

Section 1 - Service Tax



1.1.1 Banking and other Financial Services- a brief description

Financial services refer to services provided by the finance industry. The finance industry encompasses a broad range of organisations that deal with management of money. Among these organisations are banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly or through capital markets. A bank connects customers with capital deficits to customers with capital surpluses.

Service tax on Banking and other Financial Service (BFN) was levied with effect from 1 July 2001. The scope of this service has been expanded from time to time through changes/amendments in the Finance Acts.

Section 65(12) of the Finance Act, 1994 defines BFN as ‘any service’ in relation to: -

- (a) Banking companies and financial institutions including non banking financial companies (NBFC) with effect from 16 July 2001.
- (b) ‘Other body corporate’ not covered in (a) with effect from 16 August 2002. Body corporate will include all types of organisations, which are incorporated under any statute. All the services provided by body corporate will be liable to service tax. The body corporate need not be a banking company or financial institution including NBFC.
- (c) Foreign exchange broker not covered in (a) or (b) with effect from 1 July 2003. Foreign exchange broker includes any authorised dealer of foreign exchange. Being an inclusive definition, it covers any person engaged in foreign exchange broking and mainly intended to rope in other entities (like individuals, HUFs, firms) who are engaged in foreign exchange broking.
- (d) Other commercial concerns not falling under (a) to (c) with effect from 10 September 2004. Cooperative banks which are not covered under the definition of ‘banking company,’ fall under the category of ‘any other commercial concern’ and become taxable under this category of service with effect from 10 September 2004.
- (e) Other persons (including commercial concerns) not falling under (a) to (d) with effect from 1 May 2006.

The following two services were further included in the definition of banking and other financial services:

- Banker to an issue services; and
- cheque, transfer of money including telegraphic transfer, mail transfer and electronic transfer services.

Credit card services have been removed from 'Banking and other Financial services' with effect from 1 May 2006 and are being taxed separately.

1.1.2 Why we chose this topic

The banking business is no longer the monopoly of Government of India. Many new entrants from private sector have made their presence felt in banking business and have given a completely new dimension to the banking business. The banking business had gone much beyond its primary activity of borrowing/lending of money.

The service tax on Banking and other financial service is also a major contributor in service tax revenue. Its contribution during the years 2007-08 and 2008-09 is 7.09 per cent (₹ 3634.94 crore out of ₹ 51,301.79 crore) and 6.15 per cent (₹ 3747.65 crore out of ₹ 60,940 crore) respectively. Thus, this service was considered topical for taking up the review.

1.1.3 Audit objectives

The comprehensive performance review was conducted in audit to: -

- seek assurance that the mechanism to identify and bring in potential assessee providing banking and other financial services in tax net for levy of service tax was effective;
- examine the rules, regulations and procedures to identify ambiguities and lacunae that were required to be addressed; and
- identify instances of non-compliance to rules leading to loss of revenue.

1.1.4 Organisational structure

The Central Board of Excise and Customs is the Chief Executive Authority administering Service Tax. It administers service tax through six exclusive service tax commissionerates and 68 other commissionerates which administer both central excise and service tax.

The Directorate General (Service Tax) is a body constituted by Government of India in 1997 to centralise the work of service tax which has been expanding speedily by coverage of more and more services under the service tax net. This body was constituted to ensure that proper establishment and infrastructure could be created under different central excise and service tax commissionerates to monitor the assessment and collection of service tax.

1.1.5 Scope of audit and methodology

We had an entry conference with the officers of Ministry of Finance and CBEC on 24 July 2009 where the audit objectives, scope and special areas of concern were presented and suggestions of the Ministry solicited.

We test checked the records relating to this service, in 60 out of total 74 commissionerates dealing with service tax. Our selection included all the six

exclusive service tax commissionerates and 54 commissionerates dealing with both service tax and central excise. Period covered under audit was from the year 2006-07 to 2008-09.

1.1.6 Response of the department

We acknowledge the cooperation extended by the Ministry of Finance and most of the field formations in providing the necessary information and records during the conduct of this audit. However, some of the commissionerates did not provide all items of information to us. Details of these commissionerates are given in paragraphs 1.2.1 (one commissionerate), 1.2.2.1 (10 commissionerates), 1.2.3 (six commissionerates and two divisions of one commissionerate) and 1.2.4 (six commissionerates). The reasons for not being able to furnish the information were also not communicated. These were noticeable aberrations as other commissionerates were able to provide the same information. The audit recommendations and some of the audit findings were discussed in an exit conference held on 14 June 2011 with the officers of the Ministry. The responses have been incorporated appropriately in the report.



CHAPTER 1.2 FINDINGS ON SYSTEMS, RULES, REGULATIONS AND INTERNAL CONTROLS

We have arranged the audit findings in this chapter under two parts. Part A contains findings on procedural deficiencies in registration of assesseees, receipt of returns and scrutiny of returns. Part B covers ambiguities and inadequacy in rule provisions which result in foregoing of revenue. The relevant provision of Act/Rules is highlighted in a box in the beginning of the audit observation. The notional revenue implication of these findings was ₹ 1457.13 crore and the amount recoverable was ₹ 9.09 crore. Certain illustrative cases have been used to highlight these issues.

PART A: PROCEDURAL DEFICIENCIES

1.2.1 Registration

Every person liable to pay service tax has to apply for registration within a period of 30 days from the date of commencement of his business.

For registration of eligible service providers, the Government has relied largely on 'voluntary compliance'. Thus an entity, though liable to pay service tax, can evade tax by not applying for registration.

The Director General of Service Tax, Mumbai, the nodal agency to administer service tax, had issued a comprehensive action plan in May 2003 to monitor the administration of service tax. As per this instruction dated 26 May 2003, the department was required to collect the list of service tax providers from various service providers associations, yellow pages, other local association publications, advertisement appearing in newspapers, regional registration authorities, websites, etc. to identify the unregistered service providers and to get them registered.

It had identified field survey as one of the important mechanisms in the action plan to identify potential assesseees and broaden the tax base. The circular had also suggested a performance monitoring system for surveys. Every range officer was to be entrusted with the job of doing surveys to identify potential service tax assesseees in his jurisdiction and report the outcome every fortnight to their commissionerates through the divisional office.

In our earlier performance audit reports on Management Consultant's services, Scientific or Technical Consultancy services, Technical Testing and Analysis services and Technical Inspection and Certification Services (March 2006), Rent-a-cab scheme Operators' services, Photography services and Health Club and Fitness Centre services (March 2007), Business Auxiliary services (March 2008) and Construction Services (March 2009), we had commented on the inadequacy and ineffectiveness of surveys undertaken by the department. Our findings in this review are quite similar.

None of the 60 commissionerates test checked in audit had fixed any targets for survey during 2007-08 to 2008-09. No surveys were conducted in 27 out of 60 commissionerates, including all the six exclusive service tax commissionerates. Chennai III commissionerate did not provide the information on the number of surveys conducted. Out of 32 commissionerates where surveys were conducted, 9 commissionerates stated that 154 new service providers of BFN were registered through surveys resulting in additional revenue of ₹ 1.84 crore during the year 2007-08 to 2008-09. However, no new service providers could be registered through surveys for this service in remaining 23 commissionerates. Moreover, in the 32 commissionerates where surveys had taken place, the outcome was not monitored as prescribed in the DGST circular.

We attempted, on a limited scale, to identify unregistered service providers who were liable to pay tax. For this purpose, we identified entities, who had provided BFN services to various departments of State and Central Government. We also identified service providers by scrutinising returns in the Income Tax department and records of other secondary sources like Registrar of companies, Registrar of co-operative societies, Reserve Bank of India and National Bank for Agriculture and Rural Development (NABARD). Thereafter, we obtained a list of registered service providers from the jurisdictional excise commissionerates and verified whether the service providers identified by us were featuring in the list of registered providers provided by the department. We found that in 26 out of 60 commissionerates, there were 1142 service providers for this service, who, though liable to pay service tax, were not available on the departmental registration lists. The majority of them were in the commissionerates where surveys had not been conducted. However there were 92 such cases detected in 8 commissionerates¹ where surveys had been conducted. The majority were from Jamshedpur (34 cases) and Ranchi (48 cases) commissionerates.

We attempted to quantify the extent of evasion by these identified potential assesseees. Out of the 1142 identified by us, we were able to obtain data relating to 65 such providers from various sources such as income tax returns (14 cases), Registrar of companies (30 cases), Annual Accounts (11) and other sources (10 cases). We found that, prima facie, these potential assesseees had not paid service tax to the extent of ₹ 92.12 crore. This also implied additional penalty upto ₹ 92.12 crore with further interest liability of ₹ 21.35 crore. All these cases required further detailed verification by the department. The department had confirmed only two cases of non registration upto April 2011 which had a revenue implication of ₹ 9.94 crore besides interest and penalty.

