EVIDENTIARY VALUE OF A TAX AUDIT REPORT IN INCOME TAX. SC VIEW IN DEVAS ANTRIX ON 17.1.2022.POINTS OF REFLECTION.

1.The issue:

An interesting issue arises from Devas judgment which has been a matter of some debate between the income tax department and the tax payer.It is regarding the attempted utilization of tax audit report in form 3CD by both sides to prove their contention.The recent decision by hon'ble SC in **DEVAS MULTIMEDIA PRIVATE LTD Versus ANTRIX CORPORATION LTD. & ANR. ON 17.1.2022 in CIVIL APPEAL NO.5766 of 2021** brings that in sharp focus.

2.A related issue:the books

Evidentiary value of books of accounts is a related controversy that seems more or less settled.In **TAPARIA TOOLS LTD.*v.*JCIT[2015] 372 ITR 605 (SC)it was ruled that**'' *It has been held repeatedly by this court that* ***entries in the books of account are not determinative or conclusive*** *and the matter is to be examined on the touchstone of the provisions contained in the Act (See Kedarnath Jute Manufacturing Co. Ltd. v. CIT[1971]* 82 ITR 363 *(SC) ; Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT[1997]* 227 ITR 172 *(SC) ; Sutlej Cotton Mills Ltd. v. CIT[1979]* 116 ITR 1 *(SC). and United Commercial Bank v. CIT[1999]* 240 ITR 355 *(SC); [1999] 8 SCC 338.''*

In my view they definitely do carry persuasive value though they may not have defining probative value.I am fortified in my view by s 34 of the Evidence Act:

34.Entries in books of accounts, including those maintained in an electronic form, regularly kept in course of business, are relevant whenever they refer to a matter into which the Court has to inquire but such statements shall not alone be sufficient evidence to charge any person with liability.

In connection with the Income Tax Act this shall need to be read with s 292C:

[**Presumption as to assets, books of account, etc.**

IT ACT S.292C. [(1)] Where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 [or survey under section 133A], it may, in any proceeding under this Act, be presumed—

(*i*) that such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;

(*ii*) that the contents of such books of account and other documents are true; and

(*iii*) that the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.]

It can be argued that this section is only in regard to search and survey proceeding.However by principle of parity of reasoning I would be inclined to have the view that books voluntarily produced would have ,if not status of being ‘’true”,then definitely status of (rebuttable) evidence with strong persuasive value .If corroborative evidence is present then I would be inclined to elevate it to status of evidence with probative value, with the

converse being equally true.More on this in the concluding part of this article.

3.Audit requirements under IT Act 1961:

Multiple sections in IT Act require a TAR/certification from a CA.A full fledged audit report is required under s 44AA,exemption applications require it like s 10(23C),12AA,33AB,33ABA,35D,as also 44ADA,115VW etc.

We focus on TAR as referred in s 44AB specifically for that is the bone of contention.

4.A historical view on evidentiary value of a TAR through lens of judicial rulings:

I.ACIT *v.*Rushabh Vatika* [2014] 149 ITD 46 (Rajkot - Trib.)

17. Section 145(1) provides that the income chargeable under sections 28 and 56 of the I-T Act shall, subject to the provisions of Section 145(2), be computed in accordance with cash or mercantile system of accounting regularly employed by the assessee. Section 145(2) empowers the Central Government to notify accounting standards to be followed by any class of assessees or in respect of any class of income. Section 145(3) empowers the AO to discard the books of account if he is not satisfied about their correctness or completeness or where the method of accounting provided in section 145(1) or accounting standards as notified under section 145(2) have not been regularly followed by the assessee. It is therefore clear that, **barring the cases covered by section 145(3), the books of account maintained by an assessee are binding on the AO and will therefore form the basis for computation of income subject, of course, to statutory allowances/disallowances. Same logic applies to the assessee. He is bound by the entries made in his books unless he can show that they are incorrect.** The aforesaid view is duly supported by the judgment of the **Hon'ble Supreme Court in *Pullangode Rubber Produce Co. Ltd.* v. *State of Kerala* [1973] 91 ITR 18**, in which a Bench of three Judges of the Hon'ble Supreme Court has held as under:

"It is no doubt true that the **entries in the account books of the assessee amount to an admission that the amount in question was laid out or expended** for the cultivation, upkeep or maintenance of immature plants from which no agricultural income was derived during the previous year. An admission is an extremely important piece of evidence but it cannot be said that it is conclusive. It is open to the person who made the admission to show that it is incorrect."

18. In *CIT* v. *Amitbhai Gunvantbhai* [1981] 129 ITR 573 (Guj.), the Hon'ble jurisdictional High Court has held that **the basic principle is the same in law relating to income-tax as well as in civil law, namely, if there is no challenge to the transaction represented by the entries, then it is not open to the Revenue or other side to contend that what is shown by the entries is not the real state of affairs.**

19. It therefore follows that when a return is furnished and accounts are put in, in support of that return, the accounts should be taken as the basis for assessment and that an assessee cannot discard his own profit & loss account and balance sheet and more particularly the Audit Report in Form No.3CB signed by a Chartered Accountant in terms of section 44AB of the Income-tax Act. Section 44AB has been inserted in the Income-tax Act with effect from 1.4.1985 to provide for audit of accounts in cases specified therein. Rule 6G(1)(b) and (2) of the Income-tax Rules provides that the report of audit of the accounts of a person required to be furnished u/s 44AB shall be in Form No.3CB and the particulars which are required to be furnished u/s 44AB shall be in Form No.3CD. Perusal of Report of Audit in Form No.3CB shows that the Tax Auditor is required to certify that the balance sheet and the profit & loss account/income & expenditure account are in agreement with the books of account maintained by the assessee and also that the profit & loss account/income & expenditure account give a true and fair view of the profit/loss or surplus/deficit of the assessee for the relevant year. In pursuance of the aforesaid statutory requirements, the assessee-firm filed Audit Report in Form No.3CB accompanied by "Statement of particulars required to be furnished u/s 44AB" in Form No.3CD, before the AO. **A Tax Auditor is required not only by professional ethics but also by law (i.e., the legislative scheme of section 44AB) to be impartial and objective in his reporting. Apart from being an expert in accounting, audit, tax and financial matters, a Chartered Accountant in his role as Tax Auditor is also trusted by the Legislature and that is why he has been assigned the role of a Tax Auditor under several provisions of the I-T Act. The accounts audited by him have very high evidentiary value. His report cannot be lightly ignored. It is binding on the AO except in cases falling u/s 145(3) as also on the assessee. His Audit Report cannot be discarded by an assessee at his convenience.**

