

Chapter III

Non-compliance with Rules and Regulations

3.1 Introduction

Section 16 of CAG's (DPC) Act, 1971 deals with CAG's duty in relation to Audit of Receipts and requires CAG to audit receipts payable into consolidated fund of India and to satisfy that the rules and procedures are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed. To carry out our mandate as per the provisions of CAG's DPC Act, as part of our audit of field formations of CBEC, we verify records of assessees, which form the basis for tax calculation, to examine the extent of effectiveness of the systems in place in ensuring that assessees comply with extant rules and procedures in this era of self-assessment. The observations on specific failure of the department in carrying out their scrutiny, internal audit, tax base broadening etc are reported in a separate chapter on "Effectiveness of Internal Controls" and the observations on non-compliance by assessees in cases not scrutinized or audited by the department are reported separately under the title "Non-compliance with Rules and Regulations".

We have been pointing out irregularities relating to (i) Payment of Service Tax (ii) Availment of CENVAT credit and (iii) payment of interest every year and it has been noticed that these irregularities are persistent as similar nature of observations are reported by audit every year as detailed below:

Table: 3.1

(₹ in crore)

Nature of Observation	2013-2014		2014-2015		2015-2016	
	No.	Amount	No.	Amount	No.	Amount
Non-payment of Service Tax	37	12.56	47	186.50	76	82.36
Short payment of Service Tax	12	46.05	19	6.39	16	19.68
CENVAT credit	23	43.35	20	9.99	15	14.25
Interest	8	17.32	11	4.70	4	1.94
Total	80	119.28	97	207.58	111	118.23

The Ministry takes rectificatory action only in individual cases pointed out by audit by recovering the amount from that individual assessee or by issuing demand notice for the same. But no action is taken to strengthen systems in place to improve the level of compliance by assessees. This is evident from the fact that we are again reporting 92 cases of non/short payment of Service Tax/interest and irregular availing and utilization of CENVAT credit having a

total revenue implication of ₹ 92.61 crore in current report. *The Ministry needs to ensure that through use of technology and integration of data bases, they put in place such a tax levy and collection system which would make it difficult for assesseees to be non-compliant.*

Out of the 92 cases included in the current report, 80 cases which have been accepted by the department and recoveries made/recovery proceedings initiated are mentioned in **Appendix-III** and 12 cases are discussed in this chapter under the following two major headings:

- Non-Payment of Service Tax
- Incorrect Availing/Utilisation of CENVAT Credit

3.2 Non-payment of Service Tax

3.2.1 Incorrect availing of exemption

3.2.1.1 Wrong exemption on welding and ultrasonic testing services

As per para 14 of mega exemption notification dated 20 June 2012, services by way of construction, erection, commissioning, or installation of original works pertaining to railways is exempted from Service Tax. Further, as per para 7.11.11 of “Taxation of Service: An Education Guide” issued by the Board, if any person is providing services, in respect of projects involving construction of roads, airports, railways, etc., which are used by the contractor in relation to such construction, the benefit of the specified entries in the mega exemption would not be available to such persons unless the activities carried out by the sub-contractor independently and by itself fall in the ambit of the exemption. It has to be appreciated that the wordings used in the exemption are ‘services by way of construction of roads etc.’ and not ‘services in relation to construction of roads etc’.

M/s Speedcrafts Ltd., in Patna Commissionerate, received ₹ 3.78 crore from M/s Phooltas Harsco Rails Solution Pvt. Ltd., for providing (January 2014 to March 2014) welding and ultrasonic testing services. The assessee did not pay Service Tax and Education Cess of ₹ 46.74 lakh thereon on the ground that scope of work falls under the head of “Services by way of construction, erection, commissioning or installation or original work pertaining to railway” as per notification, *ibid* and thus exempted from the payment of the Service Tax. However, the services of welding and ultrasonic testing are in relation to the main service and not by way of construction, erection, installation or commissioning of railways, and hence not exempted as per para 7.11.11 of Education Guide.

Further, Audit noticed that the assessee charged Service Tax and Education Cess from Indian Railways for the same welding and ultrasonic testing

services when bills were raised directly to Railways authorities but when the bills were raised to M/s Phooltas Harsco Rails Solution Pvt. Ltd., (a joint venture company of M/s Speedcrafts Ltd.,) for the same services, it was treated as exempted.