Recommendation Nos. 1 and 2

- *The department needs to take up various measures prescribed by the DGST, including surveys to identify potential assesseees for service tax and get them registered.*
- *The Board may liaison with statutory authorities such as the RBI to obtain information regarding non banking financial companies to bring them*

¹ Hyderabad II (1), Hyderabad III (2), Vadodara II (1), Chandigarh I (3), Jamshedpur (34), Ranchi (48), Nagpur (2) and Jaipur I (1)

under the service tax net. Further, the Board should widely publicise the requirement of registration in the electronic and print media.

Pursuant to the exit conference, the Board intimated about some general measures like field surveys, collection of information from other commissionerates/ departments, collection of data through websites/yellow pages etc. on a continuous basis by the field formations to identify unregistered service providers. However, it was silent about specific measures like liaisoning with statutory authorities such as RBI to obtain information regarding non banking financial companies as recommended by us.

1.2.2 Monitoring of receipt of service tax returns

Every person liable to pay service tax has to assess and pay his own tax. He has to furnish half yearly returns to the department. A person failing to furnish timely returns is liable to pay a penalty subject to a maximum of one thousand rupees.

The scrutiny of returns is one of the critical tools for effective administration of service tax and to guard against risk of evasion by registered service providers. It, therefore, follows that the regular receipt of returns from all service providers is to be monitored by the department.

1.2.2.1 Receipt of returns

We had called for the statistics on the returns submission from all 74 commissionerates. The information was furnished by 64 commissionerates and 10 commissionerates² did not furnish the requisite information. The information furnished by these 64 commissionerates showed that a large number of returns were either not received or received late but the department had not taken any corrective action. The position of receipt of returns during the period September 2004 to March 2009 by the department is shown in the following table: -

Table No. 1

Name of service	No. of returns due	No. of returns received	Returns received by due date	Returns received late	No. of returns not received	Penalty levied and waived for late submission	Penalty not levied @ ₹ 1000/- per return
						(Lakh of rupees)	
BFN	226490	194151	181474	12677	32339	14.77	435.39
Percentage of returns due		85.72	80.12	5.60	14.28		

- The table shows that six per cent of returns were received late and 14 per cent of the returns were not received at all. We found that the test checked commissionerates had not followed any monitoring mechanism to ascertain the reasons for non-submission of returns.
- The Government had exempted small service providers delivering taxable service upto ₹ 4 lakh from payment of service tax from 1 April 2005. This

² Hyderabad IV, Delhi ST, Panchkula, Rohtak, Ahmedabad ST, Bolpur, Kolkata ST, Pune I, Pune III and Chennai III.

limit was increased to ₹ 8 lakh from 1 April 2007 and ₹ 10 lakh from 1 April 2008. Amongst the returns not received, we found 301 service providers, whose annual receipts of BFN had exceeded ₹ four lakh during the year 2005-06, but they had not submitted the returns for the year 2006-07. Further, 440 service providers, whose annual receipts of BFN had exceeded ₹ eight lakh during the year 2006-07, but they had not submitted the returns for the year 2007-08. Similarly, 513 service providers whose annual receipt of BFN had exceeded ₹ ten lakh during the year 2007-08, had not submitted the returns for the year 2008-09. The department had not taken any action to ascertain whether the value of services provided had fallen below exemption limits for these assesseees or they had stopped filing returns to evade payment of tax. Thus, it did not know why these service providers had abruptly stopped filing returns.

- The levy of penalty for delayed submission and non submission of returns serves as a deterrent but the department did not impose penalty of ₹ 4.35 crore on defaulting assesseees. This amount was 97 per cent of the total amount leviable (₹ 4.50 crore).

1.2.2.2 Registered service providers who have stopped filing returns

We did an independent verification, on a limited scale, of income tax returns and other connected records of some of the registered service providers who had stopped filing returns for service tax. We found 7 assesseees in Nagpur commissionerate, who had not filed their service tax returns but had continued to provide services during the period of non-filing. This resulted in non-payment of service tax of ₹ 20.33 lakh and interest of ₹ 4.97 lakh. Some illustrative cases are mentioned in the table below: -

Table No. 2

(Amount in lakh of rupees)

Sl. No.	Commissionerate	Name of Assessee	Revenue effect		Source of data
			Tax	Interest	
1.	Nagpur	M/s. Berar Finance	7.71	1.88	IT return
2.	Nagpur	M/s Leo Marketing and Auto Deal	3.00	0.77	IT return
3.	Nagpur	M/s Mendhekar Enterprises	2.94	0.57	IT return

1.2.3 Scrutiny of returns

The authority to conduct scrutiny of returns is provided in Rule 5A of the Service Tax Rules, 1994 which authorises the Commissioner to empower any officer to carry out 'Scrutiny, verification and checks, as may be necessary to safeguard the interest of revenue'. The Rule also allows such an officer to call for any record maintained by the assessee for scrutinising the return to determine the correctness of the assessments made. The Board has also issued guidelines vide letter F.No.137/27/2007 CX.4, dated 8 February 2007, which makes it mandatory to scrutinise returns on a regular basis. The guidelines clearly envisaged that returns' scrutiny would become the core function of the Service Tax Ranges.

1.2.3.1 The compiled departmental data for 67 out of 74 commissionerates

and two divisions of Delhi ST commissionerate for the year 2008-09 showed that 12.38 per cent of the returns received for this service (received: 52423 verified: 45935) were pending preliminary verification/scrutiny. Six commissionerates³ and two divisions of Delhi ST commissionerate did not furnish the information.

1.2.3.2 We also found 99 cases in 22 commissionerates where the departmental officers had scrutinised the returns but failed to detect irregularities like payment of service tax at lower rate, non-levy of interest and penalty, short payment of interest, etc. which had led to short levy of service tax totalling ₹ 7.02 crore and interest of ₹ 1.56 crore. Of these, the department had accepted audit observations involving revenue of ₹ 2.15 crore and had recovered ₹ 1.21 crore and issued SCNs for ₹ 1.21 crore. An illustrative case is given below: -

We observed that M/s Citifinancial Consumer Finance India Ltd., in Delhi ST commissionerate continued to pay service tax at the lower rate during the period between April 2006 to March 2008 even after the rates has been enhanced from 10.2 per cent to 12.24 per cent with effect from 18 April 2006. This resulted in short payment of service tax of ₹ 77.33 lakh.

We pointed this out in September 2009. The reply of the department was awaited (April 2011).

1.2.3.3 No system exists in the department to co-relate the taxable income as shown in the income tax return with the ST-3 return to identify cases that indicated the need for further examination due to large gaps.

We did a cross verification of ST returns with income tax returns and other records maintained by assesseees. We found that 116 assesseees (in 29 commissionerates) had shown lower figures in ST returns which had service tax implication of ₹ 21.91 crore and interest of ₹ 2.94 crore during the period from September 2004 to March 2009. Two illustrative cases are given below: -

(a) M/s State Bank of India (Industrial Estate Branch), Balasore, in Bhubaneswar I commissionerate was engaged in providing BFN. A cross verification of income tax return with the ST-3 returns filed by the assessee revealed that the assessee had exhibited taxable value in income tax return and value of taxable services in ST-3 returns as ₹ 3.93 crore and ₹ 2.40 crore respectively. In the absence of process of cross verification, the difference had not been examined. This had service tax implication of ₹ 14.23 lakh.

(b) M/s. Cholamandalam DBS Finance Ltd, in Chennai ST commissionerate, was offering income received on processing/service charges, pre-closure charges, insurance/administration charges, documentation charges and PDC (Post Dated Cheque) Swap charges for service tax.

However, other incomes like reimbursement of expenses towards cheque bouncing charges, Electronic Clearing Scheme transfer, Outstation cheque collection, field collection and recovery, post seizure interest charges were not included for service tax purposes for the financial years from 2006-07 to 2008-

³ Bangalore ST, Bolpur, Kolkata ST, Pune I, Pune III, Chennai III and Delhi ST (Division I and II)

09. These incomes have to be reckoned as consideration for the purpose of levy of service tax. Non-levy of service tax on this account worked out to ₹ 8.99 crore and interest of ₹ 2.18 crore.

When we pointed this out, the department partially accepted the audit observation involving service tax of ₹ 8.55 crore and intimated that SCN for ₹ 9.43 crore had been issued in July 2010. Further development was awaited (April 2011).

1.2.4 List of books of accounts not filed

Rule 5 (2) of Service Tax Rules, 1994, stipulates that every assessee shall furnish to the superintendent of central excise at the time of filing his return for the first time, a list of books of accounts maintained by the assessee in relation to service tax.

