R. Mahesh & Associates
CHARTERED ACCOUNTANTS

INCOME TAX ACT, 1961

Closing the Books Under the Old Act

What FY 2025–26 Demands of Every Assessee — and the Demands That Follow

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Years the Income Tax Act, 1961 governed Indian taxation — now repealed	New Income Tax Act, 2025 came into force	Due date for ITR-6 (companies) — last return under old Act

THE TRANSITION CONTEXT

Why FY 2025–26 Demands Exceptional Attention at Book Closure

On 1 April 2026, the Income Tax Act, 1961 was repealed. The new Income Tax Act, 2025 now governs all taxation from FY 2026–27 onwards. But FY 2025–26 remains entirely governed by the old Act — and the ITR filed for AY 2026–27 will be processed, scrutinised, and assessed under a law that has ceased to exist for new transactions.

There is no grace for the transition. Every provision of the 1961 Act — its disallowances, deemed incomes, and documentation requirements — applies in full to FY 2025–26. A demand raised from an AY 2026–27 scrutiny may not be finally resolved until AY 2030–31 or later.

■ The Form 3CD / Form 26 Transition

Forms 3CA, 3CB, and 3CD are being merged into Form 26 from FY 2026–27. However, for AY 2026–27 (FY 2025–26), the old Form 3CD continues in its current 44-clause structure. The Tax Audit Report must be completed in full under the old Act — and every clause carries the same scrutiny risk it always has.

SECTION 01 — PART A

Closing the Books: What Must Be Done Before Filing

1. TDS Compliance — Section 40(a)(ia) and Section 40(a)(i)

This is the single largest source of disallowances. Any expenditure on which TDS was required but not deducted — or deducted but not deposited — is disallowed in full. Verify every vendor payment against the TDS ledger. Contractual payments, rent, professional fees, commission, interest, and royalties must all be cross-checked. Do not leave this for the AO to discover — ITBA automatically cross-references TDS returns with expenses declared in the P&L.

2. Section 43B — Deductions Only on Actual Payment

Section 43B disallows certain expenditures unless actually paid before the due date of the return. Critical items: taxes and cess, employer PF/ESI/gratuity contributions, bonus and commission, interest on financial institution borrowings, and — critically — payments due to MSME vendors under Section 43B(h). Reconcile all unpaid statutory liabilities, ensure all bonus payments have been made (not just provided), and audit the MSME status of trade creditors outstanding beyond the permitted period (15 days without agreement; 45 days with agreement).

3. Section 14A / Rule 8D — Disallowance for Exempt Income

Where a business earns exempt income, Section 14A disallows the expenses attributable to earning it, including a proportionate allocation of interest under Rule 8D. The AO can apply Rule 8D mechanically regardless of the assessee's own calculation. Prepare an investment schedule and demonstrate own-fund deployment before filing.

4. Section 36(1)(iii) — Interest on Capital Borrowed for Non-Business Use

Where borrowed funds have been used to give interest-free loans to related parties — subsidiaries, group companies, directors — the department attributes a portion of the borrowing cost to the interest-free advance. Maintain a clear fund-flow analysis showing that advances were made from own funds. Prepare this documentation at book closure, not after a notice arrives.

5. Deemed Dividend — Section 2(22)(e)

Payments by closely held companies to substantial shareholders (10%+ voting power) are treated as deemed dividend. This is frequently triggered in family-owned businesses where inter-company loans or director advances exist. Ensure all related-party loans carry proper documentation, business purpose, and market-rate interest terms.

6. Cash Payment Limits — Section 40A(3) and Section 269ST

Section 40A(3) disallows any business expenditure exceeding ■10,000 paid in cash to one party in one day (100% disallowance). Section 269ST prohibits cash receipts of ■2 lakh or more from one person. Run reports on all cash payments exceeding ■10,000 and cash receipts exceeding ■2 lakh. Violations under 40A(3) must be added back voluntarily in the return.

