SET OFF RULES AND IMPACT OF HAWALA AND DEFAULT DEALERS – AUDITORS' PRECAUTION

By CA Rajendra Bhutada
FCA , DISA

INTRODUCTION :

With the passage of Seven Years time the concept of **"A White Paper on State Level Value Added Tax"**, *which was issued on 17th January 2005*, is now becoming a History. The said paper beside all other modalities of VAT dealt with the **Set Off,** as an essence of VAT system. It further speaks that the basic simplification in VAT is that the liability will be self assessed by the dealer themselves, in terms of submission of returns upon setting off the Input Tax Credit . There will no longer be compulsory assessment as is in existing Law. Penal provisions in the VAT bills should not be more stringent than in existing Sales Tax Act. The tax structure will become simple and more transparent that will improve tax compliance and also augment revenue growth.

Having seen the present ***AVATAR*** of VAT and its implementation in the Maharashtra State it seems that all the basic concepts, as conceived in terms of *White Paper*, are not only ignored but also the Input Tax Credit, which was considered to be the backbone of VAT system, is being denied just for the little deficiencies, with which the buyer dealer is not at all concerned . The transaction of sale which has already suffered the tax liability is again taxed in form of disallowance of Input Tax Credit and thus there is double taxation resulting into cascading effect . The penal provisions are pressed in to operation in form levy of Interest, Penalty etc. and Police Prosecution ignoring the materiality concept.

In my sincere attempt to deal with the topic I have tried to cover the controversies relating to Input Tax Credit and the precaution to be taken by the VAT Auditor in view of the Standards on Auditing issued by ICAI at one end and satisfying the purpose of VAT Audit from Sales Tax Department's point of view at the other end. At the same time tried to eliminate the dark corners of ignorance, though our role is of fact finders but still in order to educate the dealers it is necessary to understand the legal intricacies of the matter.

SET OFF RULES :

For almost more than Six Years we are dealing with the Set Off provisions therefore the same is well digested by all of us and therefore not required to discuss in detail but just touched upon to understand the crux of the matter from the point of view of controversy going on .

In fact section 48 of the MVAT Act 2002 contains the basic provisions which allow the Set Off and Refund. However Rule 51 to 55 of The Maharashtra Value Added Tax Rules, 2005 determines the *quantum* of set off after imposing certain restrictions terms and conditions. While the basic conditions of section 48 is production of Tax Invoice, containing certificate [as per section 86 and rule 77] and that the set off shall not exceed the amount of tax in respect of the same goods actually paid in to the Government Treasury Rule 55 contains all routine requirements and modalities relating to adjustments and carry forward. In order to avail set off, satisfaction of this minimum requirement is not the difficult task and VAT Auditors also finds no difficulties in determining the same. Further by this time the issues relating to reduction of set off under rule 53 and non admissibility under rule 54 is clear and having no ambiguity.

STARTING POINT OF CONTROVERSY :
Section 48 of MVAT Act for Allowance ? Or for Disallowance of Input Tax Credit.

While everything going on smoothly it is true that in all walks of life there are some black sheep who indulge in some or other illegal activities and more particularly in the area taxation, where an attempt is made to evade tax or to avoid legal compliances. But such instances are exceptions and therefore to punishing the culprits is the sacred duty of administrators of law to see that the regular and genuine tax payers are not inconvenienced, humiliated or harassed. The Department cannot stand on a high moral pedestal and condemn the entire business community as tax evaders or villains. The Courts in a number of cases held that it is wrong to assume that every dealer is a suspicious and a tax avoider.

The interpretation of section 48(5) in a Writ Petition decided by Bombay High Court in case of **M/s Mahalaxmi Cotton Ginning Pressing and Oil Industries (W.P. No.33 of 2012 decided on 11 May 2012)** has raised the eye brows of trade community where the question is raised as to whether this section is for allowance of Set Off or is operating in the direction of disallowance and therefore it is necessary to understand the present status of legal battle, which is going on .

SECTION 48.- SETOFF, REFUND, ETC.

(1)…….

(2) No set off or refund as provided by any rules made under this Act shall be granted to any dealer in respect of any purchase made from a registered dealer after the appointed day, unless the claimant dealer produces a tax invoice, containing a certificate that the registration certificate of the selling dealer was in force on the date of sale by him and the due tax, if any, payable on the sale has been paid or shall be paid and unless such certificate is signed by the selling dealer or a person duly authorized by him.