The shortfall in receipt of details of books of accounts for the period from April 2007 to March 2009 in 68 out of all the 74 commissionerates, is shown below:-

Table No. 3

Name of service	No. of returns received from service providers for the first time	No. of first returns where list of books of accounts not received	Percentage
BFN	9273	2438	26.29

We observed that 26 per cent of service providers had not given the list of books of accounts maintained by them. During the period from April 2007 to March 2009, in 10 commissionerates, not a single assessee had submitted the list of books of accounts at the time of filing of returns for the first time in respect of BFN. The Commissionerates had not pursued these cases to ascertain the reasons for non-submission of these details. Six commissionerates⁴ did not provide the data relating to accounts details being filed with the first ST return despite repeated pursuance for over six months.

Recommendation No. 3

➤ *The mechanisms for monitoring the receipt of returns and scrutiny of returns is required to be streamlined so that timely action is taken to pursue and resolve exceptions and deviations.*

Pursuant to the exit conference, the Board stated that e-filing of ST-3 returns had been made mandatory vide notification dated 19 February 2010 for an assessee who had paid a total service tax of ₹ 10 lakh or more in the preceding financial year. It further stated that a service tax return scrutiny manual has been prepared and circulated to its field formations on 23 April 2009 which contains guidelines for checking/verifying ST-3 return submitted by the service providers. Further it informed that the system of Automation of Central Excise and Service Tax (ACES) had been introduced throughout the country which was able to check the correctness of the returns from the

⁴ Delhi ST, Bolpur, Kolkata ST, Pune I, Pune III and Chennai III

perspective of arithmetical accuracy right away leaving the officers with greater time to perform a detailed scrutiny based on risk parameters. In addition, a revised Service Tax Audit Manual had been circulated to field formations for enhanced efficiency of internal audit which would act as a deterrent to deviations.

PART B: RULES, REGULATIONS AND SYSTEMS

1.2.5 Incorrect interpretation of exemption of interest charged on discounting of bills

As per Rule 6(2)(iv) of Service Tax (Determination of Value) Rules, 2006, interest on loans was excluded from the taxable value.

Again, notification No. 29/2004-S.T, dated 22 September 2004 exempts value of the taxable services provided to a customer, by a banking company, in relation to the interest on (a) overdraft facility, (b) cash credit facility. This notification also exempts the value of discount on bill discounting facility from the levy of service tax.

In 'bill discounting facility', a bank takes the bill drawn by borrower on his customer and pays the borrower after deducting some amount as discount. The bank presents the bill to the customer on the due date of the bill. The deduction on account of discounting is received by the bank as a consideration and has been exempted from payment of service tax by the aforementioned notification. However, if the payment by the customer is delayed, the borrower or his customer pays the bank pre-determined interest depending upon the terms of the transaction.

Therefore, the interest amount charged on bills on delayed payment by the customer is neither in the nature of 'interest on loan' nor covered under any exemption notification and thus, such interest should be chargeable to service tax.

We observed that M/s. UCO Bank, in Kolkata commissionerate, engaged in providing banking and other financial services, received ₹ 70.75 crore as interest from the 'customers' for bills on which discounting facility service was provided during the periods 2008-09. However, no service tax on such interest income was paid treating it as exempted. Had such interest been charged to tax, it would have resulted in realisation of ₹ 8.60 crore as service tax.

When we pointed this out (November 2009), the department replied (May 2010) that SCN for ₹ 10.93 crore had been issued in April 2010. Further development was awaited (April 2011).

Recommendation No. 4

➤ *Notification dated 22 September 2004 does not exempt interest amount charged for late realisation on discounted bills but the service providers were availing exemption under this notification. The government needs to clarify this issue.*

Pursuant to the exit conference, the Board stated that the matter would be examined and clarification issued.

1.2.6 Avoidance of tax on Foreign Exchange broking services

Foreign exchange broking service is leviable to service tax in the category of banking and other financial services. Notification No. 19/2008, provided that the brokers and foreign exchange dealers had the option to pay at 0.25 per cent of the gross amount of currency exchanged towards discharge of service tax liability or at the rate specified in Section 66 of Finance Act, 1994 on the consideration for this service, if the consideration had been shown separately.

We observed that prior to this notification, the service providers providing foreign exchange broking service were not indicating any consideration separately. However after the introduction of this notification, they introduced some very nominal charges as consideration on foreign exchange transactions. We did not find any uniformity in charging of this consideration.

These service providers purchased the foreign currency at the price quoted for the purchase of foreign currency and sold foreign currency at a price quoted for sale of foreign currency and the difference between the two represented the consideration for providing the service.

We found during test check that 32 assesseees in 14 Commissionerates would have paid ₹ 1330.57 crore more as service tax had they paid at 0.25 per cent of transaction value instead of 12.36 per cent of the nominal values of service charge depicted by them. Some illustrative cases are narrated below: -

We observed that M/s Indian Overseas Bank, in Chennai LTU commissionerate, was exchanging foreign currencies. The bank was charging ₹ 100/- per transaction irrespective of amount of currency exchanged although the income of the assessee was directly proportionate to the amount of currency exchanged. It was also observed that the assessee exchanged currency of ₹ 302695.52 crore in 2008-09. The service tax payable at the rate of 0.25 per cent on this amount would have been ₹ 756.74 crore but the service tax paid by the assessee at the rate of 12.36 per cent of nominal processing fee was only ₹ 1.37 lakh.

Two other examples are tabulated below: -

Table No. 4

(Amount in crore of rupees)

Sl. No.	Name of assessee	Commissionerate	Value of currency exchanged	Service tax @ 0.25% of transaction	Service tax paid on nominal consideration	Difference
1.	M/s SBI (Corporate Accounts Group) Branch	Delhi ST	85156.00	212.89	12.63	200.26
2.	M/s South Indian Bank Ltd., Thrissur	Calicut	30268.90	75.67	0.07	75.60

It was evident that the option of 0.25 per cent was totally non-operative as there was a huge gulf with the other option.

We feel that some fixed percentage of the total consideration could represent the service charge, increasing proportionately with increase in consideration.

Recommendation No. 5

➤ *The government may consider prescribing a fixed percentage of the gain from currency exchange as representing the service charges on foreign exchange transactions on which service tax would be payable.*

Pursuant to the exit conference, the Board stated that in the Budget 2011-12, the relevant rules have been amended⁵. Now the service tax is payable as a transaction graded percentage depending on the value of turnover of currency exchange. Alternatively, the value of service may be determined as the difference between the transaction value and the RBI reference rate.

1.2.7 Inconsistent treatment for availing Cenvat credit on interest income

The Cenvat Credit Rules, 2004, allows credit on input services used by a service provider for rendering of output service and utilise such credit towards payment of service tax on output service. Rule 6(3) of Cenvat Credit Rules, 2004 provides that the assessee may either claim Cenvat credit only on inputs used in providing of taxable service by keeping separate accounts of Cenvat credits of inputs, or reduce the Cenvat credit in proportion to the non-taxable service provided.

Rule 6(2)(iv) of Service Tax (Determination of Value) Rules, 2006 has excluded interest on loans in determination of taxable value of Banking and other Financial Services. Input services availed by the financial institutions are being used for providing taxable service as well as granting loans. Consideration is obtained in the form of service charges for the services provided and as interest on loans. Hence, cenvat credit availed by the financial institution for these input services should be reversed proportionate to the component of interest on loans.

We found that the income from interest received in the service of providing loans is a major portion (it ranges from 56.16 per cent to 98.72 per cent of total income of service providers). We also observed that State Bank of India branches in Delhi ST commissionerate were directed by their Headquarters to proportionately reduce cenvat credit treating interest income as exempted service. However, the other assesseees were not following this practice. This resulted in accumulation of cenvat credit of input services linked to interest earned which was exempt from service tax.

Two instances where such proportionate reduction was not effected are tabulated below with revenue implication of ₹ 43.45 crore.

⁵ Vide Notification No. 3/2011 - ST, dated 1 March 2011 and Notifications No. 24/2011 - ST and 26/2011 - ST, both dated 31 March 2011.

Table No. 5

(Amount in crore of rupees)

Sl. No.	Name of Assessee, period	Commissi onerate	Total income including interest on loan	Total taxable income	Total cenvat credit availed	Cenvat credit eligible	Excess cenvat credit availed
1.	M/s Cholamandalam DBS Finance Ltd., 2006-09	Chennai ST	2295.35	209.72 (9.14 per cent)	43.75	4.00 (9.14 per cent)	39.75 (90.86 per cent)
2.	M/s Sundaram Finance Ltd., Chennai, 2008-09	Chennai LTU	1107.19	48.49 (4.38 per cent)	3.87	0.17 (4.38 per cent)	3.70 (95.62 per cent)

It was evident that different financial institutions were following different practices resulting in lack of uniformity and excess availing of credit.

