value at cost or market value (NRV) whichever is lower irrespective of the method employed by the assessee.	Upward / Downward (+/-)
ICDS III	Construction Contracts	Disallow expected contract losses early. Add unbilled revenue if progress exceeds the 25% POCM trigger.	Upward Adjustment (+)
ICDS IV	Revenue Recognition	Recompute long-term service contract revenue using POCM instead of straight-line methods.	Upward / Downward (+/-)
ICDS V	Tangible Fixed Assets	Any forex loss or gain arising from acquisition of fixed assets shall be appropriated to the said asset.	Upward / Downward (+/-)

Major ICDS Adjustments

ICDS Standard	Subject	Key Tax Conflict	Form 3CD Reporting
ICDS VI	Effects of Forex Changes	Recalculate branch translation differences using historical exchange rates (for non-integral branches.)	Upward / Downward (+/-)
ICDS VII	Government Grants	Accelerate taxability of deferred revenue grants immediately upon actual receipt if not tied to an asset.	Upward Adjustment (+)
ICDS VIII	Securities	Aggregate securities into class buckets instead of line-by-line financial valuation.	Upward / Downward (+/-)
ICDS IX	Borrowing Costs	Capitalize extended borrowing costs into the asset base until put to use; disallow financial interest expense.	Upward Adjustment (+)
ICDS X	Provisions & Contingencies	Disallow financial provisions that are beyond "reasonable certainty".	Upward Adjustment (+)

Mark-to-Market Losses on Forward Contracts

SCENARIO

An enterprise following the mercantile system recognises expected mark-to-market (MTM) losses on forward contracts in its financial books. Under ICDS I, expected/MTM losses are inadmissible unless specifically permitted by another ICDS.

AUDIT ISSUE

How should this book-to-tax difference be reported under Clauses 13(e) and 13(f)?

REPORTING & SOLUTION

- Clause 13(a): Report the method of accounting as mercantile.
- Clause 13(e): Disclose an increase in profit for the disallowed expected/MTM loss under ICDS I.
- Clause 13(f): Provide the required ICDS disclosures, including accounting policy and contingent-loss treatment.

Judicial Guardrails on ICDS

Chamber of Tax Consultants v. Union of India (Delhi HC)

Settled that ICDS cannot override the provisions of the Income-tax Act or binding judicial precedents, including the concept of real income.

CIT v. Excel Industries Ltd. (SC)

Income accrues only when an enforceable right to receive arises — ICDS-based recognition must still align with the real-income principle.

CIT v. A. Krishnaswami Mudaliar (SC)

A foundational ruling distinguishing mercantile and cash accounting systems, establishing that the method chosen must reflect true income.

Clauses 14:

- a) Method of valuation of closing stock employed in the previous year.
- b) Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss, please furnish:

Serial number	Particulars	Increase in profit (Rs.)	Decrease in profit (Rs.)

Closing Stock & Section 145A Reconciliation

- **Financial Reporting Basis**

Financial statements typically use AS-2 / Ind AS 2 on an Exclusive Method basis, net of GST.

- **Statutory Tax Basis**

Section 145A mandates the Inclusive Method — incorporating taxes and unutilised GST input tax credit into stock valuation.

- **Reconciliation Requirement**

Clause 14(b) requires the auditor to present a full working reconciling the two bases for opening stock, purchases, sales and closing stock.

Inclusive vs. Exclusive Adjustment Mechanics (Sec 145A)

Inventory Element	Exclusive Method (₹)	GST Impact Modules (18%)	Sec 145A Inclusive Basis (₹)	Net Tax Impact
Opening Stock	1,000,000	+ 180,000	1,180,000	Reduces Profit
Purchases	5,000,000	+ 900,000	5,900,000	Reduces Profit
Sales Revenue	8,000,000	+ 1,440,000	9,440,000	Increases Profit
Closing Stock	2,000,000	+ 360,000	2,360,000	Increases Profit
Net Profit Impact	Consolidated Base	Mathematical Balance	Reconciled Balance	NIL (Revenue Neutral)

Key Technical Takeaway While individual components shift significantly, the net effect on taxable profit is completely neutral. Formal disclosure in Clause 14(b) remains mandatory to prevent electronic schema errors.

Judicial Position on Stock Valuation

Chainrup Sampatram v. CIT (SC)

Anticipated profits cannot be taxed, but anticipated losses — recognised via lower of cost or market value — may be reflected in stock valuation.

CIT v. British Paints India Ltd. (SC)

The valuation method chosen by the assessee must reflect correct profits; an incorrect method cannot be justified merely on grounds of consistency.

