

Special Audit under Service Tax Law by Department Officials



The Finance Act, 2012, introduced a new Section 72A in Chapter-V, w.e.f. 28th May, 2012 on “Special Audit” which empowers the Principal Commissioner/Commissioner of Central Excise to direct any person liable to pay service tax to get his accounts audited from a Chartered Accountant or Cost Accountant as nominated by Principal Commissioner/Commissioner subject to certain conditions specified therein. Further, Rule 5A of the Service Tax Rules, 1994, deals with access to any premises registered under these rules, by any Officer authorised by the Commissioner or audit party deputed by the Commissioner or the Comptroller and Auditor General of India. In this article, the author has examined the validity of Rule 5A(2) of the Service Tax Rules, 1994, in view of the recent judgments on the issue. Read on to know more....



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The place of beginning for scrutinising and verifying whether assessee is duly discharging service tax liability, by the department, is serving scrutiny notice on assessee intimating that an audit team would be verifying the relevant records of the business of the assessee. In this regard, to begin with, it would be germane to acquaint with the relevant provisions of service tax law under which records of the assessee

could be verified. These provisions are discussed below:

- a. At the outset it requires to be noted that unlike the Income -tax Act, 1961 or even the Delhi Value Added Tax Act, 2004 there is no provision in the Act for re-assessment of a service tax return. There can be a self-assessment in which case the return filed by the appellant is accepted as such and tax amount indicated therein is accepted as being correct. However, under Section 72 of the Act two scenarios are envisaged. One scenario is where a person who is liable to pay service tax fails to furnish a return u/s 70. The second is where such person has filed a return but “fails to assess the tax in accordance with the provisions of this Chapter or Rules thereunder”. The Assessing Officer (AO) is in either scenario empowered to require the production of such accounts, documents or other evidences as he may deem necessary and after taking into account all the relevant material which is available or which he has gathered, give an order in writing after complying with the rules of natural justice.
- b. Further, Section 72A provides for a Special Audit. The scheme is that in the first instance Commissioner has to record “reasons to believe” that the person who is liable to pay service tax has:
 - i. Failed to correctly declare or determine the value of the taxable service; or
 - ii. Wrongly availed or utilised credit or paid tax beyond the normal rebates having regard to the nature of the taxable services provided or by means of fraud, collusion or any willful misstatement or suppression of facts; or
 - iii. Operations spread out in multiple locations and it is not practicable to obtain a true and complete picture of accounts from the registered premises in the jurisdiction of the concerned Commissionerate.

It is only where one of the above three contingencies exists that the Commissioner may direct the appellant to “get his accounts audited either by a Chartered Accountant or a Cost Accountant nominated by such Commissioner”. The extent of audit and period for which it should be conducted is also to be specified by the Commissioner.

Prior to 28th May, 2012 power for conducting Special Audit, as envisaged by introducing Section

Prior to 28th May, 2012 power for conducting special audit, as envisaged by introducing Section 72A, was derived from Section 14AA of the Central Excise Act, 1944. Section 83 of the service tax law applies said Section 14AA mutatis mutandis to the service tax law.

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- c. Further, the power to search u/s 82 of the Act is also hedged in by some limitations. One such limitation is the requirement of the officer to record reasons to believe that (i) there are documents or books that have been secreted in a place (ii) such documents or books are useful or relevant for any proceedings. A third safeguard is that the provisions of the Code of Criminal Procedure, 1973 (Cr PC) pertaining to the search apply *in toto* to any search in exercise of powers u/s 82 of the Act. Therefore, even the power u/s 82 cannot be said to be totally without guidelines or restrictions.

The above discussion elucidates that department has the power to scrutinise and verify the assessee records only in specified circumstances.

Further, Ld. Department is duty bound to give the reference to statutory provision mentioning reason for conducting said scrutiny and verification as a matter of principle of natural justice. To buttress the view taken, reliance is placed on the judgment of the Apex Court in the case of *Sahara India vs. CIT (2008) 14 SCC 151* in which it was held “*that in any event, an audit, since it carries civil consequences¹, cannot be ordered without a notice issued to the assessee, indicating reasons for the audit.*” However, if the said notices do not give the reference to statutory provisions of the Finance Act, 1994 under which said scrutiny and verification is ordered or in other words, if reason for conducting the said scrutiny and verification is *non liquet*; in the absence of reference to the adequate statutory provision, whether in pursuance of provisions explicated in para a), b) or c) as mentioned above, it can be contended that said notice is *contra legem*.

Where the department serves the notice for conducting the audit under Section 72A of the

¹ The condition precedent for an order of special audit is reason to believe that the circumstances stipulated in the various sub-sections of Section 72A exist. Such insinuation of wrongful act affects the citizen in his social life and would come within the ambit of civil consequences as laid down in *Sahara India (Firm) Lucknow supra*.

Act, reference to Rule 5A of the Service Tax Rules, 1994 is given, *via* which schedule for visit by the departmental officials is intimated. At this juncture, with due reverence to this legal proceeding of audit by audit wing, we wish to reproduce the legal provisions which provide accentuation whether audit party has been empowered to perform service tax audit or not.