When we pointed this out (May 2015) the Ministry accepted the audit objection and stated (August 2017) that a SCN amounting to ₹ 2.81 crore was being issued to the assessee. Further progress was awaited (October 2017).

3.2.1.2 Incorrect exemption on cleaning services

Cleaning Service is a taxable service⁴¹ except services provided to agriculture/horticulture/dairy/educational institute and a local authority or a governmental authority by way of “water supply, public health, sanitation conservancy, solid waste management or slum improvement and up-gradation”.

M/s Punj Security Housekeeping Services Pvt. Ltd., in Chandigarh-I Commissionerate, had provided the cleaning services to M/s Bharat Heavy Electricals Ltd (BHEL) during the period from July 2014 to March 2015 and received an amount of ₹ 2.49 crore. As the assessee had provided the cleaning services to a commercial and Industrial concern, which was not exempted, he was liable to pay Service Tax on the above amount. But neither the said amount was shown in ST-3 returns nor any Service Tax was paid by the assessee. This has resulted in non-payment of Service Tax of ₹ 30.78 lakh and interest amounting to ₹ 8.71 lakh (upto February 2016).

When we pointed this out (February 2016) the Commissionerate stated (February 2016) that the reply would be submitted after verifying the facts from the assessee. The Ministry’s reply and further action taken by the Commissionerate were awaited (October 2017).

3.2.2 Non-payment of Service Tax on declared service

As per Section 66E(e) of the Finance Act, 1994, agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act is a declared service.

Further, as per Rule 6(2)(vi) of Service Tax (Determination of Value) Rules, 2006, if any accidental damage occurs due to unforeseen actions, then such amount would not be included in the taxable value of service. Liquidated damage arises due to breach of condition of agreement, contract or MOUs. If such damages are not due to unforeseen actions, then, it will be considered as consideration and Service Tax would be applicable.

⁴¹ As per negative list of services and mega exemption notification No. 25/2012 dated 20th June 2012

M/s Electronics Corporation of India Ltd., (M/s ECIL), in Hyderabad III Commissionerate, had recovered an amount of ₹ 10.34 crore during FY15 to FY16, from suppliers towards liquidated damages/late delivery charges. On examination of the agreement entered into with the supplier, it was noticed that the supplier is liable to pay liquidated damages at the rate of 1 per cent minimum and maximum of at the rate of 10 per cent for undelivered quantity per week. The liquidated damages/late delivery charges are paid by the supplier for delayed supply of the materials and such delay is tolerated by the assessee on payment of an amount by the supplier as agreed upon by a written agreement, therefore such act is a declared service in terms of Section 66(E)(e) of Finance Act 1994. The un-discharged Service Tax on liquidated damages amounting to ₹ 1.39 crore along with interest needs to be recovered from the assessee.

When we pointed this out (August 2016) the Commissionerate accepted (January 2017) the objection and stated that a SCN would be issued to recover the amount involved in the objection.

The reply of the Ministry and further progress were awaited (October 2017).

3.2.3 Undervaluation of taxable service

Section 67 of the Finance Act 1994, prescribes that where Service Tax is chargeable on any taxable service with reference to its value, then such value shall be the gross amount charged by the service provider for such services provided in a case where the provision of service is for a consideration in money.

3.2.3.1 M/s. Asianic Engineering Corporation, Ernakulam, in Cochin Commissionerate, received contract income of ₹ 8.63 crore and ₹ 2.88 crore during FY12 and FY13 respectively as per trial balance. The taxable value as per ST-3 returns, however, was only ₹ 6.83 crore and ₹ 1.78 crore for FY12 and FY13 respectively. This led to undervaluation of taxable service with the resultant short payment of Service Tax of ₹ 34.73 lakh on a differential taxable value of ₹ 2.90 crore.

When we pointed this out (December 2013) the Commissionerate replied (December 2016) that SCN demanding Service Tax amounting to ₹ 1.19 crore along with interest and penalty for the period FY12 to FY15 was issued (November 2016) to the assessee.

The reply of the Ministry was awaited (October 2017).

