Service Tax Audits by Department - Legal Position

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INTRODUCTION:

Service Tax law operates under the concept of self-assessment, wherein the assessee self assesses his tax position and pays the service tax dues at periodic intervals prescribed therein. Details of the business transactions are disclosed to the revenue by filing of the service tax returns. The returns filed by the assesses undergoes the automatic scrutiny performed by the web application ACES. Further, certain returns are selected for manual scrutiny based on the risks involved. Later on review of the service tax returns, if it comes to the notice of department that any tax has been evaded, then detailed scrutiny of the business transactions is performed by the Anti-Evasion wing of the department.

Despite, introduction of the self-assessment, the trust deficit was perceptibly clear, wherein department also introduced the concept of 'Audit' by the revenue officers by inserting rule 5A(2) to the service tax rules, 1994 vide Notification No. 45/2007, dated 28-12-2007 as well as the instruction of the CBEC F.No.137/26/2007-CX.4, dated 1-1-2008. Since its introduction, audit has only increased the intrusion of the department in day-to-day business activities of the assesses. Now it has become a routine task for the department officials so much so that separate Audit commissionerates have been established in the major cities across the country only to look after and to perform the audits. As far as assesses are concerned, departmental audits are a painful exercise and its comparison can be no lesser than a British raj, its like a periodic ghost at the door step.

The concept of conducting the audits of the books of the assesses based on the notification without any statutory backing has been a very fundamental issue raised before the judiciary. This article tries to explain the background and legal position of the audit by the departmental officers that stands as of today and what is the recourse available with the assesses and the department.

LEGAL BACKGROUND:

Rule 5A(2) of the Service Tax Rules, 1994, enabling department to perform the audit of the books of the assesses as introduced reads as below:

> *2) Every assessee shall, on demand, make available to the officer authorised under sub-rule (1) or the audit party deputed by the Commissioner or the Comptroller and Auditor General of India, within a reasonable time not exceeding fifteen working days from the day when such demand is made, or such further period as may be allowed by such officer or the audit party, as the case may be, -*
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> *i. the records as mentioned in sub-rule (2) of Rule 5;*
> *ii. trial balance or its equivalent; and*
> *iii. the income-tax audit report, if any, under Section 44AB of the Income-tax Act, 1961 (43 of 1961), for the scrutiny of the officer or audit party, as the case may be.*

On perusal of all the provisions of finance act, 1994, it can be noted that the only provision that enables department to conduct audit is Section 72A of the act, wherein commissioner can authorize the conduct of Special audit by a Chartered Accountant. Apart from section 72A, there is no provision in the act empowering department officers to conduct the audit. Department officers can at the most collect information/ materials from the assesses as required. Powers to conduct the audit is also available under Sec 44AB of the Income Tax Act by the Chartered Accountants, but that power is clearly stated in the act itself.

However, despite of above lacuna in the law, department regularly conducted audits on the basis of Rule 5A of service tax Rules, 1994 and issued audit reports requiring assesses to pay the dues remained unpaid or short paid.

This draconian provision received its true fate in the case of ***Travelite (India) versus UOI 2014 (35) S.T.R. 653 (Del.)*** wherein Rule 5A(2) of the of service tax Rules, 1994 was struck down by the Honorable Delhi High Court based on the following assertions:

- Letter to assessee can be issued for audit of records only in case of special audits of type stipulated in Section 72A;
- Parliament did not intend to provide for a general audit that “every assessee” may be subjected to, “on demand”;
- To include provision for such general audit through Rule 5A(2) of Service Tax Rules, 1994 is ultra vires rule-making power conferred under Section 94(1) ibid;
- C.B.E.&C. Instruction F.No.137/26/2007-CX.4, dated 1-1-2008 providing the mechanism for audit and scrutiny of documents shall be quashed as it attempts not only to widen scope of law impermissibly but also was patently contrary to statute - Parent statute Finance Act, 1994 itself does not authorise general audit;
- Service Tax Audit Manual, 2011 is only instrument of instructions for Service Tax authorities, it is not a statutory instrument and has no statutory force.

Further, the most profound noting of the high court was that the rule authorizing audit under 5A(2) was made pursuant to the power conferred under Section 94 of the Finance Act, 1994. On review of section 94 of the finance act, 1994, it was observed that the said section did not provided for any enabling provision authorizing revenue officers to make rules for conduting of the departmental audits. Therefore, apart from the above notings, departmental audits are illegal and unjustified as it overrides the Act and to that extent stands ***Ultra Virus*** the section 94 of Act.

POST 06.08.2014:

However, the not so smart department played its over-smart move by amending section 94 of the finance act, 1994 in union budget 2014-15, wherein the loophole pointed in above High Court Judgment was tried to be fixed by inserting a new clause (k) in sub section (2) of section (94) of Act on 06.08.2014 which reads as under:

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

Therefore, on the basis of aforesaid clause department officers use to again conduct audits post 06.08.2014 by making suitable amendment in Rule 5A(2) of Service Tax Rules, 1994. Further, CBEC has given clarification vide Circular No. 181/7/2014 S.T. dated 10.12.2014 that these amendments will prevail over the judgments given by High Courts. However, this circular was silent about the audits conducted prior to 06.08.2014 and the fate of audits conducted prior to 06.08.2014 was intelligently ignored.

Thereafter Circular No. 995/2/2015-CX dated 27th February 2015 was issued by the CBEC on the subject 'Central Excise and Service Tax Audit norms' to be followed by the Audit Commissionerates and this too contemplated the Departments officers themselves undertaking audits. A Central Excise and Service Tax Audit Manual, 2015 was also issued by the Directorate General of Audit of the CBEC in this regard.

However, the story does not ends here, the back door entry for enabling audits as created by amending section 94 of the finance act suffered the rout of the Honorable Delhi High Court once again recently in the case of ***M/s. Mega cabs Private Ltd. V/s. UOI,*** wherein the said court has noted as follows:

- The expression **"verify"** in Section 94 (2)(k) of the Finance Act, 1994 as inserted in the union budget 2014-15 cannot be construed as **"Audit"** of the accounts of an Assessee and, therefore, Rule 5A (2) cannot be sustained with reference to Section 94(2)(k) of the Finance Act, 1994;
- Rule 5A(2) as amended in terms of Notification No.23/2014 ST dated 05.12.2014 authorizing the revenue officers to seek production of the documents mentioned therein on demand is ultra vires the Finance Act, 1994 and the same is struck down to that extent;
- Circular No. 181/7/2014-ST dated 10th December 2014 of the Central Government is ultra vires the Act and the same is quashed;
- Further, Circular No. 995/2/2015-CX dated 27th February 2015 on the subject 'Central excise and service tax audit norms to be followed by the audit commissionerates and audit manual issued by the directorate General of Audit of the CBEC are also quashed as being u*ltra vires* the Finance Act, 1994.

CONCLUSION:

Therefore, the current position of the law as it stands today, department does not have any authority to conduct the audits of the assesses books of accounts and the records maintained. As far as assesses are concerned, in case any audit intimation is received for conducting of the audits, they can write a simple reply letter to the department stating the above position of the law and accordingly audits can be postponed until the above high court judgement is either stayed by the supreme court or law is suitably amended.

However, it is important to note that audit is just one wing of the CBEC and department always have a remedy to transfer the case to its Intelligence wing wherein, the anti-evasion battalion can call for information and scrutinize the same to check for any possible evasion of the taxes. However they cannot do the audits at the premises of the assessee.

All said and done, as far as the department is concerned, it is seen that despite the above judgment of the Hon’ble High court, the audit wing is still continuing its audit exercise and its routine as usual for them.