Legal Update

Legal Decisions[1]

Service Tax

LD/63/41

Travelite (India)
vs.
UOI and Others
August 4, 2014 (DEL)

Rule 5A of the Service Tax Rules, 1994 read with Section 72A and Section 94 of the Finance Act, 1994 – Access to registered premises

Since parent statute i.e., Finance Act, 1994 itself does not authorise a general audit of the type envisioned by the impugned Rule 5A(2), and furthermore only stipulates that a special audit can be undertaken if circumstances outlined in Section 72A are fulfilled, impugned CBEC circular introducing Rule 5A widening scope of law in respect of audit, is to be quashed

The petitioner is a registered service tax assessee. It is aggrieved by the letter of the Commissioner of Service Tax (CST) dated 7.11.2012, which sought its records for the years 2007-08 till 2011-12 for scrutiny by an audit party, under Rule 5A(2) of the Service Tax Rules, 1994. The Petitioner also challenges the validity of Rule 5A(2) of the Service Tax Rules, 1994, brought into force by Notification No. 45/2007 dated 28.12.2007 as well as the Instruction of the Central Board of Excise and Customs (CBEC) No. F. No. 137/26/2007-CX.4 dated 1.1.2008. It was contended that the powers of an assessing officer to call for records in respect of any period during which the respondents seek to intensively scrutinise receipts *etc., i.e.* a special audit can be ordered by recourse to Section 72-A of the Finance Act, 1994. Barring these, the Finance Act does not contain any substantive power to call for records for scrutiny as is permissible under Rule 5A(2) or for the purpose of scrutiny by any authority outside of those created under the Act, such as the Comptroller and Auditor General's office.

The Delhi High Court held as follows:

Section 72A envisages an audit of an assessee's records only in special circumstances, namely, when there is a failure to declare or compute the value of the taxable service, when the utilisation of CENVAT credit in excessive of the limit permissible or by fraud *etc.*, and when the business operations of the assessee are dispersed across multiple locations. Apart from Section 94, the Revenue could not show any other substantive provision which justifies a probe into the records of the assessee, under conditions akin to those contemplated by Rule 5A(2). The Revenue was also unable to show the compulsion of arming authorities with such sweeping powers, under the Rules.

It is well known that if the legislature contemplates a situation and enacts or provides for a part of it, the other parts are deemed to have been excluded. The law is also well settled that a rule acquires statutory force, so long as it first, conforms to the provisions of the statute under which it is framed and second, it must be within the rule-making power of the executive authority charged with framing the rules.

The "generality" of the rule-making power conferred under Section 94(1) is thus only to the extent that rules made in exercise of that power are in conformity with the provisions of the statute.

The mere fact that a rule-making power is phrased in terms that indicates a general delegation of power, cannot lead to the inference that such power may be exercised to make rules that exceed the bounds of the statute.

Rules may only give effect to the statute's provisions and intent and cannot be used to create substantive rights, obligations or liabilities that are not within the contemplation of the statute.

It is apparent that the only type of audit within the contemplation of the statute is that stipulated for in Section 74A, *i.e.* a special audit when only certain circumstances are fulfilled. The Parliament thus had a clear intention to provide for only a special audit. The fact that Section 74A prescribes the conditions meriting such special audit compels the necessary inference that the Parliament did not intend to provide for a general audit that "every assessee" may be subjected to, "on demand".

This Court is thus of the opinion that any attempt to include provision for such a general audit through the back-door, such as through the impugned rule, is *ultra-vires* the rule making power conferred under Section 94(1). Rule 5A(2) must consequently be struck down.

Likewise, this Court finds that the impugned CBEC Instruction [No. F. No. 137/26/2007-CX.4 dated 1.1.2008] being in furtherance of Rule 5A(2), which rule is *ultra-vires* the Finance Act, 1994, is

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.in. For full judgment, write to eboard@icai.in*

void for the same reasons. Executive instructions without statutory force, cannot possibly override the law; consequently, any notice, circular, guideline *etc.* contrary to statutory laws cannot be enforced.

It is clear that Section 83 of the Finance Act, 1994 authorises that Section 37B, *inter alia*, of the Central Excise Act, 1944 "shall apply, so far as may be, in relation to service tax, as they apply in relation to a duty of excise".

It is clear that the CBEC, under the power vested in it by Section 37B of the Central Excise Act, 1944 read with Section 83 of the Finance Act, 1994 issues these circulars as instructions with respect to the levy of service tax. Consequently, such circulars cannot possibly override the statute, or be contrary to the statute. The impugned circular seeks to put in place a mechanism for audit and scrutiny of documents with the objective of safeguarding the interests of the Revenue, in furtherance of the amendments made in the Service Tax Rules.

Since the parent statute in this regard, the Finance Act, 1994 itself does not authorise a general audit of the type envisioned by the impugned Rule 5A(2), and furthermore only stipulates that a special audit can be undertaken if the circumstances outlined in Section 72A are fulfilled, this Court finds that the impugned CBEC circular is not only an attempt to widen the scope of the law impermissibly but also is patently contrary to the statute. The impugned circular, to the extent it provides clarifications on a Rule 5A(2) audit, is hereby quashed; consequently, the impugned letter is quashed and set aside.

The Service Tax Audit Manual, 2011 is merely an instrument of instructions for the service tax authorities; it is but obvious that it is not a statutory instrument and has no statutory force. Thus, Rule 5A(2) cannot be sought to be justified as against it.

Companies Act

LD/63/42

Infrastructure Leasing & Financial Services Limited

vs.