(3)…….

(4)…….

(5) For the removal of doubt it is hereby declared that, in no case the amount of set off or refund on any purchase of goods **shall exceed** the amount of tax in respect of the same goods, **actually paid**, if any, under this Act or any earlier law, **into the Government treasury** except to the extent where purchase tax is payable by the claimant dealer on the purchase of the said goods effected by him,

Provided……

(6) …….

As per section 48(2), setoff is required to be granted to buyer subject to production of tax invoice containing declaration as specified in Rule 77. The declaration amongst other specifies that the vendor has paid tax or shall pay tax on the sale of goods described in the said tax invoice. However as per interpretation by the Department, section 48(5) says that set off will be granted to the extent of tax actually received in the government treasury on the same goods.

In fact the legislature, while inserting this section, intended that if tax rate as per notification is lesser than the schedule rate and the vendor has rightly paid tax as per notified rate, then buyer is restricted to claim set off as per schedule rate.

IMPACT OF BOMBAY HIGH COURT JUDGEMENT IN CASE OF M/S MAHALAXMI COTTON GINNING PRESSING AND OIL INDUSTRIES KOLHAPUR [51 VST 1].

Facts of the case : Mahalaxmi Cotton Ginning Pressing and Oil Industries, is a reseller in cotton bales at Kolhapur who has purchased goods from registered dealers supported by tax invoice and claimed the refund. However the refund is disallowed on the ground that the vendors have not paid the tax. The petitioner's set off was disallowed based on the unmatched data available on the Department's Computer system. In this case the constitutional validity of Section 48(5) of the MVAT Act, 2002 was in challenge on the ground that **it violates Article 14 of the Constitution.** According to the petitioner, section 48(5) gives **unequal treatment to equals.** Alternatively it was submitted that if its validity was upheld, the Petitioner sought that the words **"actually paid"** be read down to mean **"ought to have been paid"**. The Petitioner challenged the order of assessment and sought a **mandamus** to the State to recover from the vendor, tax paid on the goods, of which a set off was claimed.

In this petition the contention of the Dealer, submission of the department and outcome of Judgment is as under.

> The Writ petition was to challenge the **constitutional validity** of section 48(5) which was **upheld** by the court.

The dealer submitted that section 48(5) applies only to a situation involving a variation between the rate of tax mentioned in the schedule and the actual rate contained in an exemption notification and the provision has no application to a situation involving the non payment of tax by a selling dealer in a bona fide case where there is no fraud, connivance or collusion between the selling and purchasing dealers. The department submitted that the set off is to be granted to the purchaser only to the extent to which tax has been deposited in the treasury by the seller. Court opined that it is within a reasonable exercise of its legislative power in so mandating. This does not offend Article 14. A plea of hardship cannot result in the invalidation of a statutory provision in a **fiscal enactment which is otherwise lawful**.

The Act does not provide any machinery for the purchaser to ascertain whether the seller has actually paid the taxes to the Government Treasury, which has been collected from him. Section 48(5) casts a burden on the purchasing dealer which is **impossible to perform** since the Act and the Rules do not empower the purchasing dealer to seek any document from the vendor other than the tax invoice for the purchases made. Denying the benefit of set off to purchaser for failure of the selling dealer to deposit that tax, would impose a condition which is impossible to perform. The Sales Tax Department has stated before the Court that during the course of the current year, they **will set up a Dealer Information System (DIS)** and Dealer's Ledger Account showing the status of the taxes collected and paid, on the web portal of the Maharashtra State Sales Tax Department (www.mahavat.gov.in) in order to facilitate the process of the grant of additional claim of input credit to claimant dealers.