In order to deprive the Audit Report of its high evidentiary value, the assessee must establish that the Report given by the Tax Auditor is incorrect. Unless an assessee proves that the Audit Report given by a Tax Auditor u/s 44AB is incorrect, he cannot discard it. The assessee was therefore under a very heavy burden to establish that its accounts, which have been duly audited and certified by the auditors to be correct, were, in fact, incorrect and that the audit report given by the Tax Auditor was also incorrect. In the case before us, the assessee has led no evidence either before the AO or the ld. CIT(A) to prove that the profit & loss account the correctness of which has been certified by the Tax Auditor is factually incorrect or does not correctly record the details of sales/receipts/turnover and expenses. And therefore the net profit shown in the audited profit & loss account and certified by the Tax Auditor to be correct cannot be ignored.

20. Apparent state of affairs shown in the profit & loss account would have to be treated as real unless the contrary is proved. It is reiterated too often by the courts/tribunals that the onus to prove that the apparent is not real is on the party who claims it to be so.

II.Gurudev Singh *v.*ACIT [2017] 188 TTJ 44 (Cuttack - Trib.)(UO)

10. When the return of income has been filed with supporting account and **audit report in Form No. 3CB duly signed by the chartered accountant, the audited profit and loss account cannot be ignored and the Assessing Officer/Commissioner of Income-tax (Appeals) are not permissible to proceed to disallow the expenses on the basis of the artificial estimation only self-estimation** of the Assessing Officer/Commissioner of Income-tax to disallow the expenditure claimed by the assessee is not sustainable in the eyes of law **particularly when the audited books account and the balance-sheet have not been rejected by the Assessing Officer so the addition on the basis of estimation is not permissible on the flimsy ground that some of the bills and vouchers were handmade and most of the payments were made in cash** particularly when all these documents have been duly audited and have not been disputed by the Assessing Officer.

III. ITO *v.*Sir Kikabhai Premchand Trust [2010] 42 SOT 403 (Mum)

4. The Assessing Officer noticed that in the form of return of income, the assessee has not filed Audit Report in Form No. 10B with the return of income. In para 39, *i.e.*, "List of documents/statements attached" of the first page of the return of income, in front of para 39(*b*), *i.e.*, Audit Report in Form No. 10B, it was stated as '-' According to the Assessing Officer in the absence of audit report in Form No. 10B, the assessee was not eligible for exemption under section 11 of the Act.

20……In this regard, we find that along with return of income, the assessee had filed report of auditor which was required to be given under the Bombay Public Trust Act, 1950. The said report of the auditor clearly mentions that the assessee maintain profit and loss accounts and also disclosed receipts and disbursement correctly. This report is dated 11-10-2006 and had been filed along with return of income. In these circumstances, we are of the view that the report in Form No. 10B, which is similar to the report under the Bombay Public Trust Act, 1950 would not have been obtained by the assessee. The plea of *bona fide* omission to file Form No. 10B along with return of income in our view deserves to be accepted.

A TANGENTIALLY CONTRA VIEW

IV.DCIT *v.* Sahara India Financial Corpn. Ltd. [2004] 2 SOT 733 (LUCK.)

16. It is true that the object of making appointment of auditors for special audit is to assist the Assessing Officer and the report of the special auditor is not binding upon the Assessing Officer, because if such a view is taken, then the statutory power conferred upon the Assessing Officer under sections 144 and 145 shall not be available to him and he shall be bound to make the assessment only on the basis of such a report alone. This is not the object of section 142(2A). The report of the DVO also cannot be equated with the report of the special auditor, because sub-clause (6) of section 16A of the Wealth-tax Act, 1957, provides that on receipt of the order under sub-section (3) or sub-section (5), from the valuation cell, the Assessing Officer shall, so far as the valuation of the asset in question is concerned, proceeds to complete the assessment in conformity with the estimate of the Valuation

Officer. It is to be pointed out that no such provision has been made in Income-tax Act, 1961, for making assessment in conformity with the special audit report.

17. The caption of section 142 and section 142(2A) is "Inquiry before assessment". This caption suggests that the Assessing Officer can make inquiry and for such an inquiry, he can, at any stage of the proceedings, direct the assessee to get the account audited by an accountant. The modalities of appointment of the auditor are set out in this provision. However, it is nowhere provided that such report shall be binding or the assessment shall be made in conformity with the special audit report. **Thus, so far as the evidentiary value of the audit report under section 142(2A) is concerned, we are unable to agree with the learned CIT(A) that the special audit report is binding upon the Assessing Officer, rather we agree with the contention of the CIT/Departmental Representative that the audit report is to be equated as an expert's report and has to be considered and appreciated like any expert's opinion *i.e.*, it may be accepted or rejected or partly accepted and partly rejected or may be considered alongwith the other material and thus it does not have the same binding effect as the report of DVO has, while estimating the value of any asset. It means the Assessing Officer is not bound to accept the report of the special auditor and the same has to be considered in the facts and in the circumstances of the case.** However, if there is no adverse material or adverse circumstances of sufficient and satisfactory reasons for rejecting or discarding such report, then such report has to be considered and relied upon, because the reference to special auditor is made after recording the satisfaction that there is complexity of the accounts, which necessitates the examination by the special auditor. Once such complexity of the accounts of the assessee is found by the Assessing Officer and further he is of the opinion that it is necessary to get the accounts audited by an accountant under section 142(2A), then the expert's view obtained through such special audit report has to be taken into account while deciding the relevant issues.