Meaning of the term 'Rule'

Before proceeding further, we would like to reproduce the legal meaning of this term 'rule' in order to prepare a platform for subsequent submission, as '*a self-imposed guide for conduct*' or '*a rule of procedure*.' The rules are basically the guide which prescribe the procedure that needs to be followed in order to regulate some action. The law is also well settled that a rule acquires statutory force, so long as it

- First, conforms to the provision of statute under which it is framed and
- Second, it must be within rule making authority of the executive authority charged with framing the rules.

Reliance has been placed on *Municipal Corporation vs. Birla Cotton, Spinning and Weaving Mills*, AIR 1968 SC 1232 and *General Officer, Commanding in Chief vs. Subhash Chandra Yadav*, (1988) 2 SCC 351; *Dr. Mahachandra Prasad Singh vs. Honourable Chairman, Bihar Legislative Council and Ors.*, (2004) 8 SCC 747.

In a nutshell, the rules are basically the guide which prescribe the procedure that needs to be followed in order to regulate some action. Such general standard or guide to conduct having behind it the sanction of a statutory provision is a statutory rule having the statutory force.

Power to make Rules

Now moving towards the legal provision of Section 94, the Central Government has been empowered with the following:

- General powers to make rules and
- Specific powers to make rules on twenty one (21) mentioned subjects.

At the outset, relevant extract of Section 94 of *ibid* which is applicable in the instant case is reproduced below:

"94. Power to make rules

- (1) *The Central Government may, by notification in the official gazette, make rules for carrying out the provisions of this Chapter.*

- (2) *In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely—*

.....

- (k) *Imposition, on person liable to pay service tax, for the proper levy and collection of the tax, of duty of furnishing information, keeping records and the manner in which such records shall be verified.*

.....

- (n) *Any other matter which by this Chapter is to be or may be prescribed."*

Both of these powers have been given for carrying out the provisions of this Chapter V of the Finance Act, 1994. To elucidate the purpose of these rules, we would like to refer the meaning of term '*carrying out*' in the *Advance Law Lexicon Legal Dictionary* wherein this term has been given meaning '*to accomplish*' or '*to put into operation*.' Putting reliance on this meaning, it can be succinctly contended that the Central Government, *vide* Section 94, has been empowered to make rules '*to put into operation*' the provisions of the Chapter i.e. '*to accomplish*' that provision. Taking discussion into upper level, it can be contended that Central Government could make rules only on those subject matters which are already contained under the provision of this Chapter V and hence these rules would only be *intra-vires* to the main provisions. Contrary to this, if this Chapter does not contain any provision for which Central Government has made rules '*to accomplish*' them or '*to put them into operation*' then such rules would, in the eyes of law, be considered as *ultra-vires* and would not be made applicable. The "generality" of 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.

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Section 72A- Special Audit was recently introduced vide Finance Act, 2012 wherein if the Commissioner has reason to believe that any of the specified defaults have been made by the assessee, then they may direct the assessee to get its accounts audited by a Chartered Accountant or Cost Accountant.

Keeping this discussed principle of *ex aequo et bono* in mind while interpreting clause (k) of this Section 94(2) under the shed of which the Ld. Audit Wing issues moot notice to the assessee to scrutinise and verify their relevant records, we would like to highlight the relevant extract of this clause *vis-à-vis* scrutiny or verification of records:

“Of duty of furnishing information, keeping records and the manner in which such records shall be verified.”

Based on this, it can be contended that the Central Government may make rules to put into operation the provisions of this Chapter, *inter-alia*, the manner of verification of records kept by the assessee. Making harmonious interpretation of this clause, the Central Government may make rules only for ‘the manner’ in which verification of records could be made and accordingly, the Central Government is not empowered to authorise any party who shall conduct audit of the assessee under the regime of service tax and verify the records. Based on this, rules specifying the manner could be made under the coverage of this impugned section never except when this Chapter contains the provision of verification of records of the assessee. *The expression ‘verified’ has to be interpreted in the context of what is permissible under the Act itself.* In addition, the party who shall be authorised to conduct the audit of service tax shall take shed only of the Act and hence shall be governed by the Chapter V of the Act and the manner in which such verification could be done shall be governed by the rules framed by the Central Government.

‘Verify’ is not wide enough to permit the audit of the accounts of the noticee by any officer of service tax department. Acknowledging audit by a departmental officer amounts to confessing that the audit by a Chartered Accountant or a Cost Accountant is more desire than reality.