7. Depreciation — Rates, Block Continuity, and Scrapping

FY 2025–26 is the last year under the existing Income Tax depreciation table. Reconcile the asset register with the depreciation schedule; verify commissioning dates for all additions; remove scrapped or sold assets from the block; and claim additional depreciation under Section 32(1)(iia) for eligible manufacturing assets — one of the provisions that should be fully availed this year.

8. Carry Forward of Losses — Timely Return Filing

Business losses, speculative losses, and capital losses can be carried forward only if the return is filed on time. A return filed after the due date forfeits the right to carry forward most losses. For FY 2025–26, where businesses may have incurred capital losses on market corrections, the timing of the return is critical.

9. Deduction Claims — Documentation Before Filing

Section 80G donations (approval certificates required), Section 80JJAA (incremental employment — payroll data matching EPFO records), Section 80IC/10AA (registration certificates), and Section 35(1)(ii)/(iia) for research contributions all require documentary support before the return is filed. The certificate not obtained before filing cannot easily be produced after a notice.

10. MAT Computation — Section 115JB

If a company's tax liability under normal provisions is less than 15% of book profits, MAT applies. Book profit adjustments include: income-tax expense added back, provisions for doubtful debts not written off added back, deferred tax adjustments, and exempt income reductions. Prepare a detailed MAT computation from the audited P&L and track available MAT credit under Section 115JAA.

> *"Every provision of the Income Tax Act, 1961 applies in full to FY 2025–26. The Act's repeal from 1 April 2026 changes nothing about the obligations, disallowances, and liabilities that crystallised during the year."*

SECTION 02 — PART B

Demand Notices and Disallowances to Expect

Filing a return is the beginning of the assessment process. The department's processing infrastructure — combining ITBA, AIS, TDS data, and AI-driven risk scoring — examines every return filed for AY 2026–27 under the full force of the old Act.

Category 1 — Section 143(1)(a): Automated Prima Facie Adjustments

■ TDS Credit Mismatch — HIGH PROBABILITY

Where TDS credit claimed in the return (Schedule TDS) does not match Form 26AS / AIS, the system raises an automatic prima facie adjustment. Reconcile TDS credit claimed with Form 26AS before filing. Do not claim TDS not yet reflecting in Form 26AS — carry it forward.

■ AIS Income Discrepancy — HIGH PROBABILITY

Where AIS income (salary, interest, capital gains, rental income) is higher than what the return reports, Section 143(1)(a)(vi) allows the department to add the difference. Download and reconcile AIS before finalising the return. File corrections via the AIS feedback mechanism where entries are factually wrong.

■ MSME Outstanding Beyond Due Date — HIGH PROBABILITY

MSME payment dues outstanding beyond the statutory period are disallowable under Section 43B(h). The GSTN-linked MSME registry now allows the department to cross-check. Add back disallowable MSME dues voluntarily in the return to significantly reduce scrutiny risk.

Category 2 — Section 143(2): Scrutiny Assessment Risk Profiles

The following return profiles carry elevated CASS risk scoring for AY 2026–27:

Profile	CASS Risk Profile	Trigger
01	**Large Deductions vs Turnover**	Section 80 series or Section 10 exemptions disproportionately high vs gross receipts
02	**Sudden Turnover Spike/Drop**	Unexplained change from prior year — risk of suppression or inflated expenses
03	**High-Value Property Transactions**	Sale consideration below stamp duty value — Section 50C / 56(2)(x) scrutiny
04	**F&O; Losses vs Business Income**	F&O; turnover in return not matching broker-reported SFT data
05	**Transfer Pricing — Sec 92CE**	Cross-border related-party transactions — mismatch between Form 3CEB and return
06	**GST–ITR Turnover Mismatch**	Gross receipts in ITR materially lower than aggregate GSTR-1/3B turnover