18. In the present case, as is mentioned by the learned CIT(A) also and as pointed out by us, the special auditor had brought to the notice of the concerned Departmental authorities about the difficulties faced by him and it was only when the Departmental authorities orally agreed for demonstrative report, that test check was done and the report was accordingly submitted on the basis of such test check.

19. The Assessing Officer received the report of the special audit on 25th February, 1999. He did not reject the report at this stage, nor examined the special auditor, nor issued any further directions to him. The Assessing Officer could have

remanded the matter to the special auditor with further directions. This course was also not adopted. In case report was not found satisfactory or did not furnish the required details, then the Assessing Officer was expected to grant further time to the special auditor and to issue further directions. In case, the report was not satisfactory then other special auditor could have been appointed under section 142(2A), such course is not barred. Under section 142(3), it is provided that the assessee shall be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry conducted under section (2) or any audit report under sub-section (2A) and proposed to be utilized for the purposes of the assessment. This provision is as under :

> "(2A) If, at any stage of the proceedings before him, the Assessing Officer, having regard to the nature and complexity of the accounts of the assessee and the interests of the Revenue, is of the opinion that it is necessary so to do, he may, with the previous approval of the Chief CIT or CIT, direct the assessee to get the accounts audited by the accountant, as defined in the *Explanation* below sub-section 2 of section 288, nominated by the Chief CIT or CIT in this behalf and to furnish a report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed and such other particulars as the Assessing Officer may require."

20. The intention of the legislature in granting opportunity of being heard to the assessee against the utilization of adverse reports against the assessee appears to be very clear. It also means that if the report favouring the assessee is not going to be accepted, then also the assessee should be provided the opportunity or further direction should be given to the assessee for obtaining and furnishing a complete and correct report. In the present case, the Assessing Officer neither rejected the report on its receipt nor asked the assessee to obtain a further report nor provided any opportunity to the assessee or to the auditor to meet out the defects. Since none of such courses were opted, **in our view, the Assessing Officer was not justified in discarding the report while passing assessment order by observing that the same was incomplete and was demonstrative only.** Although the Assessing Officer has mentioned in para 4.5 that the report is being utilized for the purpose of assessment wherever considered relevant and necessary. But on perusal of the assessment order, it is found that the report has not been considered for deciding any point; rather the report has been criticized, condemned and has been discarded. In view of these facts, the Assessing Officer was not justified in his approach while discarding the report of the special auditor in the manner in which he has done so.

21. It appears that the Assessing Officer has not appreciated the correct import of section 142(2A) and the intention of Legislature behind this provision. The procedure laid down for making reference to the special auditor indicates that it is only when complexity of accounts is found, that **an expert of accounts having specialized skill is appointed to examine the account books.** The special auditor is appointed by the Department. He works under the Department and is to be treated as its agent. He carries out the directions issued to him by the Department and remains under direct control and supervision of the Department. The Assessing Officer or the Departmental authorities can issue further directions and also remove the special auditor and can also appoint some other special auditor in place of the auditor appointed originally. Viewed in the context of the process of appointment etc. the principal *i.e.,* the Department is not justified in discarding report of special auditor unless there are justifying reasons.

It is also to be kept in mind that the expenses of special auditor are borne by the assessee. Hence, the financial burden cast upon the assessee should always be kept in mind.

22. In view of the above, we do not accord our approval to the approach of Assessing Officer and to the treatment given by him to the report of special auditor. However, on perusal of the order of the learned Commissioner (Appeals), it is found that the learned CIT(A) has also not gone by the report of the special auditor, although he has observed that the assessment order had to be framed in accordance with the observations of the special auditor. He has considered other evidence and other material while adjudicating various issues. **Although the learned CIT (Appeals) was not justified in holding that the special audit report was binding but in the context of the facts and circumstances of the present case, which have been narrated above, the report should have been duly considered alongwith other material. However, since neither the Assessing Officer has accepted the report nor the learned CIT(A) has placed absolute reliance on such report alone for deciding the various issues, the discussion remains only of academic interest. The grounds taken by the Department are, therefore, of no consequence.** In any case, we do not find substance in the grounds taken by the Department. Consequently these grounds stands rejected.

5.THE RULING IN DEVAS

In the above backdrop the ruling in Devas case(relevant part) is now ripe for our contemplation.

A.The issue in Devas case(culled from media reports):

In July 2003, Antrix entered into a memorandum of understanding with Forge Advisors LLC*, a Virginia, USA-based corporation, intended to make both parties become "strong and vital partners" in evaluating and implementing major new satellite applications across diverse sectors including agriculture, education, media and telecommunications.*

A year later, Forge Advisors made a presentation proposing an Indian joint venture, to launch what came to be known as 'DEVAS' (Digitally Enhanced Video and Audio Services) — a platform to deliver multimedia and information services via satellite to mobile devices.