Recommendation No. 6

- *In view of this anomalous position, the government may clarify that Cenvat credit on input services should be reversed in the proportion of interest income from loans to the total income.*

Pursuant to the exit conference, the Board stated that in the Budget 2011-12 amendment had been made in the Cenvat Credit Rules, 2004⁶ requiring a banking company and a financial institution including a non-banking financial company providing taxable service to pay, for every month, an amount equal to fifty per cent of the Cenvat credit availed on inputs and input services in that month. Thus effectively, only 50 per cent of the Cenvat credit availed is allowed to be utilised towards payment of tax or duty.

1.2.8 Incorrect suo-moto adjustment of excess service tax paid

As per Rule 6(4A) of the Service Tax Rules, 1994, where an assessee has paid to the credit of the central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, as the case may be, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter, as the case may be. Under sub-rule (4B), the adjustment of excess amount paid under sub-rule (4A), may be adjusted with a monetary limit of rupees fifty thousand (Rupees one lakh with effect from 1 March 2008) for a relevant month or quarter, as the case may be.

We found that a separate row was provided in the ST-3 return form to show amount adjusted under Rule 6(4A). However, the checklist prescribed in Annexe 2.1 of manual for Scrutiny of Service Tax Returns for preliminary scrutiny of ST-3 returns did not have an item to check the ceiling of ₹ 50000/one lakh. We found 12 instances where the assessee adjusted ₹ 2.07 crore in excess of the prescribed limits. A few examples are given below: -

⁶ By introducing Rule 6(3B).

1.2.8.1 M/s State Bank of India, in Kolkata ST commissionerate, paid service tax on foreign exchange earned for the period from April 2008 to September 2008 which was not actually payable. We found, that the service provider adjusted this amount against service tax liability for the month of March 2009. This amount was required to be claimed as refund and no adjustment was permissible under the Rules cited supra. This had resulted in irregular adjustment of ₹ 29.05 lakh for March 2009 on which interest of ₹ 1.89 lakh was chargeable.

When we pointed this out to the Department in October 2009, the department accepted (March 2011) the audit observation.

In other cases presented in the table below, the assessee adjusted amount largely in excess of the limit of ₹ 1 lakh per month: -

Table No. 6

(Amount in lakh of Rupees)

Sl. No.	Name of the Assessee, Commissionerate	Period	Amount of excess ST paid and adjusted	Actual amount eligible for adjustment	Excess amount adjusted	Interest payable on excess amount adjusted	Total
1	M/s. Citifinancial Consumer Finance (India) Limited, Delhi ST	October 2006 to September 2007	97.27	3.00	94.27	13.99	108.26
2	M/s SBH (IFB) Hyderabad, Hyderabad II	Oct-07, Jun-08 and Sept-08	22.76	3.00	19.76	1.97	21.73
3	M/s SBI, Commercial Branch, Chennai, Chennai ST	March-07	14.83	1.00	13.83	3.60	17.43
4	M/s SBH Main Branch, Gunfoundry, Hyd., Hyderabad II	Jun-07 to Aug-07	16.42	3.00	13.42	1.16	14.58

In the case of M/s. SBI, Commercial Branch, Chennai, in Chennai ST commissionerate, the department had accepted the audit observation (January 2010) and issued SCN for ₹ 14.83 lakh in February 2010. Reply in other three cases was awaited (April 2011).

Recommendation No. 7

➤ The Government should include an item in the ST-3 preliminary scrutiny checklist for checking the limit of adjustment permitted under Rule 6(4A) of Service Tax Rules. This check should also be incorporated in the ACES.

Pursuant to the exit conference, the Board stated as ACES had been developed and monitored by Director General of Systems, the matter would be taken up with them.

1.2.9 Non-maintenance of documents for availing exemption on discount charges

CBEC Notification No. 29/2004 ST dated 22 September 2004 read with No. 30/2004 of the same date and Rule 4A of Service Tax rules provide that discounts charges on bills discounted are exempted from service tax provided that the discount charges are shown in a document containing other essential information specified in Rule 4A.

M/s Vijaya Bank in Bangalore LTU Commissionerate had collected discounted charges of ₹ 145.21 crore during 2004-05 to 2008-09 on account of bills discounted. The bank had not issued any separate invoice/bill or challan but had credited amounts net of discount directly to the customers' accounts. Consequently, the conditions specified in rule and notifications for claiming exemption had not been fulfilled. Similarly, SBI commercial branches, Jaipur and Bhilwara collected ₹ 4.58 crore as discounting charges and availed exemption without issuing any documents.

When we pointed this out (August 2009), the LTU Bangalore contended (November 2009) that under notification 30/2004 the customers were provided with the option of issuing **any document** viz. account statements/pass book, vouchers containing various details required as per service tax rules. It was also stated that this was the uniform practice followed across the Banking industry considering the magnitude of the transactions. The reply of the department did not specify the document(s) issued by banks that contained all the mandatory information namely name, address and the registration number of persons providing and receiving taxable service; description, classification, and value of taxable service and service tax payable thereon.

Recommendation No. 8

➤ *We recommend that the Board should make it binding on banks and similar financial institutions to disclose the documents issued to fulfil the mandatory information requirements for availing exemption on discount charges.*

Pursuant to the exit conference, the Board stated that Banking industry was issuing statement of accounts periodically wherein all the charges debited to parties accounts were reflected in which the details of discount, interest or other such charges were clearly mentioned. However, the Board informed that it would consider issuing a suitable clarification in this regard.

1.2.10 Discount received on Collateralized borrowing and Lending Obligations (CBLO)

The discount received from CBLO attracts Service Tax under 'Banking and other Financial Services' under Section 65 (12) (a) (vi) of chapter V of Finance Act, 1994 under other auxiliary financial services.

CBLO is a discounted instrument used in electronic book entry form with maturity period ranging from one day to one year. The borrowers can deposit securities (Central Government securities including Treasury bills with a residual maturity period of more than six months) with Clearing Corporation of India Ltd., (CCIL) which acts as a Central Counterpart (intermediary) for both borrowers and lenders. The CCIL issues bonds discounted on face value which are purchased by the lender at discounted value. On the date of maturity, borrower deposits the face value with CCIL and the lender gets the same amount. Thus, the lender receives the discount amount in the form of a consideration. We observed that various assesseees had not paid service tax on the discount, as described below: -

- M/s. Federal Bank Ltd., Ernakulam, in Cochin commissionerate, received an amount of ₹ 7.86 crore as discount on CBLO during the period from April 2008 to March 2009 on which service tax of ₹ 97.13 lakh was payable.
- M/s. Vijaya Bank, in Bangalore (LTU) Commissionerate, received an income of ₹ 19.69 crore towards CBLO activities for the period from 2005-06 to 2008-09 on which service tax of ₹ 2.15 crore was payable.
- Similarly M/s. Dhanalakshmi Bank Ltd, Thrissur and M/s. South Indian Bank, Thrissur, both in Calicut commissionerate, had not paid service tax on ₹ 4.92 crore (₹ 3.55 crore and ₹ 1.37 crore respectively), of discount received on CBLO during the period April 2007 to March 2009. Service tax of ₹ 60.74 lakh (₹ 43.83 lakh and ₹ 16.91 lakh respectively) was recoverable.

On this being pointed out (September 2009), the respective commissionerates stated (November 2009) that the discount received by M/s. Vijaya Bank and M/s. Federal Bank Ltd. were the interest for the number of days the funds were borrowed/lent. Since interest on loans was exempted from service tax, the demand of service tax on discount received on CBLO was contrary to the provisions of Act, read with Service tax (Determination of Value) Rules, 2006.

The reply was not tenable. The lending and borrowing is done through CCIL which acts as an intermediary. The intermediary gets guarantee from the borrower through deposited securities and provides guarantee of payment to the lender. Therefore, this instrument is not a direct loan arrangement between two parties. The lender receives the discounted amount as an income. It is relevant to mention that the discount on account of discounting of bills is a similar kind of transaction and was specifically exempted vide notification No.29/2004 dated 22 September 2004. This indicated that the discount received on CBLO is liable to service tax until specifically exempted.

In the cases of M/s. South Indian Bank, Thrissur, the department stated (January 2011) that SCN had been issued in October 2010.

No reply has been received in respect of M/s Dhanalakshmi Bank Ltd. (April 2011).

Recommendation No. 9

- *It is recommended that the Board may examine the issue and clarify the levy of service tax on discount earning from CBLO.*

Pursuant to the exit conference, the Board stated that the matter would be examined and clarified.



CHAPTER 1.3 VALUATION OF TAXABLE SERVICE

The value of taxable service is determined as per Rule 3 of Service Tax (Determination of Value) Rules, 2006. We found 64 instances of undervaluation which resulted in short payment of service tax of ₹ 53.80 crore that was recoverable with interest of ₹ 1.54 crore and penalty. A few cases are described below: -

1.3.1 Undervaluation due to wrong calculation

The branches of State Bank of India (SBI) were maintaining a separate account for the commission and exchange amount earned by them. The service tax was paid for the amount received in this account in month 1 by debiting the same account in month 2. The SBI Head office at Mumbai had instructed the branches to add back the service tax paid in month 2 to work out the total exchange/commission earned in month 2 on which tax would be paid in month 3.