The **interpretation** of the words **'actually paid, if any, into the Government treasury'** was challenged and the petitioner submitted that the **seller is authorized agent of the Government** to collect the tax on behalf of State from the buyer and should pay into the treasury. So payment of tax by the buyer to the agent should mean 'paid into the government treasury'. In its submission The State denied the contention of the petitioner. It submitted that the supplier is not the agent of the State so the payment of tax to the dealer does not mean payment into Government treasury. Under section 48(2), facility is given to purchasing dealer to claim set off even before tax is paid into government Treasury. But section 48(2) does not expand the scope of set off. **Set off is a concession given by legislature to prevent cascading effect.** So legislature is entitled to prescribe any condition for the same. **Claiming set off is not the right of the dealer**. And more ever, the Court cannot rewrite the provisions of the Statute. The State submitted that the set off will be denied to the purchasers, if the seller has not paid the taxes and also in case of default by the seller, the taxes will be recovered from the purchaser. It will be refunded back to them after the final recovery from the selling dealer. For this purpose, the whole machinery of the Sales Tax Department will be invoked wherever possible against defaulters with a view to recover the amount of tax due from them.

The right to claim set off is a right conferred by Statute and the legislature while recognizing an entitlement to set off, in certain circumstances, is lawfully entitled to prescribe the conditions subject to which a set off can be granted.

It was a Writ of mandamus, which means a prayer to the High Court to issue order to subordinate court, an officer of government, or a corporation or other institution commanding the performance of certain acts or duties. Here the petitioner prayed to receive or collect tax from the seller and grant refund to the buyer. Ld. Advocate General appearing on behalf of the State has tendered a statement of the steps that would be pursued against the defaulting selling dealers –

''The Sales Tax Department will identify the defaulters namely, registered selling dealers who have not paid the full amount of tax due in the Government Treasury either by not filling the returns or by filling returns but not paying the full tax (i.e. short filling) or where returns are filed but sales to the concerned dealers are not shown (i.e. undisclosed dealers).''

Recently in 3rd week of October 2012 the Department has published on its web site year wise list of **short filers and non filers of returns**. The Hon'ble High court further stated that "at the same time, we have set out in detail the assurance which has been placed before the Court by the State Revenue in the present case, of the steps that would be taken to pursue recoveries against selling dealers who have either not filed the returns or, having filed returns have not deposited the tax collected from the purchasing dealer in whole or in part.''

Decision the case of **Gherulal Balchand, of Punjab and Haryana High Court** is not followed by the Bombay High Court by stating that the judgment does not involve a challenge to provision like 48(5) of MVAT Ac**t.**

CIRCULAR FOLLOWED BY JUDGEMENT CREATED HAVOC.

Trade Circular No. VAT/MMB-2012/52/Adm- 8T of 2012 issued by the Commissioner of Sales Tax Maharashtra on 21-6-2012 which is followed by the Judgment of the Bombay High Court in case of M/s. Mahalaxmi Ginning and Oil Industries is really not in the spirit of verdict, which gives directions as under.

No Input Tax Credit Claim shall be allowed unless the corresponding tax is paid by the selling dealer in to Government Treasury.

In case of mismatch of annexure J2 of Purchaser with J1 of respective seller in electronic matching the ITC shall be denied to the extent of unmatched amount.

> The "Input Tax Credit (ITC) claim shall not be allowed if the purchases are effected from hawala dealer and even through such hawala dealer has paid the taxes partially or fully as these are not genuine transactions".

This circular also clarifies that the action will be taken against defaulters and taxes recovered from them shall be given to the purchasing dealers at the end of the each year after reconciliation.

It would not be out of context to mention that in case of **B. Arunkumar Trading P. Ltd. (1999) 112 STC 346** the **Andhra Pradesh High Court** categorically held that the State Government or the Commissioner has no power to interpret provisions of statute and direct assessing authorities to make assessments accordingly. Assessing authorities, appellate authorities and the revision authorities are performing quasi-judicial functions and it is in each and every case that these authorities are expected to pass objective orders while interpreting the provisions on their own. The powers of these authorities cannot be bogged down by Circulars or administrative instructions.

COMMON TRADE PRACTICE TERMED AS HAWALA:

In commonly understood trade practice there are some Registered Dealers who does not carry on any business but still they issue the bills and sales relating to such bills are not shown in their returns. Before central repository system even they use to issue 'C' Forms, F Forms and other required documents.