The proposal indicated that the service conceived under Devas would be launched by the end of 2006. On 17 December 2004, Devas Multimedia Private Limited was incorporated as a private company, following which Antrix signed an agreement with it on 28 January, 2005. ***As part of the deal, Devas would develop a platform capable of delivering multimedia and information services via satellite and Antrix would provide the space segment for offering the services. For this, ISRO leased two communication satellites for 12 years at a cost of Rs 167 crore to Devas. These satellites were built at the cost of Rs 766 crore by ISRO.***

Pursuant to this deal, Devas obtained approvals from the Foreign Investment Promotion Board between May 2006 and September 2009 and brought into India an investment of around Rs 579 crore. But when the 2G controversy broke in 2011, Antrix, on 25 February 2011, terminated

the agreement ***on the ground of "force majeure" (unforeseen circumstances that prevent a party from fulfilling a contract).***

This termination led Devas to initiate commercial arbitration before the ICC arbitral tribunal. Independently, its Mauritius investors initiated a BIT arbitration under the India-Mauritius Bilateral Investment Treaty and German company Deutsche Telecom also invoked BIT arbitration proceedings under the India-Germany BIT.

In January 2021, Antrix made a request to the Ministry of Corporate Affairs to authorise it to file a winding up petition before the NCLT, which was accorded on 18 January.

A day later, on 19 January 2021, the NCLT appointed an official liquidator. By its 25 May order, NCLT directed winding up of Devas, which was upheld by NCLAT in September 2021, and now by the SC.

In its winding up petition, Antrix claimed that the persons in-charge of the formation as well as management of Devas did not possess the necessary technical knowhow or intellectual property rights of the services, either at the time of signing of the agreement or even till date.

It even alleged money laundering on the company's part, giving details of how foreign investment was siphoned to offshore accounts.

Devas in SC

In its appeal before SC, Devas claimed NCLT and NCLAT breached the mandatory requirement of advertisement before ordering the winding up. Furthermore, it claimed that Antrix was estopped (barred) from pleading fraud at a belated stage and that its petition was barred by limitation.

"The erroneous finding of fact was on account of application of incorrect standard of proof on the question of fraud and the hearing was in violation of the principles of natural justice since Devas was denied permission to cross-examine Antrix officials," the appeal stated.

In rebuttal, Antrix and the central government said that Devas was and is not equipped to provide the services for which it had entered into an agreement. There was manipulation of minutes of meetings and the nature of financial fraud was shocking, they added. Regarding the requirement of an advertisement, the Centre claimed it was not required when winding up is sought on the ground of fraud.

The SC found merit in the Centre's assertion on the issue of advertisement and further held Devas did not have any creditors or customers who would get prejudiced by NCLT's failure to order advertising of the winding up petition.

The court said that Devas was sought to be wound up not on the ground of its inability to pay, but fraud, adding that its shareholders were fully aware of this aspect as they had shown extreme urgency in enforcing the ICC arbitration and BIT arbitration awards.

On the point of limitation, SC rejected Devas's contention that Antrix should have filed its petition within three years of the date when fraud was discovered. This date, according to Devas, is 11 August 2016, when the CBI had registered its case. Therefore, the petition ought to have been filed on or before 10 August 2019, the company said.

The SC however held that the parameter regarding limitation was not applicable in this case where fraud is the basis for a winding up petition. The date of commencement of the limitation period may not be static, the court ruled.

Devas' argument that Antrix was estopped from pleading fraud because termination of the agreement between them was not triggered by this

allegation, but the force majeure clause, also did not hold ground. On this, the court said that Antrix cannot be expected to plead fraud in the arbitral proceedings even before discovery of fraud.

The court did not accept Devas' pleading that the auditors too did not point to fraud and said chartered accountants are not experts either in criminal law or in technology that formed the subject matter of agreement between the two companies.

Devas' plea that it was not given a chance to cross-examine Antrix officials was held as an unfounded ground to attack NCLT and NCLAT orders. Antrix, the court added, had asserted that Devas offered services that were non-existent. Therefore, it could not have led any evidence to show non-availability of those things, either by subjecting their officials to cross-examination by Devas or oral evidence. It was incumbent upon Devas to demonstrate the availability of the services it promised to offer.

The next ground of attack by Devas was that despite the winding up petition containing specific allegations of fraud against its shareholders, the NCLT did not hear them.

The SC dismissed this contention and found merit in Centre's arguments that Devas shareholders cannot be heard because they have ducked CBI summonses to avoid criminal prosecution in the case registered by the central probe agency.

"Taking advantage of their citizenship/residence abroad, these shareholders are prosecuting proceedings for the enforcement of ICC arbitral tribunal award and BIT award, even while making it impossible for CBI to serve summons on them for the past five years. It is not open to such persons to raise the bogey of failure to afford an opportunity," the court said.

Lastly, the court rejected Devas' claim that the dispute at hand was between two private entities. It said the agreement dealt with utilisation

*of government property and since the company has secured two arbitration awards against the government of India, the dispute cannot be brushed under the carpet as a "**private lis**" (**private suit**).*

It also turned down the argument that the CBI case is still pending and in case it ends in acquittal, the clock cannot be turned back if the company is wound up now. The court described the argument "attractive" at "first blush", but went on to add that it "cannot hold water, if scrutinised a little deeper". According to the court, the standard of proof required in a criminal case is different from the standard of proof required in NCLT proceedings.

Summing up its reasons to affirm NCLAT's finding, the SC said: "Allowing Devas and its shareholders to reap the benefits of their fraudulent action, may nevertheless send another wrong message namely that by adopting fraudulent means and by bringing into India an investment in a sum of Rs 579 crore, the investors can hope to get tens of thousands of crores of rupees, even after siphoning off Rs 488 crore."

B.The aspects of ruling germane to our issue:

DEVAS MULTIMEDIA PRIVATE LTD Versus ANTRIX CORPORATION LTD. & ANR. CIVIL APPEAL NO.5766 of 2021
WITH CIVIL APPEAL NO.5906 of 2021

JANUARY 17, 2022

EXTRACTS:
''9.10 The Chartered Accountants/Auditors are not experts either in Criminal Law or in the technology that formed the subject matter of the Agreement between Antrix and Devas. **The statement of Chartered Accountants**

are always qualified with certain riders such as "*according to the information and explanations given to us in the course of our audit*" or "*to the best of our knowledge and belief and according to the information and explanations given to us*".