3.2.3.2 M/s Flytech Aviation Ltd., in Hyderabad-ST Commissionerate, engaged in providing business auxiliary service and management, maintenance or repair service, had collected an amount of ₹ 93.01 lakh from

students towards hostel charges in relation to coaching services offered to hostellers during the period from FY13 to FY15. However, the assessee did not include this amount in its value of taxable service. This has resulted in short payment of Service Tax of ₹ 11.50 lakh besides interest.

When we pointed this out (March 2016) the Commissionerate accepted (February 2017) the objection and stated that a SCN would be issued to recover the amount involved in the objection.

The reply of the Ministry and further progress were awaited (October 2017).

3.2.4 Non-discharge of Service Tax under various taxable services

As per section 68 of Finance Act, 1994, every person providing taxable services to any person shall pay Service Tax at the rate specified in section 66B in such manner and within such period as may be prescribed. Further, as per rule 6 of Service Tax Rules, 1994, the Service Tax shall be paid to the credit of the Central Government by the 6th day of the month, if the duty is deposited electronically through internet banking and by the 5th of the month, in any other case.

M/s PTC Engineering India Pvt. Ltd., in Noida-II Commissionerate, was required to pay (November 2015 to March 2016) Service Tax to the extent of ₹ 24.75 lakh for Manpower Recruitment Agency, Goods Transport Agency and Renting of Immovable Property services but did not pay the same. Hence, Service Tax amounting to ₹ 24.75 lakh was recoverable from the assessee along with interest and penalty, as applicable.

When we pointed this out (May 2016) the Ministry accepted the audit objection (June 2017) and stated that a draft SCN was under preparation. Further progress was awaited (October 2017)

3.2.5 Non-discharge of Service Tax by service recipient under reverse charge mechanism

The service recipient is liable to pay Service Tax under Reverse Charge Mechanism in certain cases. As per clause (h) of Notification dated 20 June 2012, where service provider engaged in man power supply is individual, proprietor, partnership, HUF or association of person and the service recipient is body corporate, the service recipient is liable to pay Service Tax to the extent of 75 per cent of taxable value.

M/s CTA Logistics in Ahmedabad ST Commissionerate, received manpower supply services amounting to ₹ 2.48 crore during FY13 to FY14. In some of the invoices service providers clearly mentioned that Service Tax was required to be paid on 75 per cent of the value by service recipient. However the assessee, being service recipient, did not pay any Service Tax under

reverse charge mechanism as per above notification. This resulted in non-payment of Service Tax of ₹ 23.02 lakh calculated on 75 per cent of the taxable value of the service received.

When we pointed this out (August 2014) the Ministry accepted the audit objection and stated (September 2017) that SCN was under preparation.

Further progress was awaited (October 2017).

3.3 Incorrect availing/utilisation of CENVAT credit

3.3.1 Non-reversal of CENVAT credit on exempted service

Rule 6 of the CENVAT credit Rules, 2004 provides that CENVAT credit *shall not be allowed* on such quantity of input or input service used in or in relation to provision of exempted services.

3.3.1.1 M/s Apollo Hospitals Enterprise Ltd., in Hyderabad ST Commissionerate, was engaged in providing Cosmetic & Plastic Surgery service, Franchise service, Renting of immovable property service etc. It was noticed that during the period from FY13 to FY15, the assessee also rendered health care services by a clinical establishment, which is an exempted service. The assessee had taken the credit of tax paid on common input services like common premises rent and security services etc. Therefore, the assessee was required to reverse the CENVAT credit attributable to input services for providing the exempted service for the above period which worked out to ₹ 2.16 crore besides interest.

When we pointed this out (November 2015) the Ministry accepted the audit objection and stated (May 2017) that an amount of ₹ 81.35 lakh was recovered and a SCN was being issued for recovery of remaining amount.

3.3.1.2 M/s Alembic Ltd., in Vadodara-I Commissionerate, availed CENVAT credit of Service Tax paid on services utilized for construction of Residential complex comprising of 532 residential units. Total amount of CENVAT credit availed by the assessee amounted to ₹ 3.54 crore during FY13 and FY15.

On scrutiny, we noticed that the assessee got booking for 360 units before receipt of completion certificate (July 2014) on which Service Tax was paid. However, in respect of remaining 172 units (32.33 per cent) booked after receipt of completion certificate, Service Tax was not required to be paid by the assessee.