All this they are doing just to earn money and this is their only business activity. In this end ever they never deals into commodity as there is no business activity. After issuing bills they also provide for fake L R, Delivery Memo and accept the payments by cheques or DD'S. Later on they pay back the cash to beneficiary [who accepts such bills] after deducting their share in the nature of service charge. The beneficiary on the basis of such bills records the purchases and ultimately the whole transaction appears as true business dealing whereas in fact it is bogus. This practice is considered as Hawala Transactions by the Sales Tax Department.

HAWALA DEALERS AND THEIR SYSTEM:

During last few months, the 'Hawala Dealer' is the most discussed and hottest topic publicized by the Sales Tax Department. In fact, if we go through the entire MVAT Act and Rules we won't find the words like **'Hawala Dealer', 'Suspicious Dealer', 'Bona Fide dealer' and "Beneficiary'** but one may read these words in Trade Circulars issued by the Hon'ble Commissioner of Sales Tax and also on website of Department of Sales Tax. In business and governmental parlors the term Hawala is understood in a variety of shades and meanings. It is not necessarily a bad term nor could always be called an illegal act.

It will be interesting to find different manifestation of the term 'Hawala'. The definition given by **Interpol** says - **"Hawala is money transfer without money movement"**. One more definition of Hawala says that – **"it is an alternative means of conducting of funds transfer"**. In fact the Hawala is an informal system for fund transfer which is basically a parallel or alternative to traditional banking or financial channels. Although the advent of modern banking has made hawala banking less common than before, the introduction of severe restrictions to banking privacy through legislation and enforcement has made a hawala system, via a hawala network, as a very attractive option again for privately transferring money. Hawaladars, or Hawala dealers, arrange money transfers that are often backed only by trust, family connections or regional relationships. Hawala though originated in South Asia during ancient times but in operation throughout the world. Not only transfers which are against public policy are done through hawaladars, but the avoidance of government control (For tax dodging, money laundering, weapons brokering, child prostitution and funding terrorism) is an important reason, the system has survived in these days.

In Hawala transaction, the sender of money goes to a hawaladar in his city and gives him a sum of money for someone in another city or even country. The hawaladar calls another person in the destination city and tells him to give the sum to the recipient. At the end of a set period, the two hawaladars tally, how much each of them has received from, and paid out on behalf of, the other, and they settle the debt.

In the light of the above meaning of 'Hawala' the Trade Circular address certain dealers as Hawala dealers without defining the said term therein,

Hawala, Paper Transaction: Misnomers: The term paper transaction' is used by the Department in the sense that it is an illegal transaction. In fact the chain of transactions from manufactures/producer to wholesalers to retailers to consumers is a normal business practice. So also the sale by transfer of documents of title by a middleman or an agent, without either of them taking delivery of the goods, was and is considered perfectly legal even though it is only a paper transaction. In the premises if certain commodities change hands without actual delivery of the goods in between. The issue has also been made more complicated by the indiscriminate use of the terms namely, **ascertained goods, goods in deliverable state, constructive delivery** etc. borrowed from the Sale of Goods Act. Actually, The VAT Act is a perfectly codified law of tax on sale or purchase of goods envisaged by the Constitution of India. Therefore there is no occasion to import definitions of other laws to interpret its provisions. The transactions are to be legally interpreted as per provisions of this special law without reference to other laws unless expressly provided for.

DEFAULT DEALERS:

Though the default dealers are not defined but the Short Fillers or Not Fillers may be considered as Default Dealers. On the screen the names of the suppliers of the dealer with the date / invoice numbers and amounts, are flashing. "These are your bogus purchases and therefore you will not get ITC [set off] on these purchases.

DEPARTMENTAL APPROACH IN SO CALLED HAWALA TRANSACTIONS:

On getting information of the so called Hawala Transactions the Departmental Officers enters in to the premises of Dealer and records the statement U/S 14 of the MVAT Act and thereafter suggestion cum threatening come in one breath saying that If you have paid the VAT after reducing the setoff, you should pay that amount immediately otherwise your case will be sent to Police for which I will not be responsible",. The dealer tries to make clear to the officer that those purchases were made through the brokers, who had arranged for the delivery of the goods for which the delivery challans are available for both inward and outward delivery. The payments were made by account payee crossed cheques. But the officer says that, "the enforcement branch must have raided those suppliers or those brokers who might have given the affidavits that they have not sold the goods but have given only paper bills**.**"The dealer requests the officer to give him copies of the report of the raids or copies of the affidavits given by those so called bogus dealers, or at least the copies of the returns which were filed by those dealers. But the officer says, "I have got the information which is in this computer only. I do not have any other information or documents. But you must pay the difference amount and tell me the date by which you will file the revised returns and pay the taxes or be ready to face the police action. The dealer then examines his real position and acts accordingly but there are few dealers who are firm on their stand and ready for the litigation.