We found that four commissionerates of Gujarat, involving six branches of SBI had not added back the service tax paid, as instructed. Consequently, the total income of exchange and commission was getting understated. During the period from 2004-05 to 2008-09, this resulted in short payment of service tax of ₹ 97.46 lakh including interest.

When we pointed this out (October 2009), the department reported (October 2009) that the entire amount of ₹ 97.46 lakh had been recovered immediately after the audit observations.

1.3.1.1 Similarly, State Bank of India, Industrial Finance, State Bank of India, Overseas branch and State Bank of India, Leather and International branch, all in Chennai (ST) commissionerate, had not added back the service tax payments of the earlier months.

The short payment of service tax for the years from 2006-07 to 2008-09 worked out to ₹ 2.57 crore which was recoverable with interest.

It was ascertained that the correct procedure had been adopted from May 2009.

When we pointed this out (January 2010), the department admitted the audit observations in all the three cases (August 2010) and intimated that SCN for ₹ 2.57 crore had been issued to these assesseees in July 2010.

1.3.1.2 Three bank branches (two branches of State Bank of India and one branch of State Bank of Patiala), in Ludhiana commissionerate, had also not added back the previous month's service tax liability during 2004-05 to 2008-09 resulting in short levy of service tax of ₹ 26.18 lakh. This amount was required to be recovered along with interest of ₹ 8.14 lakh and penalty.

1.3.2 Non inclusion of foreclosure charges in the assessable value

Ministry of Finance letter F.No. 345/6/2008- TRU dated 11 June 2008 has clarified that any amount collected by a service provider on account of lending is either interest or service charges. Pre-closure / fore-closure charges are collected for early payment of loans. These charges not being 'interest' are required to be treated as consideration for the services provided and are accordingly leviable to service tax under Section 65(105)(zm).

M/s. Infrastructure Development Finance Corporation Ltd (IDFC), in Mumbai (ST) commissionerate, had collected ₹ 825.54 lakh on account of foreclosure charges of loans during the period April 2006 to September 2009, on which service tax amounting to ₹ 99.00 lakh was not paid. This was recoverable with interest.

When we pointed this out in December 2009, the Department accepted the audit observation and reported that show cause notice for ₹ 98.78 lakh had been issued in March 2010. Further progress was awaited (April 2011).

1.3.3 Incorrect interpretation of the nature of 'Commitment Charges' leading to its non inclusion in the assessable value

Commitment charges are made for keeping available the undisbursed balance of a loan commitment. Therefore, they are in the nature of charge for services provided and should be included in the assessable value for service tax under BFN services.

1.3.3.1 We found that M/s. Federal Bank Ltd., in Delhi ST Commissionerate, had received directions from its head office to treat commitment charges as taxable. However, M/s. State Bank of India (Corporate Accounts Group Branch) and M/s. State Bank of Patiala (Commercial branch), both in Delhi commissionerate, had received instructions to the contrary. They had not included ₹ 2.84 crore received on account of 'commitment charges' while computing assessable value. Service tax amounting to ₹ 34.98 lakh had not been paid on this amount and was recoverable with interest and penalty.

We pointed this out in October 2009. The reply of the department was awaited (April 2011).

1.3.3.2 During scrutiny of the records of M/s. Indorama Synthetics (India) Ltd., Butibori, in Nagpur commissionerate, registered under BFN service, we found that the assessee had raised loan from two German banks (IKB Deutsche Industriebank, Germany and DEG –Deutsche Institutions-UND Entwicklungsgesellschaft-MBH). According to the loan agreements, the assessee had to pay commitment fee for any undrawn amount of loan. During the years 2005-06 to 2007-08, the assessee had paid ₹ 1.71 crore towards commitment fee to these banks on which service tax of ₹ 18.80 lakh was not paid. This was the liability of the assessee as the service providers (German banks) did not have any office in India. Thus, service tax of ₹ 18.80 lakh was recoverable with interest of ₹ 7.45 lakh and penalty.

This was pointed out in September 2009. The reply of the department was awaited (April 2011).

1.3.3.3 Similarly, M/s Infrastructure Development Finance Corporation Ltd., in Mumbai ST commissionerate had collected commitment fees of ₹ 97.35 lakh during the period April 2006 to March 2009 but had not included in assessable value. Service tax of ₹ 12.03 lakh was payable with interest.

When we pointed this out in December 2009, the department accepted the audit observation and reported (January 2011) issue of show cause notice for ₹ 19.05 lakh in March 2010. Further development was awaited (April 2011).

This issue was also discussed in the exit conference. The Board stated that this would be examined and clarification for achieving a uniform practice would be issued.

1.3.4 Undervaluation due to incorrect classification

Notification No. 29/2004, dated 22 September 2004 provided that discount earned from discounting of bills, bills of exchange or cheques would be exempted from service tax.

M/s. Canbank Factors Limited (a subsidiary of M/s. Canara Bank), in Chennai ST Commissionerate, was providing BFN and claiming exemption under Notification No. 29/2004, dated 22 September 2004 in respect of bank charges and discount charges and the same was allowed in the service tax assessments for the financial years 2006-07 to 2008-09.

As disclosed by the assessee company, the only activity of the assessee was the business of factoring. While, 'factoring' has similarities to 'bill discounting', the former involves outright sale and purchase of receivables whereas the latter is a borrowing where an invoice is used as a collateral. Therefore, two transactions are not identical and the provisions of the notification of September 2004 do not cover the discount income from factoring services. The incorrect exemption resulted in non-payment of service tax of ₹ 21.33 crore which was recoverable with interest.

When we pointed this out in November 2009, the department accepted (January 2010) the audit observation and issued SCN for ₹ 21.33 crore in July 2010. Further development was awaited (April 2011).

1.3.5 Miscellaneous charges and commissions

As per section 67(1) (i) of Finance Act, 2006, where service tax is chargeable on any taxable service with reference to its value, then such value shall in a case where provision of service is for a consideration in money, be gross amount charged by the service provider for such service provided or to be provided by him.

As per section 67(3) of Finance Act, 2004, inserted on 16 June 2005, the gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.

1.3.5.1 M/s Karnataka State Financial Corporation, in Bangalore ST commissionerate, received an amount of ₹ 7.61 crore towards risk premium charges, monitoring agency commission and application fee during the period April 2005 to March 2009. However, Service Tax amounting to ₹ 92.79 lakh on the said charges had not been paid by the assessee and was recoverable with interest.

1.3.5.2 Similarly, in three other cases M/s. ING Vysya Financial Services, M/s. Cisco Systems Capital India Pvt Ltd. and M/s. Vulcan International Insurance, in Bangalore ST commissionerate, had also not added miscellaneous income, service charges, early termination fee and insurance charges to the gross amount of service. This resulted in undervaluation and consequential short payment of service tax amounting to ₹ 58.24 lakh which was recoverable with interest.

1.3.5.3 Cash Management Service (CMS) attracted service tax with effect from 1 June 2007 as exclusion of CMS from the scope of “BFN” was removed through budget changes in 2007 amending section 65.

Since Chit funds were in the nature of CMS, foreman commission on Chit funds attracted service tax with effect from 1 June 2007. According to Profit and Loss Account of M/s. Kerala State Financial Enterprises (KSFE), Thrissur, (Calicut Commissionerate) as on 31 March 2008, it had received an amount of ₹ 9614.96 lakh as foreman commission, finance charges, writing charges and scrutiny fee being the taxable value under BFN. As against the service tax liability of ₹ 11.88 crore, the assessee paid an amount of ₹ 42.85 lakh due to non-inclusion of foreman commission in assessable value. Thus, there was short payment of service tax of ₹ 11.46 crore which was recoverable with interest.

On this being pointed out (September 2009), the department stated (January 2011) that the registered M/s. KSFE Limited, Thrissur, is not providing service under BFN. The branches of the firm all over Kerala have taken independent registration and discharging service tax liability on foreman commission received on chit funds separately. Wherever instance of short payment were noticed, SCNs have been issued to safeguard revenue, by respective jurisdictional offices.

The reply of the department is not accepted in audit. All the receipts of the enterprises including the receipts of branch offices were shown in the centrally maintained profit and loss account. So all type of payments including taxes paid were also shown in this profit and loss account. Thus the total service tax payment shown in their profit and loss account represents the payment of service tax paid at branches as well. The amount of service tax payment was shown as ₹ 42.85 lakh only. Thus the amount of service tax paid was less than the tax payable by the assessee. Further, the department had not produced the details of service tax paid after pointing out by audit.