Since, the construction services provided by the assessee in respect of these 172 units were exempted from payment of Service Tax, it was not entitled to avail CENVAT credit for input services utilized in respect of these units. Thus,

the assessee was required to reverse the proportionate CENVAT credit of ₹ 1.14 crore.

When we pointed this out (August 2015) the Ministry accepted the audit objection and reported (May 2017) that the assessee had reversed under protest the CENVAT credit of ₹ 1.18 crore as per the proportionate of area of unit sold and that the SCN was not issued in view of further investigation. Further progress was awaited (October 2017).

3.3.2 Premature utilisation of CENVAT credit on exempted service

As per rule 3 (4) of the CENVAT Credit Rules, while paying duty of Service Tax, the CENVAT credit shall be utilized only to the extent such credit is available on the last day of the month/quarter for payment of duty or tax relating to that month/quarter.

M/s Man Structural Private Ltd., in Jaipur Commissionerate, provided works contract services to M/s UP Power Transmission Corporation Ltd., (UPPTL), Allahabad for a value of ₹ 13.18 crore, on which Service Tax (including cess) of ₹ 93.04 lakh was payable. Scrutiny of records revealed that against the total liability of ₹ 93.04 lakh for the months of January to March 2016, the assessee paid ₹ 45.99 lakh through cash and remaining amount of ₹ 47.05 lakh by utilisation of CENVAT credit. The assessee had no credit balances in his CENVAT account as on 31st March 2016. The CENVAT credit utilised was availed by the assessee during the months of April to June 2016, whereas the amount of Service Tax was to be paid during January to March 2016. Thus, utilization of CENVAT credit ₹ 47.05 lakh availed after March 2016 for payment of Service Tax to be paid during January to March 2016 was incorrect, which resulted in short payment of Service Tax.

When we pointed this out (September 2016) the Commissionerate stated (December 2016) that the assessee deposited ₹ 47.05 lakh alongwith interest of ₹ 2.48 lakh.

The Ministry in its reply (September 2017) claimed that the issue was pointed out by its IAP. While we acknowledge that IAP pointed out non-payment of Service Tax by the assessee, the Ministry may note that audit point is on a different issue i.e., premature utilisation of CENVAT credit by the assessee for payment of Service Tax.

3.3.3 Non-Payment of amount of CENVAT credit availed on clearance of inputs as such

Rule 3(5) of CENVAT Credit Rules (CCR), 2004, provides that when inputs or capital goods, on which CENVAT credit had been taken, are removed as such from the premises of provider of output service, the provider of output service shall pay an amount equal to the credit taken in respect of such inputs or capital goods.

M/s. Vodafone Cellular Ltd, in Cochin Commissionerate, cleared (January 2015) three pairs of dark fibre (inputs) with a value of ₹ 3.05 crore as such to M/s. Vodafone South Ltd, Mumbai. The assessee, however, did not reverse proportionate CENVAT credit of ₹ 41.31 lakh, as per ST-3 return for the second half year of FY15, even though reversal of ₹ 41.31 lakh was shown in the invoice. This had resulted in short-reversal of CENVAT credit of ₹ 41.31 lakh.

When we pointed this out (October 2015) the Ministry accepted the audit objection (August 2017) and stated that a SCN was being issued to the assessee.

3.3.4 Incorrect availing of CENVAT credit on input services for older period

As per Notification No. 21/2014-CE(NT) with effect from 01 September 2014, the provider of input service shall not take CENVAT credit of input services after six months of the date of issue of the documents specified in Rule 9(1) of CENVAT Credit Rules, 2004 which was extended up to one year with effect from 1st March 2015.

Audit scrutinised CENVAT register of input service pertaining to M/s Netmagic IT Services Ltd., in Mumbai ST-VI Commissionerate, for the months of September 2014 to March 2015. It was observed that the assessee had availed Service Tax credit of ₹ 12.70 lakh on input services of older period i.e. after six months/one year of the date of issue of documents. This resulted in irregular availing of CENVAT credit which was recoverable alongwith interest.

When we pointed this out (November 2016) the assessee had paid CENVAT credit of ₹ 12.70 lakh along with interest of ₹ 7.84 lakh

The Ministry's reply was awaited (October2017).