SOME IMPORTANT ASPECTS IN DISALLOWANCE OF INPUT TAX CREDIT

Assessment is necessary before any action.

The Judgment in the cases of **Premium Paper and Board Industries Ltd v/s. The Joint Commissioner of Sales Tax, Investigation-A & Ors (W.P.No.347 of 2012 dt.30/04/2012)** along with other matters, indicates that, if department wants to make allegation against purchase transactions of claimant dealer as hawala transactions, then it has to make the assessment and decide the issue. Without such assessment, department cannot claim any transaction as hawala transaction. In the assessment proceedings the dealer will get his right, to contest against the allegation. After that he will be able to contest the issue further before appellate authority. This action will be as per principles of natural justice. Therefore, the demand made by department on account of set off disallowance will be premature, if it is made before assessment is completed.

In spite of Circular 8 T Dealer can rely on some important decisions –

Tata Iron and Steel Company (9 STC 276 SC) – The Supreme Court held that though the tax can be collected from the purchaser, the primary liability to pay the sales tax is on the seller and that the liability of sales tax need not be passed on to the purchaser.

Khazanchand Vs State of JK (AIR 1984 SC 762) – The Supreme Court held that the liability is of the selling dealer to pay tax irrespective of the fact whether he makes profit or loss or whether he has received the sale price or not. The purchaser is not bound to pay the Sales Tax payable by the vendor unless he has agreed to do so and where the purchaser agrees to pay the amount, it forms part of the sale price.

India Agencies (139 STC 329 SC), A three member bench of Supreme Court held that condition on which the concession was granted was mandatory and liberal view cannot be taken merely on the grounds of hardship.

M/s Sanjana [AIR 1971 SC 2039] - The Supreme Court held that the words 'tax paid' has a meaning 'tax ought to have been paid'.

M/s Gherual Balchand [45 VST 195] P & H High Court has allowed the set off though the seller had not paid the taxes into the Govt. treasury. It has been further observed that, before grant of registration certificate the Revenue has to make full inquiry about the bonafides of the vendor and it satisfied then only the registration certificate is issued to him.

M/s Multi Mail Producer [122 STC 605] the Madhya Pradesh High Court had observed that once the dealer produces the purchase bill, it will be presumed that the tax on that transaction has been paid and no other evidence is necessary.

RELEVENCE OF AUDIT U/S 61 vis-à-vis ACTION PROPOSED BY THE DEPATMENT.

In addition to Audit U/S 61 by an "Accountant" there are three different Audit branches viz- **Business Audit, Refund Audit, Desk Audit** yet another biggest hurdle, the **"Issue Based Audit'.**
As long as the auditor's responsibility is concerned he has to ensure that the conditions stipulated by section 48 relating to Tax Invoice and other general conditions by rule 55 are followed properly then there is no issue in allowing the setoff. Even if the auditor opines to disallow the set off still the dealer has an option **not to accept in submission part of 704**. The discussions are going on in our fraternity that the controversy created by the Bombay High Court is likely to be presented in different manner again which shall take care of rescue of genuine buyer who should not suffer for the default of others. However it would be important

to note that when the website of state government on which we are uploading the audit reports where the information is available about the default dealers and still we don't use that information ,then probably we may be failing in discharging our professional duties.

AUDITORS ROLE AND PRECAUTION :

Irrespective of the fact whether Dealer has actually affected purchases or supplier turns defaulter for any reason or the purchase itself is bogus the VAT Auditor is required to act diligently . The reporting by the VAT Auditor is under scanner which is clear from the Internal Circular 8 A of 2010 dated 20.07.2010 and at the same time the **Standards on Auditing** issued by ICAI are binding on its members who are required to follow the same. It is also necessary to see what kind of certification is stipulated in form 704 and the risks associated with the same.