1.3.5.4 M/s. State Bank of India, Kerala Circle, in Trivandrum commissionerate, was engaged in providing BFN on commission basis. According to the P&L Account of the assessee, bank received commission/exchange on letter of credit, deferred payment/other guarantees, loan processing fee/up front fee, SD locker, postage, telegraph, etc amounting

to ₹ 262.08 crore on which service tax of ₹ 32.15 crore was payable. However, the assessee paid ₹ 23.49 crore, for the years 2006-07 to 2008-09. Thus, there was short payment of service tax to the extent of ₹ 8.66 crore which was recoverable with interest.

1.3.5.5 M/s Suresh Rathi Securities Pvt Limited, Jodhpur, in Jaipur II commissionerate while providing share broking services to its clients collected an amount of ₹ 86.15 lakh during 2007-08 to 2008-09 as late payment charges for making payment to stock exchanges on behalf of the clients. These charges were directly linked to the taxable service being provided to customers and were part of the assessable value. The assessee did not pay service tax of ₹ 10.65 lakh leviable thereon which was recoverable with interest.

1.3.6 Suppression of assessable value

We compared the financial records and ST-3 returns of M/s. IVF Advisors Ltd, an assessee in Mumbai ST commissionerate and found that the value of taxable service under the category of banking and financial services during the period August 2008 to March 2009 had been declared as ₹ 3006.95 lakh in the ST-3 return whereas ₹ 3299.17 lakh had actually been received by the assessee as per its accounts. Thus, the assessee had understated the assessable value by ₹ 292.22 lakh and evaded service tax of ₹ 36.12 lakh. This was recoverable with interest of ₹ 3.13 lakh and penalty.



In terms of rule 4 of the Cenvat Credit Rules, 2004, credit of excise duty or service tax paid on any input, capital goods or any input service is allowed to a provider of taxable service. Credit can be utilised towards payment of service tax on output service subject to the fulfilment of certain conditions.

We observed incorrect availing and utilisation of cenvat credit totalling ₹ 105.30 crore, by providers of banking and financial services in 75 cases. Interest of ₹ 6.26 crore was also leviable in these cases. The department had accepted audit observations involving revenue of ₹ 9.90 crore, recovered ₹ 3.07 crore and issued SCNs for ₹ 9.48 crore.

Some illustrative cases are mentioned in the following paragraphs: -

1.4.1 Separate account of dutiable and exempted goods not kept

Prior to 1 April 2008, if Cenvat credit had been availed on common inputs and input services which were used in providing taxable as well as exempted services and separate account of their use was not maintained, then the output service provider was allowed to utilise credit only upto 20 per cent of the amount of service tax payable on taxable output service.

1.4.1.1 We observed that M/s Infrastructure Development Finance Co Ltd, in Mumbai (ST) commissionerate, provided infrastructure advisory work to the International Finance Corporation for World Bank projects in India during the period 2006-07 and 2007-08 and recovered advisory fees. The assessee availed exemption from service tax under Notification No. 16/2002 dated 2 August 2002 for services provided to International Organisation. The assessee did not maintain separate accounts for receipt, consumption and inventory of input services use for taxable and exempted services.

As per the provisions mentioned above, the assessee was liable to restrict the utilisation of cenvat credit to 20 per cent of the service tax payable during the period 2006-07 and 2007-08. Out of the 24 months in 2006-07 and 2007-08, the assessee paid service tax of ₹ 1198.04 lakh in 12 months⁷. While the utilisation of cenvat credit to make these payments should have been restricted to ₹ 239.61 lakh (20 per cent), the actual utilisation was ₹ 626.65 lakh. This led to excess utilisation of credit of ₹ 387.04 lakh which was recoverable with interest of ₹ 95.84 lakh.

When we pointed this out (December 2009), the Department accepted (January 2011) the audit observation and reported that SCN for ₹ 387.04 lakh had been issued in March 2010.

⁷ May 2006, September 2006, December 2006, January 2007, March 2007, April 2007, May 2007, July 2007, August 2007, September 2007, December 2007 and March 2008

1.4.1.2 M/s. Dena Bank, in Mumbai service tax commissionerate, had received an amount of ₹ 1165.41 lakh as agency commission from Reserve Bank of India for handling Government business (as exempted service) during the period 2006-07 to 2008-09. As the assessee was not maintaining separate accounts for input credit for use in taxable and exempted services, the assessee was liable to restrict utilisation of Cenvat credit to 20 per cent of the service tax payable for the period 2006-07 to 2007-08 and pay an amount equal to 8 per cent of the value of the exempted services during 2008-09. The assessee did not restrict the utilisation of cenvat credit to 20 per cent during the years 2006-07 to 2007-08. This resulted in excess utilisation of credit of ₹ 644.01 lakh during these two years. Thereafter, the assessee did not pay at the rate of 8 per cent of the value of exempted services of ₹ 403.63 lakh. This resulted in non-payment of service tax of ₹ 32.29 lakh during the year 2008-09. Thus, the assessee short paid service tax of ₹ 676.30 lakh which was recoverable with interest of ₹ 185.44 lakh.

When we pointed this out, department intimated that the assessee had segregated services in respect of which they were entitled to utilise 100 per cent cenvat credit during the period 2006-07 and 2007-08 as per Rule 6(5) of Cenvat Credit Rules, 2004. Department further intimated that for 2008-09 the assessee had paid service tax of ₹ 32.29 lakh at the rate of 8 per cent of the value of exempted services along with interest of ₹ 1.05 lakh through the cenvat account and that action was being taken for recovery of interest in cash.

Department's contention that the assessee had utilised 100 per cent credit only on the 16 services specified under Rule 6(5) of the cenvat credit was not correct. Test check of cenvat credit register (soft copy) of 2006-07 and 2007-08 in respect of Ahmedabad and Bhopal regions of Dena Bank revealed that the assessee had availed 100 per cent credit on general insurance (Oriental Insurance Co.), ATM maintenance (NCR Corporation), Sundry expenses, repairs of motor car services, authorised service station services, transport of goods by road, market research agency services, air travel agent services, advertising services, telephone services (BSNL) etc. These services were not specified services on which 100 per cent credit was available as mentioned under Rule 6(5) of the Cenvat Credit Rules, 2004.

1.4.1.3 M/s Gruh Finance Ltd. and M/s. State Bank of India (Specialized Commercial Branch), Ahmedabad, in Ahmedabad (S.T) commissionerate and M/s. The Surat People's Co-operative Bank, in Surat-I commissionerate, had received commission on taxable and non-taxable services rendered and had availed and utilised entire cenvat credit on all the common input services towards payment of service tax without restricting the utilisation to the extent of 20 per cent of service tax payable which resulted in excess utilisation of cenvat credit. The credit utilised for the year 2005-06 to 2007-08 was ₹ 138.37 lakh, whereas credit eligible to be utilised (20 per cent) was ₹ 80.24 lakh. This resulted in short payment of service tax to the extent of ₹ 58.13 lakh which was required to be paid in cash. The assesseees were also liable to pay interest of ₹ 18.97 lakh.

With effect from 1 April 2008, an output service provider not maintaining separate accounts was permitted to choose one of the following options:

- (i) Pay an amount of 8 per cent of the value of exempted services
- (ii) Pay an amount equal to the Cenvat credit attributable to inputs and input services used for provision of exempted services provided by him subject to certain conditions.

1.4.1.4 M/s State Bank of India, Karnal, in Panchkula commissionerate, was rendering both taxable BFN (commission and exchange income) and exempted services (interest on cash credit, discounting of bills, overdraft, bill of exchanges etc). The assessee had availed of cenvat credit of service tax on common input services (telephone, courier, audit fee etc.) but had not maintained separate accounts for input services used in the taxable and exempted output services. The assessee provided exempted output services valued as ₹ 58.72 crore during the year 2008-09. It was liable to pay an amount equal to eight per cent of the exempted output service of ₹ 58.72 crore provided during 2008-09. The unpaid service tax of ₹ 4.70 crore was recoverable with interest of ₹ 45.80 lakh.

1.4.1.5 M/s Akola Janta Commercial Co-op Bank Ltd, in Nagpur Commissionerate, was engaged in providing various taxable banking and financial services like forex broking, lending, issue of letter of credit and bill of exchange, providing bank guarantee, over draft, bill discounting facility etc. It was also providing exempted services such as interest on loans / cash credit / overdraft, discount on bills / cheques purchased and commission received on Government transactions for which it had received ₹ 57.67 crore as per P&L account for the year ended 31 March 2009. It had availed and utilised cenvat credit of service tax paid on various input services during the year 2008-09 without maintaining separate accounts for input services used in providing exempted and taxable services. The assessee was required to pay eight per cent of ₹ 57.67 crore amounting to ₹ 4.61 crore and interest of ₹ 29.99 lakh.