9.12 If the auditors of a company fail to make a report in terms of Section 143(12), despite having knowledge about the fraud, they may become liable for penal consequences under Section 448 read with Section 447 of the Companies Act, 2013. But the failure of the auditors to make a report as required by Section 143(12) or as required by the order issued under Section 143(11), cannot operate as estoppel against the company. **The auditor's report can neither be taken as gospel truth nor act as estoppel against the company. The statement in the auditor's report, is as per the information given to them or as per the information culled out to the best of their ability.**

10.8 A party alleging the nonexistence of something, cannot be called upon to prove the nonexistence. It is the party who asserts the existence or who challenges the assertion of non existence, who is liable to prove the existence of the same.

10.9 In the case on hand, Antrix asserted that Devas offered services which were non existent, through a device which was not available and that even the so called intellectual property rights over the device were not available. Therefore, obviously Antrix cannot lead evidence to show the nonexistence or non availability of those things, either by oral evidence or by subjecting their officials to cross examination by Devas. Devas never produced before the Tribunals any device nor did they demonstrate the availability to Devas services."

This then is the issue.Per the hon'ble SC **"***The auditor's report can neither be taken as gospel truth nor act as estoppel against the company. The statement in the auditor's report, is as per the information given to them or as per the information culled out to the best of their ability.*"[PARA 9.12].And this is

because *''The statement of Chartered Accountants are always qualified with certain riders such as "according to the information and explanations given to us in the course of our audit" or "to the best of our knowledge and belief and according to the information and explanations given to us"[PARA 9.10]*

6.THE BASICS:

The best way probably to approach this is to do a root study as to where this all is coming from ,and add the perspective we are concerned about i.e.tax audit under Income Tax Act 1961.

What does a tax audit do?:introductory

6.1.A tax audit determines whether financial records and transactions are correctly recorded and accounted for. This, in turn, ensures that the records reflect the actual income of the taxpayer and that the claims for deductions made are accurate. There can theoretically be four types of audit reports:

a. unqualified view,

b. qualified view,

c. adverse view, and

d. disclaimer (of view).

6.2 An unqualified or "clean" opinion is the best type of report a business can get.

6.3 **Key point to understand is that this is an expert view/opinion at best**.If we consider the T A R under the IT Act, Rule 6G stipulates as under:

> **Report of audit of accounts to be furnished under section 44AB.**
>
> **6G. (1) The report of audit of the accounts of a person required to be furnished under section 44AB[1] shall,—**

(*a*) in the case of a person who carries on business or profession and who is required by or under any other law to get his accounts audited, **be in Form No. 3CA**;

(*b*) in the case of a person who carries on business or profession, but not being a person referred to in clause (*a*), **be in Form No. 3CB.**

(2) The particulars which are required to be furnished under section 44AB shall be in **Form No. 3CD.**]

[1a] [*(3) The report of audit furnished under this rule may be revised by the person by getting revised report of audit from an accountant, duly signed and verified by such accountant, and furnish it before the end of the relevant assessment year for which the report pertains, if there is payment by such person after furnishing of report under sub-rule (1) and (2) which necessitates recalculation of disallowance under section 40 or section 43B.*]

1a. Inserted by the Income-tax (Eighth Amendment) Rules, 2021, w.e.f. **1-4-2021.**

6.4 Form 3CA in IT Rules 1962,para 3 is vital:

.....

3. **In *my/our opinion and to the best of *my/our information and according to examination of books of account including other relevant documents and explanations given to *me/us, the particulars given in the said Form No.3 CD are true and correct subject to the following observations/qualifications, if any:**

a.

……

b.

……

c.

……

6.4.1 Form 3CB is more significant-

.....

2. *I/we **certify that the balance sheet and the *profit and loss/income and expenditure account are in agreement with the books of account** maintained at the head office at ……and ** ……branches.

3.(a)*I/we **report the following observations/comments/discrepancies/inconsistencies**; if any: ……

(b) Subject to above, -

(A) *I/we have obtained all the information and explanations which, **to the best of *my/our knowledge and belief,** were necessary for the purpose of the audit.

(B) **In *my/our opinion,** proper books of account have been kept by the head office and branches of the assessee **so far as appears** from*my/ our examination of the books.

(C**) In *my/our opinion and to the best of *my/our information and according to the explanations given to *me/us,** the said accounts, read with notes thereon, if any, **give a true and fair view** :-

(i) in the case of the balance sheet, of the state of the affairs of the assessee as at 31st March; and

(ii) in the case of the *profit and loss account/income and expenditure account of the *profit/loss or *surplus/deficit of the assessee for the year ended on that date.

4. The statement of particulars required to be furnished under section 44AB is annexed herewith in Form No.3CD.

5. In *my/our opinion and to the best of *my/our information and according to explanations given to *me/us, the particulars given in the said Form No.3 CD are true and correct subject to following observations/qualifications, if any:

a. .....

b. .....

c. .....

6.5.There are **vital qualifications as well as vital certifications** in the formats above.The qualifications,as we shall see were noted by the hon'ble SC In Devas case.

6.6 Let us club these:

The following are **qualifications/disclaimers** as per audit report categories referred above.

a. ''In *my/our opinion and to the best of *my/our information"

b. ''according to …… explanations given to *me/us "

c. ''subject to following observations/qualifications "

d. ''Subject to above, -"

e. ''to the best of *my/our knowledge and belief"

Certifications are of four types:

a. ''are true and correct"

b. ''true and fair view"

c. "I/we report the following observations/comments/discrepancies/inconsistencies"

d. ''certify that the balance sheet and the *profit and loss/income and expenditure account are in agreement with the books of account"

6.6.1 None are unqualified because they are preceded by and are to be read subject to what precedes it.A sort of ejusdem generis.