B.P.L. Limited

January 9, 2015 (SC)

Section 391 of the Companies Act, 1956 – Power to compromise or make arrangements with creditors and members

Legal Update

On initiation of arbitration proceeding by the Financial institution against the company, a money decree was passed as an arbitration award; Company was under process of restructuring, held, hypothecation would still continue and financial institution would continue as a secured creditor and it did not became an unsecured creditor and, hence, was not bound by scheme of arrangement

The respondent company entered into a shareholder agreement with Sanyo. The companies BPL and Sanyo had equal partnership in the ratio 50:50 in the joint venture. The respondent filed an application seeking permission for holding a meeting for consideration for approval of compromise or arrangement proposed to be made between companies and the creditors. The appellant financial institution raised objections and prayed for stay of various proceedings before number of forums including Debt Recovery Tribunal, *etc.*

The Division Bench of the High Court adverted to the deed of hypothecation executed by the BPL in favour of the appellant company and opined that the appellant-company had failed to take follow up action to get an escrow account; that the formalities relating to creation of charge had been duly followed; that in the arbitration award there was no reference that BPL had agreed to lift the charge created; in the absence of the agreed position that the charge be got lifted, and the appellant continued to be a secured creditor and passing of the arbitration award did not create any change in the status.

The Division Bench appreciating the contentions further came to hold that the appellant was a secured creditor after the hypothecation deed was executed; that once the charge had been created it continued to bind the parties till steps were regressed.

The Supreme Court held as follows:

The financial institution contended that arbitration award has been passed on consent which is a simple money decree and, therefore, the deed of hypothecation, even if assumed to be executed at one point of time, has become irrelevant. That the status of the appellant had changed from a secured creditor to that of an unsecured creditor. That the principles of Order II, Rule 2, C.P.C. would be applicable as the appellant would be debarred to issue on the basis of the charge of hypothecation. Emphasis has been laid on the factum that there having been a change of status, the appellant company cannot be clubbed with the secured creditors as a class and even if it is kept in homogenous category of secured creditors, it should still fall under a separate class, regard being had to the fact it has obtained an award from the arbitral tribunal. In this context, it is to be seen that whether the arbitration award has the effect of obliterating or nullifying the status of the appellant and making him an unsecured creditor as a consequence of which it would not be able to sue on the basis of a charge created in its favour.

In the case at hand, the learned Arbitrator has passed an award on consent. It is trite that it has the status of a decree but there is nothing expressed in the award that the decree has extinguished the charge. It was not extinguished because the award does not say so.

The consent award in an arbitral proceeding would not bar a suit for enforcement of the charge for the same reasons and it would not be hit by Order II, Rule 2 CPC. The present case does not relate to a charge as engrafted under Section 100 of the Transfer of Property Act, or simply for equitable mortgage. In the present case, the charge is by hypothecation and relates to movable property. Needless to say, provisions of Rules 14 and 15 of Order XXXIV would not be directly applicable but the principle inherent under the said Rules, as enunciated would be applicable.

The said plea has been advanced on the foundation that the controversy between the parties having been finally put to rest by the arbitral award, the respondent would not have dragged the appellant to the said proceeding as that would vex him twice. The issue before the Company Court was quite different than that was before the Arbitral Tribunal. True it is, it has the status of a decree which is executable, as a decree having gone unchallenged, but the lis of framing a Scheme under the Act is of different character. It could not have been directly or substantially in issue before the learned Arbitrator. That apart, the status of the appellant as a secured creditor has not changed. Therefore, the plea of *res judicata* which has been canvassed by the learned senior counsel for the appellant does not commend acceptance.

It cannot be said that the respondent have waived the hypothecation by accepting the arbitration award. The arbitral award was passed on consent and from the same it would be inappropriate to deduce that the hypothecation stood annulled.

Sections 176 and 177 of the Contract Act, 1872, which pertain to the rights of pawnee on default made by the pawnor, when read in a conjoint manner clearly establish that a pledge does not get extinguished and, in fact, continues even when the pawnee has sued and recovered a part of the debt without enforcement of the pledge or the security. As per Section 176, when the pawnor makes default in making the payment, the pawnee may bring a suit upon the debt or promise and retain the good(s) pledged as a collateral security. A pawnee has both collateral and concurrent rights and can institute a suit for the purpose of realisation of the said debt or promise while retaining the goods as a collateral security. Section 176 also makes it clear that it is the discretion of the pawnee and it gives an option to him and merely because pawnee has filed a suit for recovery, that would not affect or destroy the charge or the right of the pawnee in respect of a pledged goods or the collateral security. Thus, it is within the domain of discretion of pawnee to file a suit for recovery of a debt and yet retain the collateral security or pledged goods. It would not bar or prohibit a pawnee from subsequently selling the pledged goods or the collateral security. It is pertinent to mention here that there is a difference between a hypothecation and a pledge. In the case of a pledge, the security is in possession of the pledge, but in the case of hypothecation, the possession remains with the owner *i.e.* the pawnor. Though such a distinction exists, yet it is an accepted legal principle that hypothecation is treated as a sub-species of pledge and virtually has the same legal effect. The appellant shall remain as a secured creditor, for it was registered as such under the Registrar of Companies.

After registration of the deed of hypothecation, if a condition subsequent is not satisfied, that would be in a different realm altogether. In any case, the finding has been recorded that the respondent was not at fault and, in any case, that would not change the status of the appellant as a secured creditor.

Thus, the appellant cannot be treated as an unsecured creditor and it is not permissible for him to put forth a stand that it would not be bound by the Scheme that has been approved by the Company Judge. ■