Clauses 15:

Give the following particulars of the capital asset converted into stock-in-trade:

- a) Description of capital asset;**
- b) Date of acquisition;**
- c) Cost of acquisition;**
- d) Amount at which the asset is converted into stock-in-trade.**

Capital Asset Converted into Stock-in-Trade

Reporting under Clause 15 follows a strict timing rule: it is required in the year of conversion, whereas the resulting capital gains tax liability under Section 45(2) arises only in the year of actual sale. The following procedures support this disclosure.

1

Inspect valuation reports issued by Registered Valuers to establish Fair Market Value (FMV) as on the conversion date.

2

Verify the Board Resolutions and/or Deeds that formally effect the conversion.

TIMING DISCONNECT

Form 3CD reporting is triggered by the act of conversion itself.

Section 45(2) tax liability is triggered separately — only when the converted stock is actually sold.

Both events must be tracked independently across assessment years.

Land Converted to Stock-in-Trade

SCENARIO

An assessee converts land purchased in 2015 (cost: ₹30 Lakhs) into stock-in-trade for a real estate project on 10 May 2025. Fair Market Value on that date is ₹2.5 Crores. No sale occurs during FY 2025–26.

AUDIT ISSUE

Must this conversion be reported in Clause 15 for FY 2025–26, even though the Section 45(2) tax liability has not yet arisen?

REPORTING & SOLUTION

- Yes — reporting in Clause 15 is mandatory in the year of conversion.
- This holds irrespective of when the tax liability actually arises under Section 45(2).
- Case law reference: CIT v. Groz-Beckert Saboo Ltd. (SC) — conversion of a capital asset into business stock triggers a change in asset character.

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Clauses 16:

Amounts not credited to the profit and loss account, being,-:

- a) the items falling within the scope of section 28;**
- b) the proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned;**
- c) escalation claims accepted during the previous year;**
- d) any other item of income;**
- e) capital receipt, if any.**

Uncredited Receipts & the Auditor's Role

● Scope

Covers capital receipts, state subsidies, pro-forma credits, and export claims routed directly to reserves rather than the P&L account.

● Auditor's Role

The auditor discloses the receipt under Clause 16(e); the Assessing Officer separately evaluates taxability under Section 2(24)(xvi).

● Case Law — Ponni Sugars & Chemicals Ltd. (SC)

The purpose test governs whether a government grant is capital or revenue in nature, reinforcing the need for complete disclosure by the auditor.

Clauses 17:

Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, please furnish:

Details of property	Consideration received or accrued	Value adopted or assessed or assessable	Whether provisions of second proviso to subsection (1) of section 43CA or fourth proviso to clause (x) of subsection (2) of section 56 applicable? [Yes/No]

Sale of Land/Building Below Stamp Duty Value

SCENARIO

Property sold for ₹1.00 Crore. SDV on the registration date is ₹1.18 Crores; SDV on the agreement date is ₹1.08 Crores. An advance of ₹1 Lakh was received in cash/bearer cheque before the agreement.

AUDIT ISSUE

Which SDV applies, and does the variance exceed the permissible 10% safe-harbour tolerance band?

REPORTING & SOLUTION

- The agreement-date SDV benefit applies only where advance consideration is received via account payee cheque, bank draft, or electronic clearing on or before the agreement date.
- Since the advance here was paid in cash, the client loses the agreement-date SDV benefit.
- Disclose the registration-date SDV (₹1.18 Cr) against consideration (₹1.00 Cr) — the variance exceeds the 10% safe-harbour threshold and must be reported in Clause 17.

Key Takeaways for the Tax Auditor

Common threads running through Clauses 9–17

1

Don't rely on management alone

Cash ceilings (Clause 12), FMV on conversion (Clause 15) and stamp valuation (Clause 17) all call for independent verification, not certification.

2

Trace disclosures to source documents

Deeds, board minutes, Registrar filings and bank statements should back every particular reported under Clauses 9, 10 and 11.

3

Quantify, don't just tick boxes

ICDS impact (Clause 13) and the Section 145A reconciliation (Clause 14) require quantified adjustments, not a bare "Yes/No".

4

Read the year as a whole

Intra-year changes in PSR, business segments, or accounting method must all be captured — not just the position as on 31st March.

5

Cross-check against the ITR and Annual Report

Business codes (Clause 10) and figures reported elsewhere should be internally consistent across the audit file.

6

Anchor every clause in the Guidance Note

TAQRB review findings show recurring, avoidable errors — build them into the audit checklist for each engagement.

Documentation, Discussion & Closing Remarks

AUDIT DOCUMENTATION REMINDER — SA 230

Every entry in Clauses 9–17 must be backed by written management representations, valuer certificates, and clear reconciliation sheets.

“Thorough reporting in Form 3CD protects both the client from unexpected demand notices and the practitioner from TAQRB quality review actions.”

Thank you.



THANK YOU

M S V P & Associates.
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