6.7 Accounting and auditing may sound similar but are different.**Accounting maintains the monetary records of the**

business/professional entity. Auditing evaluates the financial records and statements produced by accounting.

6.8 An audit is important as it **provides credibility to a set of financial statements and certifies that the accounts are true and fair/correct**. It can also help to improve an entity's internal controls and systems.

6.9 In US a tax audit is when the IRS(Internal Revenue Service) examines your tax return information to ensure all the reported data is correct.Its like the scrutiny assessment in India.There are **four kinds** of such tax audits in US: **field, correspondence, taxpayer compliance measurement program and office audit.**

7.Building on our understanding;bases of assessment-

7.1Where does this leave us?A vital clue is provided to us from a most unlikely place in the Income Tax Act.I would specially like the young entrants in practice to understand this carefully.For it's a lesson on the fact that legislature in drafting the Act never used the words superfluously and how judicial decisions enable our understanding the provisions of law.Too often I find superfluous reading leading to peripheral and superficial understanding specially by youngsters.This is a lesson in gravity .**It tells us that we need to have both,a wide perspective and a tunnel vision.We must know the big picture as well as the detail.For law and its interpretation is both-an art as well as a science.**

7.2 Income tax assessment is about ,well ,assessment of income and tax payable thereon.The key point,ref(supra) derives from s 143(3) of the Act of 1961.Let's look at it:

143(3) On the day specified in the notice issued under sub-section (2), or as soon afterwards as may be, **after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require** on specified points, and **after taking into account all relevant material which he has gathered**, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment:…..

7.2.1 The three key factors in above may be noted,specially the third-

1.such evidence as the assessee may produce

2.such other evidence as the Assessing Officer may require

3.all relevant material which he(AO) has gathered

So a tax assessment may has as its basis,not just evidence but also ''all relevant material".This is obviously in exclusion of ''evidence" referred in the same section.

7.2.2 Interestingly,the corresponding section in the **1922 Act** viz., 23(3) had a different mandate:

23(3) On the day specified in the notice issued under sub-section (2), or as soon afterwards as may be, the Income-tax Officer, after hearing such evidence as such person may produce and such other evidence as the Income-tax Officer may require, on specified points, shall, by an order in writing, assess the total income of the assessee) and determine the sum payable by him on the basis of such assessment.

No stipulation of ''material''.

7.2.3 The term is used as a noun here in 143(3).Not a verb.We hear and read the phrase''**material evidence**'':there the function of 'material' is that of a verb.It is ,in that sense, a description of **''the quality of evidence that possesses such substantial probative value as to establish the truth or falsity of a point in issue in a lawsuit.''**What we mean here ,as a noun is **''that tangible which affects the merits of a case''.**I would have preferred if instead of merely using the term ''material'',the phrase ''material fact'' would have been used.For that is what the impact of the word actually is.Understood in this sense a ''material fact is **a fact that a reasonable person would recognize as germane to a decision to be made''.**However in 143(3),probably what is meant is the use of the term in sense of **tangible materiality** e.g.a confirmatory letter,an expert's report,a bank statement etc .

7.3 Be that as it may,its clear that what can be considered legitimately by AO and used as a base in sustainable assessment is what may fall well short of being accorded the status of ''evidence''.This is where,in my opinion ,an audit report falls.But we need to make a distinction hitherto not made.An audit report obtained by assessee needs corroboration by independent ''material''to establish his claim .Mere fact that it is audited won't be sufficient by itself.Contrarily,if AO asks and is not given an independent corroboration ,he can proceed to make addition on account of non verifiability.He need not prove the negative.This draws from decisions culled above.It also draws from **s 103** of the Evidence Act itself: **The burden of proof as to any particular fact lies on that person who wishes the**

Court to believe in its existence, unless it is provided by any law that the proof of that fact shall lie on any particular person.

7.3.1 In addition,if the audit report contains a negative i.e. that certain expenses e.g. are of a personal nature then the AO can use that as 'material'and the burden of proving its not so is on the assessee.

7.4 I am fortified largely in my view by one of the most remarkable ,but regrettably largely unreferred judgment in the case of **ADDL CIT *v.* Jay Engineering Works Ltd[1978] 113 ITR 389 (DELHI).Key extracts are as under:**

*''While **the word "evidence" may recall the oral and documentary evidence** as may be admissible under the Indian Evidence Act**, the use of the word "material" shows that the Income-tax Officer not being a court can rely upon material which may not be strictly evidence admissible under the Indian Evidence Act for the purpose of making an order of assessment. Courts often take judicial notice of certain facts which need not be proved, while administrative and quasi-judicial authorities can take "official notice" of wider varieties of facts which need not be proved before them. Thus, not only in respect of the relevancy but also in respect of proof the material which can be taken into consideration by the Income-tax Officer and other authorities under the Act is far wider than the evidence which is strictly relevant and admissible under the Evidence Act.''***

7.4.1This decision was relied upon in Goodyear India Ltd.v.DCIT **[2019] 102 taxmann.com 300 (Delhi - Trib.)**wherein it was held that an audit report can be accepted '' **When the accounts of the taxpayer are duly audited by the statutory auditors and proves to be supported with documents……..''**

7.4.2In **Vikrant Dutt Chaudhary *v.* CIT** [2016] 389 ITR 411 (Punjab & Haryana)the decision of Jay was again quoted with approval.It was also

followed in Pricewaterhouse Coopers (P.) Ltd. *v.*ACIT [2020] 183 ITD 354 (Kolkata - Trib.)(PARA 20).