Some other similar cases are tabulated below:

Table No. 7

(Amount in lakh of rupees)

Sl. No.	Name of Assessee	Commissi- onerate	Period	Value of Exempted service	8 per cent of exempted income
1	M/s Bank of India	Kolkata ST	2008-09	1314.91	105.19
2	M/s City Union Bank Ltd.	Trichy	2008-09	23131	1850.48
3	M/s Bank of India, Mumbai Corporate Branch	Mumbai ST	2008-09	3905.83	312.47
4	M/s ABN AMRO Bank	Mumbai	2008-09	296.34	23.71

For the case mentioned at sl. no. 1, when we pointed this out in October 2009, the department admitted the audit observation and intimated that SCN had been issued in January 2010.

1.4.2 Short-payment of amount under Rule 6(3) of Cenvat Credit Rules, 2004

Rule 6(3A)(a) read with Rule 6 (3)(ii) of the Cenvat Credit Rules, 2004 prescribe that the manufacturer of goods or the provider of output services can pay an amount equal to the credit availed that is attributable to exempted products or exempted services. The payment can be made on a provisional basis every month.

1.4.2.1 M/s Allahabad Bank in Kolkata ST commissionerate rendered various taxable financial services as well as exempted services. The assessee did not maintain separate accounts for common input services used for taxable and exempted output services. It determined the amount payable provisionally every month without considering the interest on cash credit and overdraft facility which were exempt from service tax. Failure to do so had resulted in short-payment of ₹ 515.56 lakh for the period from April 2008 to March 2009 which was recoverable with interest of ₹ 47.69 lakh.

The issue was pointed out by us to the Department in October 2009. Reply was awaited (April 2011).

We observed three other similar cases which are tabulated below: -

Table No. 8

(Amount in lakh of rupees)

Sl. No.	Name of Assessee	Commissione rate	Period	Income from exempted output services	Cenvat credit to be reversed	Cenvat credit actually reversed	Short reversal of cenvat credit
1	M/s Lakshmi Vilas Bank Ltd.	Trichy	2008-09	34318	164	Nil	164
2	M/s Tamilnadu Mercantile Bank Ltd.	Tirunelveli	2008-09	28266	117	5.37	111.63
3	M/s Global Trade Finance Ltd.	Mumbai ST	2008-09	42668	65.20	8.13	57.07

1.4.3 Improper distribution of cenvat credit by input service distributor

In terms of rule 7 of the Cenvat Credit Rules, 2004, an input service distributor (ISD) may distribute the cenvat credit in respect of the service tax paid on the input service to its manufacturing unit or units providing output service. The input service distributor is required to be registered for distribution of input service credit.

We found three assesseees who had distributed cenvat credit although they were not registered. This resulted in incorrect distribution and availing of cenvat credit of service tax amounting to ₹ 1.55 crore which was recoverable with interest.

1.4.3.1 M/s. Bank of India, in Kolkata (ST) commissionerate, availed and utilised credit on input services distributed by their Head Office located at Mumbai during the period from June 2005 to October 2007. We ascertained that the head office of the service provider at Mumbai had taken registration as input service distributor with effect from 10 December 2008. Consequently, the distribution of credit by their Mumbai office before taking registration and its availing by the assessee were both irregular. This resulted in irregular availing of service tax credit amounting to ₹ 33.96 lakh (including interest) during the period from June 2005 to October 2007.

When we pointed this out, the department admitted the audit observation and intimated (February 2010) that a show cause notice had been issued for ₹ 26.95 lakh in January 2010. Further development was awaited (April 2011).

Two more instances of distributing cenvat credit without proper registration are given in the table below: -

Table No. 9

(Amount in lakh of rupees)

Sl. No.	Name of Assessee	Commissionerate	Period	Observation
1	M/s SBI, Commercial Branch, GPO, Indore	Indore	2008-09	Cenvat credit irregularly received and availed ₹ 82.51 lakh
2	M/s Bank of India	Goa	2006-09	Cenvat credit irregularly distributed ₹ 39.04 lakh

1.4.4 Overstatement of cenvat credit balance in ST-3 returns

We found that the ST-3 return of M/s. Citifinancial Consumer Finance India Limited in Delhi ST commissionerate for the period April 2006 to September 2006 had a closing balance of Cenvat credit of ₹ 9.47 crore whereas in the ST-3 return for the period October 2006 to March 2007, the opening balance of cenvat credit had been depicted as ₹ 11.47 crore. This resulted in excess availing of cenvat credit of ₹ two crore.

The assessee accepted the audit observation and stated (9 October 2009) that the account would be corrected and appropriately reflected in ST-3 return for period April 2009 to September 2009. Confirmation of the correction was awaited from the department (April 2011).

1.4.5 Incorrect availing of cenvat credit on exempted services

In terms of Rule 6(1) of Cenvat Credit Rules, 2004, an assessee is not entitled to avail cenvat credit on such portion of input services which is used for providing exempted output services.

The Food Corporation of India (FCI), in order to meet out its funding requirement for procurement and distribution of food grains, obtained funds from various banks in India routed through SBI. In order to carry out the

operation, a consortium had been formed for which SBI was the lead bank. The share of each bank was fixed by the RBI.

M/s. Indian Bank, in Chennai (ST) commissionerate, received interest on the advance funded to FCI. The transaction was routed through the lead bank SBI, which collected handling charges inclusive of service tax.

M/s. Indian Bank availed and utilised credit of the service tax paid on the handling charges during the financial years 2007-08 and 2008-09. The handling charges paid to SBI were in the nature of an input service used for providing the output service of giving advance. For the service of giving advance to FCI, the Indian Bank had received consideration in the form of interest which was exempt from payment of service tax. Since the output service was tax exempt, the assessee was not entitled to avail Cenvat credit of the Service tax paid on handling charges (corresponding input service) which amounted to ₹ 72.62 lakh. This amount was recoverable with interest.

When we pointed this out (November 2009), the department accepted (February 2010) the audit observation and intimated (May 2010) that SCN for ₹ 72.62 lakh had been issued in April 2010.

1.4.6 Availing of Cenvat credit without proper documents

According to Rule 9 of Cenvat Credit Rules, 2004, Cenvat credits shall be taken by the manufacturer or provider of out put service or input service distributor, as the case may be, on the basis of an invoice, a bill of entry, a challan, etc.

M/s SBI Dispur branch, in Guwahati Commissionerate, took credit of ₹ 30.40 lakh for the period from March 2006 to February 2009 but no supporting records/documents on the basis of which credit was taken, could be made available to audit.

When we pointed this out (December 2009), the department intimated (March 2010) that a SCN had been issued to the assessee. Further development was awaited (April 2011).

1.4.7 Irregular availing of Cenvat credit before paying service tax

As per rule 4(7) of the Cenvat Credit Rules, 2004, cenvat credit of input service can be availed a day after the date on which payment is made on the value of the input service.

M/s Dena Bank, in Mumbai ST commissionerate had availed cenvat credit of ₹ 305.50 lakh on Core Banking System (CBS) charges payable to M/s Wipro Ltd in March 2009. We found that the actual CBS charges paid up to 31 March 2009 involved service tax of only ₹ 265.32 lakh. This resulted in irregular availing of cenvat credit of ₹ 40.17 lakh in March 2009.

When we pointed this out, the department intimated (November 2009) that the assessee had been directed to reverse/make payment of the cenvat credit

wrongly availed by them along with interest. Thereafter, the department issued SCN for ₹ 40.17 lakh in March 2011.

1.4.8 Irregular availing of cenvat credit on ‘input services’

The Cenvat Credit Rules, 2004, provide that cenvat credit can be taken for service tax paid on input services which are utilized for providing output services.

M/s. Canara Bank, in Bangalore LTU Commissionerate, availed cenvat credit on Service Tax paid on services such as Life Insurance service, Forward contract service, Authorized service station service, Stock broker service, TV or radio programme service, construction of residential complex service, Real Estate agent’s service, Cable operator service, Program producer service etc during the years 2006-07 to 2008-09. As these services had no relation to providing the output service of ‘Banking and other Financial Services’, they could not be termed as input services and availing of cenvat credit of ₹ 195.43 lakh on such services was irregular and was required to be recovered with interest.



1.5 Service tax collected but not remitted to the Government

Section 73 A of the Finance Act, 1994 (as amended with effect from 18 April 2006), provides that any person who is liable to pay service tax and has collected any amount in excess of the service tax assessed shall forthwith pay the amount so collected to the credit of the Central Government.

We found 14 cases of retention of service tax collected amounting to ₹ 1.41 crore that was recoverable.

A few cases are described below: -

1.5.1 On scrutiny of records of M/s Central Bank of India, Civic Centre, Bhilai, in Raipur commissionerate, we observed that during 2006-07 to 2008-09 the assessee had collected service tax of ₹ 158.28 lakh from customers but deposited only ₹ 84.74 lakh through challan and retained an amount of ₹ 73.54 lakh. This resulted in irregular retention of service tax of ₹ 73.54 lakh, which was recoverable with interest and penalty.