Internal Circular No. 8 A of 2010 Dated 20/07/2010

Having Subject as **Scrutiny of Desk Audit Reports in Form 704** filed u/s 61 of the MVAT Act, 2001 the said circular proposes action based on scrutiny of 704 by the **Desk Audit Cell** which shall scrutinize the audit report in form 704 and for deficiencies pointed out by the VAT auditor the follow up action is proposed against the Dealer. However for incomplete, wrongly certified and having found negligence in preparing Audit Report the **Committee for Disciplinary Action** is proposed. However during the scrutiny (face checking) or desk audit of form 704, if it is observed by the officer that the audit report submitted by the auditor is incomplete or has been wrongly certified by the auditor or auditor is negligent in preparing audit report the Desk Audit Cell in Mumbai or joint Commissioner of Sales Tax (VAT Admin) will report to the following Committee for examination and further necessary action. The Constitution of the committee is as under:

Addl. Commissioner of Sales Tax [Est.]	Chairman
Joint Commissioner of Sales Tax [HQ-1.]	Member
Joint Commissioner of Sales Tax [Legal]	Member
Deputy Commissioner of Sales Tax [Desk Audit Cell, Mumbai]	Member Secretary

The committee shall scrutinize the audit report referred to them and if they form an opinion that disciplinary action needs to be initiated against the auditor, then the Committee shall refer the case to respective institute for initiation of disciplinary action, with the approval of Commissioner of Sales Tax. Such cases shall also be selected for Business Audit.

Though the department referred in this internal circular the period of audit till F.Y. 2008-09 since issued in August 2010 but still the disciplinary action proposed is to be kept in to mind while conducting VAT Audits.

APPLICATION OF AUDITING STANDARD FOR AUDIT REPORT IN FORM 704.

Auditors' Responsibility Statements-Para 1(C) of Part I of Form 704 requires VAT auditor to report as to whether he has conducted audit in accordance with the Standard Auditing Principals generally accepted in India. Thus while conducting the VAT Audit the Standards on Auditing [SAs] are also applicable. Besides SAs the VAT auditor is also expected to take into account various other auditing pronouncements such as Guidance Notes etc issued by the ICAI.

The VAT Auditor make the "auditor's responsibility statements" mentioning that the maintenance of books of account and sales tax related records is the responsibility of the entity's management and his responsibility is to express an opinion on maintenance of sales tax related records based on the audit carried out by him. Further, the vat auditor has conducted the audit in accordance with statement also mentions that eh auditor has obtained reasonable assurance about the financial statement also mentions that the auditor has obtained reasonable assurance about the financial statements and sales tax related records being free from material mis-statements. Further, the auditor has examined the documents on test check basis to form his opinion.

Reporting requirements [Clause 2 [B]-Though in clause 1 C the VAT Auditor clarifies his role and responsibility but the reporting under clause 2 B is more specific and in relation to the topic of this paper following certification needs more attention.

Clause [b] Instructions to be followed -This clause requires the vat auditor to certify that he has not only read but also followed the instructions for preparation of the audit report. That is to say, all the instructions which are given at the beginning of Form are to be followed scrupulously. Since this is the part where certificates are to be given by the auditors the information given in the schedules and the annexure also acquires the status of the certificates. It is the responsibility of the dealer to prepare the information required for schedule and annexure from the books of account and give the same to the vat auditor. The auditor's responsibility is to verify the books of account and related records, documents and supporting evidences. There are sets of instructions and Trade circulars issued by the Commissioner of Sales Tax. Besides, in the instructions in relation to e-template, some of the instructions are contradictory. Therefore, the vat auditor may is expected to have understanding of such instructions.

Clause (h) Computation of set off admissible in respect of purchases made during the period under audit and adjustments thereto are correct. While ascertaining the correctness, *I /we have taken into account the factors such as goods returned, adjustments on account of discounts as also debit/credit notes issued or received on account of other reasons and these

claims and adjustments are supported by necessary documents. The Set-off is worked out only on the basis of tax invoices in respect of the purchases.

Clause (k) The records related to the receipts and dispatches of goods are correct and properly maintained.