7.4.3 GOODYEAR INDIA LTD. vs. CIT(2000) 246 ITR 116(DEL) puts it beyond a pale of doubt:

"The other question which was highlighted is that once there was a tax audit under s. 44AB, the ITO should not insist upon for production of the records or vouchers or details. Such a broad proposition cannot be laid down. ***No doubt sanctity is to be attached to the audit report given by a qualified chartered accountant. Merely because an audit report is available there is no fetter on the power of the ITO to require the assessee to justify its claim with reference to records, materials and evidence.*** *Such a power is inherent in an AO in the scheme of the Act."[PARA 5].*

7.5 The issue is however not free from difficulty.There are contra views holding an audit report has high evidentiary value.Two decisions given earlier serve as illustrations (cited above in detail)- **Rushabh Vatika & Gurudev Singh(supra.Para 4).**

8.WHAT THEN IS THE ACCEPTABLE POSITION?

8.1 The aspect of ''material''occuring in s 143(3) and its judicial interpretation in Jay and its follow up decisions make it clear that an audit report forms a relevant consideration in determining an assessee's income.But it is niether the holy grail nor the gospel truth.It needs corroborative evidence to bind parties to it.

8.2 I am reminded of a celebrated judgment which is known for its view that a diary cannot be held to be a book of account.The decision in question is a three judge SC judgment: **CENTRAL BUREAU OF INVESTIGATION Vs. V.C. SHUKLA & ORS.** AIR 1998 SC 1406 dated 2.3.1998.

8.2.1 However ,in my humble opinion the decision should be a celebrated one for greater reasons.The decision is an authority on s 34 of the Evidence Act ref in para 2(supra).There is a school of thought which contends that s 34 of Evidence Act has no relevance vis-à-vis the IT Act.Well they can suit themselves .I can do no better than to refer to para 21 of **Sheraton Apparels *v.*ACIT [2002] 256 ITR 20 (Bombay) which utilizes the same .**For our purpose ,an auditor who audits u/s 44AB cannot have his report placed on a pedestal higher than the books he audits.Armed with this understanding ,lets have a brief fascinating journey provided by the judgment .

''15.....***Section 34*** ***of the Act reads as under:-***

" Entries in books of account when relevant - Entries in book of account, regularly kept in the course of business, are relevant whenever they refer to a matter into which the court has to inquire but such statements shall not alone be sufficient evidence to charge any person with liability."

16.From a plain reading of the Section it is manifest that to make an entry relevant thereunder it must be shown that it has been made in a book, that book is a book of account and that book of account has been regularly kept in the course of business. From the above Section it is also manifest that even if the above requirements are fulfilled and the entry becomes admissible as relevant evidence, still, the statement made therein shall not alone be sufficient evidence, to charge any person with liability. It is thus seen that while the first part of the section speaks of the relevancy of the entry as evidence, the second park speaks, in a negative way, of its evidentiary value for charging a person with a liability. It will, therefore, be necessary for us to first ascertain whether the entries in the documents, with which we are concerned, fulfil the requirements of the above section so as to be admissible in evidence and if this question is answered in the affirmative then only its probative value need be assessed.

17.'Book' ordinarily means a collection of sheets of paper or other material, blank, written, or printed, fastened or bound together so as to form a material whole. Loose sheets or scraps of paper cannot be termed as 'book' for they can be easily detached and replaced. In dealing with the work 'book' appearing in Section 34 in Mukundram vs. Dayaram [AIR 1914 Nagpur 44], a decision on which both sides have placed reliance, the Court observed:-

" In its ordinary sense it signifies a collection of sheets of paper bound together in a manner which cannot be disturbed or altered except by tearing apart. The binding is of a kind which is not intended to the moveable in the sense of being undone and put together again. A collection of papers in a portfolio, or clip, or strung together on a piece of twine which is intended to be untied at will, would not, in ordinary English, be called a book..... .....I think the term "book" in S. 34 aforesaid may properly' be taken to signify, ordinarily, a collection of sheets of paper bound together with the intention that such binding shall be permanent and the papers used collectively in one volume. It is easier however to say what is not a book for the purposes of S. 34, and I have no hesitation in holding that unbound sheets of paper in whatever quantity, though filled up with one continuous account, are not a book of account within the purview of S. 34."

We must observe that the aforesaid approach is in accord with good reasoning and we are in full agreement with it.....

23.It cannot be gainsaid that the words 'account', 'books of account', 'business' and 'regularly kept' appearing in Section 34 are of general import. necessarily, therefore, such words must receive a general construction unless there is something in the Act itself, such as the subject matter with which the Act is dealing, or the context in which the words are used, to show the intention of the legislature that they must be given a restrictive meaning.

24.Indubitably, the Act lays down the rules of evidence to be applied and followed in all judicial proceedings in or before any Court including some Courts - martial. Keep in view the purpose for which the Act was brought into the statute book and its sweep, the words appearing in Section 34 have got to be given their ordinary, natural and grammatical meaning, more so, when neither the context nor any principle of construction requires their restrictive meaning. While on this point we may refer to Section 209 of the Companies Act, 1956 which expressly lays down what 'books of account' to be maintained thereunder must contain and, therefore, the general meaning of the above words under the Act may not be applicable there.

.....