Statutory Provision related to Audit

On perusal of this Chapter, there is one specific

“Section 72A- Special Audit” which was recently introduced *vide* Finance Act, 2012 wherein if the Commissioner has *reason to believe* that any of the specified defaults have been made by the assessee then they may direct the assessee to get its accounts audited by a Chartered Accountant or Cost Accountant. The relevant subsection has been reproduced below for the kind reference:

“(1) If the Commissioner of Central Excise, has reasons to believe that any person liable to pay service tax (herein referred to as “such person”),—

(i) has failed to declare or determine the value of a taxable service correctly; or

(ii) has availed and utilised credit of duty or tax paid—

(a) which is not within the normal limits having regard to the nature of taxable service provided, the extent of capital goods used or the type of inputs or input services used, or any other relevant factors as he may deem appropriate; or

(b) by means of fraud, collusion, or any wilful mis-statement or suppression of facts; or

(iii) has operations spread out in multiple locations and it is not possible or practicable to obtain a true and complete picture of his accounts from the registered premises falling under the jurisdiction of the said Commissioner;

He may direct such person to get his accounts audited by a Chartered Accountant or Cost Accountant nominated by him, to the extent and for the period as may be specified by the Commissioner..”

Rule 5A of Service Tax Rules, 1994

Now reference has been made to the Service Tax Rules, 1994 to know the manner of verification prescribed therein.

There is one “Rule 5A-Access to a registered premises” which directs assessee to make available the records, cost audit reports, income tax audit report *etc.* on demand made by various service tax authorities *inter-alia* including CAG. Relevant extract has been mentioned below:

“(2) Every assessee, shall, on demand make available to the officer empowered under sub-rule (1) or the audit party deputed by the Commissioner or the Comptroller and Auditor General of India, or a Cost accountant or Chartered accountant

nominated under Section 72A of the Finance Act, 1994,-

- (i) the records maintained or prepared by him in terms of sub-rule (2) of rule 5;
- (ii) the cost audit reports, if any, under Section 148 of the Companies Act, 2013 (18 of 2013); and
- (iii) the income-tax audit report, if any, under Section 44AB of the Income Tax Act (43 of 1961) for the scrutiny of the officer or the audit party, or the Cost Accountant or Chartered Accountant, within the time limit specified by the said officer or the audit party or the Cost Accountant or Chartered Accountant, as the case may be.”

Application of Provision of Service Tax Law on subject topic

Applying this section in the instant case, the audit party neither falls under the meaning of ‘Chartered Accountant’ nor under ‘Cost Accountant’ to audit the accounts of assessee nominated by him.

At this juncture, we would like to submit that since the parent statute in this regard is the Finance Act, 1994 itself which does not authorise a general audit by audit party, other than Chartered Account or Cost Accountant, envisioned by the impugned Rule 5A(2). Moreover, rules cannot exceed the bounds of the statute and rules may only give effect to the statute’s provision and intent and cannot be used to create substantive rights, obligation, or liabilities that are not within the contemplation of statute. There is a distinction between auditing the accounts of noticee and verifying the records of the noticee. Audit is a special function which has to be carried out by a duly qualified person like a Cost Accountant or a Chartered Accountant. It cannot possibly be undertaken by any officer of the service tax department. Based on this, since Section 72A which is the only section under which service tax audit can be conducted, hence verification of accounts by audit personnel of Ld. Commissioner which is not empowered under this impugned section cannot conduct or direct the audit of any person who is liable to pay service tax under the regime of service tax law.

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Directing the special audit by a departmental officer would flout the fundamental tenets of the service tax law.

To buttress this view, reliance has been placed on the recent judgment of the Delhi High Court in the matter of *M/s Travellite (India) [W.P. (C) 3774/2013, C.M. No. 7065/2013]* wherein it was held that Rule 5A(2) of STR is *ultra vires* since it overrides the statutory Section 72A. Against the aforementioned judgment of that court in *Travellite (India) [W.P. (C) 3774/2013, C.M. No. 7065/2013]*, Special Leave Petition No. 34872/2014 was filed in the Supreme Court by the Union of India. By order dated 18th December, 2014, the Supreme Court while directing notice in the said Special Leave Petition directed that there would be a stay of the operation of the decision of that court in *Travellite (India) vs. Union of India (supra)*.

However, the amended clauses have also been held as *ultra-vires* in the recent judgment of the Delhi High Court in the matters of *M/s Mega Cabs (P.) Ltd vs. Union of India [2016] 6 TMI 163 (Delhi) [W.P. (C) 5192 of 2015, C.M. No. 9417/2015]*. Held that Section 94(2)(k), Rule 5A(2) of Service Tax Rules, 1994, suffers from vice of excessive delegation and Circular No. 181/7/2014 ST dated 10-12-2014 is *ultra vires* the Finance Act. Against the aforementioned judgment of that court in *M/s Mega Cabs (P.) Ltd, Special Leave Petition No. 26675/2016* was filed in the Supreme Court by the Union of India. By order dated 26th September, 2016, the Supreme Court while directing notice in the said Special Leave Petition directed that there would be a stay of the operation of the decision of that court in *M/s Mega Cabs (P.) Ltd vs. Union of India (supra)*.

As on date, it can be contended that there is no statutory power with the department to order special audit by departmental officials because the matter is still pending before Supreme Court. Further, it can also be contended that the validity of audit proceedings should be made subject to the outcome of decision of Apex Court in abovementioned cases. ■