Clause 5- Qualification or remarks having impact on the tax liability-In this chapter while discussing the reporting requirement at clause 3 as also on various clauses of certificates and opinion required in Para 2B, discussion about the qualification and its quantification of the impact on the tax liability, if any, of the dealer is to be given. One has to consider last Para of instruction No. 11 wherein the vat auditor is called upon to give his material remarks and qualification in Para 5 of part 1. This being the case, only material remarks having impact on the tax liability is to be given in brief. Disclaimers or remarks and observations wherein the auditor is not in a position to quantify the tax impact may be reported here with appropriate disclosure. Other observations which are not qualificatory in nature and not having any tax impact may also be reported here in Para5. Observations in relation to matters which are not in respect of certificates/opinions covered by Para 2 B may also be reported here.

SPECIAL CARE WHILE REPORTING IN ANNEXURE J2 WITH REFERENCE TO SEC. 48 (5), CIRCULAR 8 T OF 2012 AND HAWALA DEALERS.

The auditor can ask for the Pivot Table (Excel Utility), in which Party wise, Value wise, TIN wise details of purchases can be obtained on which the set off has been claimed by the dealer. A v lookup (Excel command) will have to be operated with the above table with the list of the hawala dealer, Short Filler, Non Filler etc. which is available on the web site of Department. This comparison will through up the list of parties from whom purchase has been made by the client from such dealers which are Hawala Dealers, Short Filler, and Non Filler from the department's point of view.

The above list needs to be presented to the client for his confirmation who shall decide the stand he wishes to take in respect of these transactions. The first simple stand can be that the client accepts the fact that bills are hawala bills and therefore does not claim set off on the bills of hawala parties due to which there will be tax payable and interest u/s 30 (2). In the above case the client will also have to revise the return to reduce the claim of set off which is claimed by him.

It is possible that the client feels that although the department has labeled the dealer as hawala but they are not in fact so and are still operating in the market and therefore the dealer wants to claim set off. In this situation it will be responsibility of the auditor to take a stand in the matter he needs to verify the documentary evidence available with the client.

Secondly he needs to discuss with the client in respect of availability of set off. It is to be noted that set off is not disallowable legally u/s 48 (5) merely because the dealer is, declared as suspicious dealer by the department. It is to be verified as to from what date the registration of the suspicious party has been cancelled. If the said dealers was registered at the time of purchase (documentary evidence to be provided by your client), then in such case set off can be allowed by the auditor. It may be noted that the auditor has to gather sufficient evidence and prepare a note which would form part of audit working papers.

The stand of the client to claim set off may not be wrong, because it has come to light that the department is labeling the dealers as hawala dealers, suspicious dealers without proper documentary evidence. In such situation it would be appropriate on the part of the client to litigate the matter. The issue arises whether the auditor needs to report the matter in Form 704 in respect of allowance of set off pertaining parties alleged to be suspicious dealer hawala dealers. It is my personal opinion that while commenting in response to clause 2 B(h) Part 1 of the audit certification, we need to draft an appropriate note to inform the Government of the fact that the set off of the entire local purchase has been taken. We also need to mention that, "on the basis of information and documentary evidence provided by the client, set off has been claimed on all local purchases although the department is likely to take an adverse stand in some of the cases.
Another problem which the auditor and the client whose 704 is to be uploaded may face is that Annexure J2 may not accept the TIN No. of the dealers who are hawala dealers and hence the net and tax figures of such parties shall have to be written in others row No. 1000 and a suitable remark will have to be made in the report while giving response to the audit certificates.

The auditor has to be cautious while reporting purchase made by the client from hawala dealers especially in cases where there is no proper documentation and / or documentation is insufficient & the suppliers has been labeled as hawala dealer. The auditor needs to ensure that the above exercise is done only in cases where dealer from whom purchase is made is labeled as hawala dealer by the department. In case of disallowance of set off u/s 48 (5) for non tax payers or short tax payers the claim has to be fully allowed by the auditor as the client has purchased from a genuine dealer and supplier has shown the purchases made by your client.

Negative certification, if any is to be incorporated with reasons and should correspond to the relevant certificate. Further, the auditor's remarks are to be included at Para 5 of Part-1 and qualifications having the impact on the tax liability in brief, wherever applicable.