28.What is meant by the words 'regularly kept' in Section 34 came up for consideration before different high Courts; and we may profitable refer to some of those decisions cited at the Bar. In Ramchand Pitembhardar Vs. Emperor [19 Indian cases 534] it has been observed that the books are 'regularly kept in the corse of business' if they are kept in pursuance of some continuous and uniform practice in the current routine of the business of the particular person to whom they belong. In Kesheo Rao vs. Ganesh [AIR 1926 Nagpur 407] the court interpreted the above words as under:

" The regularity of which S.34 speaks cannot possibly mean that there is not mistake in the accounts, as that would make the section a dead letter; no accounts could be admitted in evidence till they had been proved to be absolutely correct, which is in itself an impossible task and also cannot be begun till they have been admitted in evidence. Regularly or systematically means that the accounts are kept according to a set of rules or a system, whether the accountant has followed the rules or system closely or not. Nor is there any thing in the section that says the system must be an elaborate or reliable one. Both those matters, the degree of excellence of the system and the closeness with which it has been followed, affect the weight of the evidence of an entry, not its admissibility. The roughest memoranda of accounts kept generally according to the most elementary system, though often departing from its, are admissible in evidence, but would of corse have no weight."

29.The view expressed by the Kerala High Court in Kunjamman Vs. Govinda Kurukkal [1960 kerala Law Times 184] in this regard is that the words 'regularly kept' do not necessarily mean kept in a technically correct manner for no particular set of rule or system of keeping accounts is prescribed under Section 34 of the Evidence Act and even memoranda of account kept by petty shopkeepers are admissible if they are authentic While dealing with the same question the Punjab & Haryana High Court observe in Hiralal Mahabir Pershad Vs. Mutsaddilal Jugal Kishore [(1967) 1 I. L. R P &: H 435] that the entries should not be a recital of past transactions but an account of transactions as they occur, of course, not necessarily to be made exactly at the time of occurrence and it is sufficient if they are made within a reasonable time when the memory could be considered recent.

30.In our considered opinion to ascertain whether a book of account has been regularly kept the nature of occupation is an eminent factor for weighment. The test of regularity of keeping accounts by a shopkeeper who has dally transactions cannot

be the same as that of a broker in real estates. Not only their systems of maintaining books of account will differ but also the yardstick of contemporaneity in making entries therein. We are, therefore, unable to subscribe to the view of Mr. Sibal that an entry must necessarily be made in the book of account at or about the time the related transaction takes place so as to enable the book to a pass the test of 'regularly kept'……..

33.The rationale behind admissibility of parties' books of account as evidence is that the regularity of habit, the difficulty of falsification and the fair certainty of ultimate detection give them in a sufficient degree a probability of trustworthiness (wigmore on evidence $ 1546). Since, however, an element of self interest and partisanship of the entrant to make a person - behind whose back and without whose knowledge the entry is made - liable cannot be ruled out the additional safeguard of insistence upon other independent evidence to fasten him with such liability, aha been provided for in Section 34 by incorporating the words such statements shall not alone be sufficient to charge any person with liability.

.....

38.A conspectus of the above decisions makes it evident that even correct and authentic entries in books of account cannot without independent evidence of their trustworthiness, fix a liability upon a person…….."

8.3 This then is how we can conclude.An auditor can ,at best, authenticate the entries.But independent evidence shall be required to fix liability based on those books on a person even if audited.But this ,importantly is about absolving of a third party.Its not self absolving.If X by virtue of his audit report and books wishes to fix liability on Y he shall need independent verification.But if a liability gets fastened on him by virtue of his own audit

report he has to get contrary evidence(**refer para 19,Rushabh Vatika,para 4 ,supra).**

8.3.1 This is where our basic understanding of s 34 of Evidence Act goes wrong.And we erroneously conclude that self certifications cannot apply to income tax.In my humble understanding we haven't read the section.VC Shukla case (supra) can be fruitfully referred to understand this in detail.The illustration under s 34 proves my point.Here is how it goes.

" Illustration

A sues B for Rs. 1,000, and shows entries in his account-books showing B to be indebted to him to this amount. The entries are relevant, but are not sufficient, without other evidence, to prove the debt."

8.4 Some other points are in order:

Ishwar Dass v. Sohan Lal, AIR 2000 SC 426. : Entries in account books regularly kept in the course of business are admissible though they by themselves cannot create any liability.

Dharam Chand Joshi v. Satya Narayan Bazaz, AIR 1993 Gau 35:Unbound sheets of paper are not books of account and cannot be relied upon.

Dharam Chand Joshi v. Satya Narayan Bazaz, AIR 1993 Gau 35.: Books of account **being only corroborative evidence** must be supported by other evidence.

8.4.1 The audit report no doubt strengthens the value-the corroborative value.And corroborative value only.

8.5 Even within form 3 CD the certifications ,qualifications et al by an auditor make for an interesting read."Cannot be commented upon because necessary evidence in this regard is not in possession of assessee","Stock reported as certified by partners" etc etc.It requires a conscious and careful

reading and then we can marvel at the brilliant observations made in Devas case(supra) by the hon'ble Apex court.But once the assessee signs the audit report the defence under Article 20(3) of the Constitution goes.

[Article 20(3): **'No person accused of an offence shall be compelled to be a witness against himself'**.[**OFFENCE**:S 2(38) of General Clauses Act: (38) "offence" shall mean **any act or omission made punishable by any law for the time being in. force].**

It can be argued also and further that this right is not available in civil proceedings anyway.

Section 114(h) of the Evidence Act too is an obstacle:

" (h) That if a man refuses to answer a question which he is not compelled to answer by law, the answer, if given, would be unfavourable to him."

8.6 Be that as it may,a book of account and even a TAR is largely an exparte statement of facts and cannot be given the status of evidence other than corroborative.On a lighter note even if an auditor is an accomplice we will do well to remind ourselves of s 114(b) again of the Evidence Act: ''**That an accomplice is unworthy of credit, unless he is corroborated in material particulars".**

8.7 But this argument ,even if taken seriously,needs to work both ways if it is to be applied fairly.But then life isn't fair.So the corroborative value story works only one way.

9. Devas has said the final word.And we can but comply with it,in all earnestness.

Anadi Varma