Category 3 — Full Disallowance Risk Reference Table

Section	Disallowance / Demand Trigger	Risk	Preventive Action
Sec 40(a)(ia)	TDS not deducted or not paid to government by return due date	HIGH	Reconcile TDS register with expense ledger; pay pending TDS within time
Sec 43B(h)	MSME creditor balances outstanding beyond 15/45 days at year-end	HIGH	Audit vendor MSME status; add back disallowable dues voluntarily
Sec 43B (others)	PF/ESI contribution unpaid; bonus/gratuity accrued but not paid	HIGH	Clear all PF/ESI dues; obtain bonus payment challans before filing
Sec 14A / Rule 8D	Proportionate disallowance for expenses to earn exempt income	MED	Prepare investment schedule; demonstrate own-fund deployment
Sec 36(1)(iii)	Interest disallowance — borrowed funds re-lent interest-free	MED	Fund-flow showing advances from own capital; notional interest where applicable
Sec 2(22)(e)	Loans/advances to substantial shareholders — deemed dividend	MED	Market-rate interest on all director/shareholder loans; document business purpose
Sec 40A(3)	100% disallowance — cash payments exceeding ■10,000/day/party	MED	Run day-wise cash payment report; add back violations voluntarily
Sec 50C / 56(2)(x)	Property below stamp duty value — difference taxed as income	HIGH	Obtain DVO valuation where dispute exists; disclose both values separately
Sec 68/69	Unexplained cash credits/investments — source not explainable	HIGH	Maintain PAN + ITR confirmations from all creditors, lenders, share applicants
Sec 80JJAA	New employee deduction — headcount not matching EPFO records	LOW	Reconcile 80JJAA claim with EPFO ECR data; ensure new hire UANs are active
Sec 115JB	MAT liability computed incorrectly — book profit adjustments missed	MED	Prepare detailed MAT computation from audited P&L; with all Schedule III adjustments

The GST–ITR Cross-Check: A Key Enforcement Lever

The GSTN and ITBA systems now share data at the PAN level, comparing GSTR-1 turnover, GSTR-3B declared turnover, and gross receipts in the ITR. Prepare a formal reconciliation statement explaining differences between GST turnover and income tax gross receipts. Common differences: rental income (under house property in ITR), export income (zero-rated under GST), interest income (exempt from GST), and year-end invoicing timing differences. This document is the first thing any AO will ask for in a scrutiny.

SECTION 03

The Transition Risk Unique to This Year

Because the new Act came into force on 1 April 2026, there is a natural tendency to treat the old Act's provisions as less important. This is a dangerous assumption. The department will assess AY 2026–27 returns entirely under the old Act. Its appellate machinery — CIT(A), ITAT, High Courts — will adjudicate disputes under the old Act's provisions for years to come.

■ New Forms, Old Obligations for AY 2026–27

CBDT has renumbered forms under the new Act (Form 3CD becomes Form 26, Form 26AS becomes Form 168) — but these changes are effective from FY 2026–27 only. For the return you are filing now (AY 2026–27, FY 2025–26), all forms remain under the old numbering and old structure. The Tax Audit Report is still Form 3CD, not Form 26.

The most productive approach: treat FY 2025–26 closure with a systematic provision-by-provision review, contemporaneous documentation, proactive reconciliation against AIS and GST data, and a return filed with full disclosure. The assessees who approach this transition year carefully will spend the next five years without a notice on their table.

THE CA PERSPECTIVE

The Last Return Under the Old Act Is Not the Time to Cut Corners

At R. Mahesh & Associates, we have guided clients through every major change in India's tax landscape over two decades — from the introduction of e-filing, to GST, to the faceless assessment regime. Each transition year has been an opportunity for assessees who prepared carefully, and a source of sustained litigation for those who did not.

> **FY 2025–26 is different only in that it is the final chapter of a 65-year-old law. The obligations it imposes are no less real for being the last. Close your books with the same rigour you would demand of the last submission under any law — because that is precisely what this is.**

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