Where dealer is required to maintain the records about the sales, purchases, Imports and Exports under Central Excise Act, 1944, the Customs Act, 1962 or under the State Excise Act in such cases the Auditor should invariably correlate the details of sales, purchases, Imports and

Exports disclosed under the said Acts and disclosed under MVAT Act, 2002. Any material difference noticed should be reported at Para 5 of Pat-1 accordingly. In case of doubts the VAT auditor may also obtain necessary clarification or management representation letters to form his opinion.

THE SUMMERY OF STANDARDS AND ITS APPLICABILITY IN RELATION TO VAT AUDIT

In my opinion the VAT Auditor may refer to the following Standard on auditing which are briefly discussed here-in-after.

SA 230 (Revised) - Audit Documentation- The auditor should make suitable documentation during the conduct of audit. Documentation refers to the working papers that the auditor obtains in connection with the performance of audit. Working paper aid in planning , performance, supervision and review of their audit work . It provide evidence of their work performed.

SA-250 Consideration of Laws Regulation in an Audit of Financial Statement-The auditor should consider the effect and obtain the general understanding of the legal and regulatory framework applicable to the entity and how they are complying with that framework. The auditor should identify instances of non-compliance with these laws and regulation where non compliances are materially affecting the Reporting Requirement.

SA – 315 Identifying and assessing the risk of material mis-statement through understanding the entity and its environment. The auditor should use professional judgment to assess audit risks and to design audit procedures to ensure that it is reduced to an acceptably low level. Audit risk means the risk that the auditor gives an inappropriate opinion when the financial statement are materially misstated.

SA-500 Audit Evidence - The auditor is required to obtain sufficient and appropriate audit evidence to enable them to draw reasonable conclusion there from on which their opinion is based on the financial information. The auditor normally relies on evidence that is persuasive rather than conclusive in nature. The auditor may be obtaining evidence on selective basis by way of either judgmental or statistical sampling procedure. External evidence is more reliable than internal evidence. Internal evidence is more reliable when related internal control are satisfactory. Written evidence is more reliable than oral evidence and self obtained evidence is more reliable than obtained through entity.

SA-505 External Confirmations - Audit Evidence include both information contained in accounting records underlying the financial statement and other information. In this case the information available on web site can be considered as external confirmation.

SA- 580 Written Representation -During the course of an audit management makes many representation to the auditor either unsolicited or in the response to specific enquiries.

Representation should be obtained from the management in writing in respect of matter which is material for reporting when other sufficient appropriate audit evidence is not available.

PROPFESSIONAL MISCONDUCT :

Part I of the Second Schedule to the chartered Accountants Act 1949 inter alia provides that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he fails in discharging his duties. Having seen the overall scope of reporting requirement of Form 704 and the disciplinary action proposed by the Sales Department the VAT Auditor can be charged in following situations.

(a) Failed in disclosing a material fact known to him the disclosure of which is necessary.

(b) Fails to report a material misstatement know to him.

(c) Is grossly negligent in the conduct of his professional duties.

(d) Fails to obtain sufficient information to warrant the expression of an opinion or his exception are sufficiently material to negate the expression of an opinion.

(e) Fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

WRAPPING UP :

It is universal truth that 'nobody pays taxes with pleasure' therefore in a political system of welfare of the people, the collection of resources is the major hurdle for development process and for that the State has to use forceful steps to collect the revenue. While doing so the State has to punish the defaulters but at the same time it is the duty of the State to see that honesty is not disgraced and the dishonesty is not given premium.

Our country has progressed rapidly but every step has unfortunately brought a downside in form of Hawala, fraud, abuse, and stealing. No one would like to protect the Hawala dealers but there should not be any injustice to the bona fide buyers. Fraudulent practices are exercised universally but the punishment there is more hard .Western Countries have created a system in which who try to break the system by using unfair means is punished. **Even school and colleges have a strict code** against cheating and no matter how high profile the person is. The Society don't flinch at teaching the wrong doer a lesson.

We professional are needed to be vigil in respect of mal practices being followed in business circle since the transactions though prima facie appears to be a reasonable one but so is not the case. Even after making default good by the dealer, for incorrect reporting auditor cannot

be spared therefore it is the need of a time that we do not bat without helmet even in practice match in order to save our head.

I am thankful to Managing Committee of Nagpur Branch for reposing their confidence in me by offering repeated opportunities for paper presentation and sharing my views with all of you.