We pointed this out to the department in September 2009. Reply was awaited (April 2011).

1.5.2 We observed that after reduction in rates of service tax from 12.36 per cent to 10.30 per cent with effect from 24 February 2009, 10 assesseees (six branches of State Bank of India, four branches of State Bank of Patiala) in three commissionerates continued charging the higher rate from their customers and collected service tax of ₹ 135.30 lakh in the month of February and March 2009 but deposited service tax of ₹ 112.75 lakh at the lower rate. This resulted in undue retention of service tax of ₹ 22.55 lakh which was required to be recovered with interest and penalty.

We pointed this out to the department in September 2009 & December 2009. Reply was awaited (April 2011).

1.5.3 On reconciling the Ledger Accounts, which contains the details of the service tax collected by the assesseees, with the ST-3 returns for the period 2006-07 to 2008-09, we observed that M/s. Bank of India in Delhi ST commissionerate collected service tax of ₹ 4.01 crore but paid only ₹ 3.59 crore. This resulted in short payment of service tax amounting to ₹ 41.29 lakh, which was required to be recovered with interest and penalty.

We pointed this out to the department in December 2009. Reply was awaited (April 2011).



CHAPTER 1.6 MISCELLANEOUS ISSUES

We found 33 instances of non compliance to different provisions of Acts and Rules leading to revenue loss of ₹ 52.27 crore that was required to be recovered. The cases are cited in the subsequent paragraphs.

1.6.1 Service tax on exchange (forex) broking services

Exchange (forex) broking services are liable for levy of service tax under section 65(12) (IV) of the Finance Act, 1994 read with section 65(105) of the Act *ibid*.

Scrutiny of trial balance/ledger account of two branches of State Bank of India, Ludhiana, in Ludhiana commissionerate, revealed that they had received exchange (forex) charges of ₹ 318.55 lakh during 2007-08 and 2008-09 but had not paid service tax of ₹ 39 lakh by treating the services as exempted. This was required to be recovered along with interest of ₹ 5.58 lakh.

When we pointed this out (November 2009), the department intimated (August 2010) that the assessee had paid service tax of ₹ 32.89 lakh including interest.

1.6.2 Service tax on lease rent of wagons

Financial leasing services including equipment leasing and hire purchase fall under “Banking & other financial services” and are liable to tax with effect from 16 July, 2001.

M/s Lafarge India & M/s Tata Steel Ltd, in Jamshedpur Commissionerate, purchased railway wagons which was used by the railways. The two assesses received lease rent amounting to ₹ 3.26 crore during the year 2006-07 to 2008-09 but did not pay applicable service tax of ₹ 39.88 lakh including education cess. This was recoverable with interest of ₹ 11.95 lakh and penalty.

The audit observation was pointed out in December 2009. The reply of the department was awaited (April 2011)

1.6.3 Irregular benefit under Export of Service Rules, 2005

Export of service is exempt from the levy of service tax under rule 3(2) of the Export of Service Rules, 2005. Export of service is defined as service provided from India and used outside India and payment must be received by the service provider in convertible foreign exchange.

We test checked the records of 12 assesses in Delhi (ST) commissionerate, relating to export of service viz. invoices, ST-3 returns, bank realisation

certificates etc. We found that M/s Indiabull Financial Services Limited had received consideration for service provided in Indian rupees instead of convertible foreign exchange. Thus, it was not eligible to avail any benefit under the rules ibid. This resulted in non-payment of service tax and cess aggregating to ₹ 122.42 lakh on value of service of ₹ 990.48 lakh that was claimed for exemption during July 2008.

This was pointed out in September 2009. The department replied that M/s. Indiabull Financial Services Limited had deposited ₹ 122.42 lakh from their available cenvat and interest amount of ₹ 17.75 lakh vide challan dated 14 December 2010.

1.6.4 Exemption availed before date of effect

As per provisions of notification No. 29/2004 ST dated 22 September 2004, interest collected in relation to overdraft, cash credit facility etc. were exempted from payment of service tax. However, income of interest was taxable during the period from 10 September 2004 to 21 September 2004.

1.6.4.1 We found that M/s. United Bank of India, Kolkata in Kolkata ST commissionerate did not pay service tax of ₹ 1.83 crore on the income of interest in relation to service provided on overdraft and cash credit facility during the period from 10 September 2004 to 21 September 2004 (12 days). The department failed to detect the omission which resulted in loss of revenue to the tune of ₹ 1.83 crore.

When we pointed this out in October 2009, the department accepted the audit observation (March 2011). Further development was awaited (April 2011).

1.6.4.2 Similarly, 12 more assesseees, in three commissionerates, did not pay service tax of ₹ 3.97 crore on the interest income realised by them during the period between 10 September 2004 to 21 September 2004.

1.6.5 Non levy of service tax on service charges collected for maintenance of provident fund accounts

Under section 65(45) of the Finance Act, 1994, 'financial institution' has the meaning assigned to it in clause (c) of section 45-I of the R.B.I Act, 1934. Sub-clause (vi) of the said clause (c) defines 'financial institution' as any non-banking institution which carries on its business or part of its business in the activity of collecting, for any purpose or under any scheme or arrangement by whatever name called, money in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing money in any other way, to persons from whom money is collected or to any other person.

M/s Coal Mines Provident Fund Organisation (CMPFO), Dhanbad an autonomous body under Ministry of Coal, in Ranchi commissionerate, engaged in the services of collecting subscription in lumpsum from coal companies received ₹ 207.36 crore towards service charges at the rate of three

per cent on the gross amount of provident fund contributions collected during the period 2006-07 to 2008-09. The amount so collected was further invested in Banks (SBI/ICICI) and securities. These services were in the category of Banking & Other Financial Services as the CMPFO fulfilled the definition of a financial institution. As such M/s CMPFO was liable to pay service tax and education cess amounting to ₹ 25.42 crore, interest of ₹ 5.69 crore and penalty.

When we pointed this out in December 2009, the department accepted the audit observation (November 2010). Further reply was awaited (April 2011).

1.6.6 Non-payment of Service Tax under section 66 A

As per section 66 A of Finance Act, 1994, where any service specified in clause (105) of section 65 is provided by a person or a business from a country other than India, the recipient has to pay service tax on the service provided.

1.6.6.1 M/s. ICICI Venture Funds Management Co. Ltd, in Bangalore LTU Commissionerate, paid ₹ 103.84 crore during 2006-07 to 2008-09 in foreign currencies as professional fees to foreign consultants and advisors for various services that come under Banking and other Financial Services, Business support services, Business auxiliary services etc. The applicable service tax of ₹ 12.79 crore was recoverable with interest and penalty.

When we pointed this out (November 2009), the department stated (December 2009) that service tax of ₹ 5.96 crore along with interest of ₹ 2.46 crore had been recovered. Action taken to recover the balance was awaited (April 2011).

1.6.6.2 In two other cases of similar nature, M/s Federal Bank Ltd., Ernakulam, in Cochin commissionerate and M/s Dhanalakshmi Bank Ltd., Thrissur, in Calicut commissionerate, had not paid service tax on services received from outside the country. When we pointed this out, they deposited service tax and interest of ₹ 34.81 lakh.

We found three more assesseees who had not paid service tax amounting to ₹ 24.39 lakh on services received from outside the country. The action taken by the department was awaited (April 2011).

1.6.7 Non payment of service tax by M/s National Security Depository Ltd. (NSDL)

According to the Board Circular No.96/7/2007-S.T dated 23 August 2007 as amended by Circular No.98/1/2008-S.T dated 2 January 2008, the depository service provided by Central Depository Services (India) Ltd. (CDSL) including electronic access to securities information for a fee are liable to Service tax under "Banking and other financial services."

M/s. National Security Depository Ltd. (NSDL), Mumbai had collected ₹ 7.39 crore from M/s. Geojith BNP Paribas, Ernakulam, in Cochin commissionerate, as settlement fee for inter settlement transfer, settlement fee for pool-pool transfer, miscellaneous fee settlement for debit to beneficiary

account, pledge fee, settlement fee on clearing member account etc. during the period 2005-06 to 2008-09. Since NSDL was also providing depository services, they were also liable to pay service tax. Therefore, the unpaid service tax of ₹ 87.47 lakh was recoverable with interest and penalty.

1.6.8 Service tax on postage and other charges

M/s. State Bank of India, Commercial Branch, Bhilwara and Jaipur, both in Jaipur I commissionerate, collected ₹ 54.49 lakh as postage and telegraph charges (Bhilwara - ₹ 44.17 lakh and Jaipur - ₹10.32 lakh) during 2006-07 to 2008-09 on bills purchased. This was required to be treated as consideration in terms of Rule 5(1) of Service Tax (Determination of Value) Rules, 2006, attracting liability of service tax of ₹ 6.08 lakh. This amount was recoverable with interest.

1.6.9 Non-levy of service tax on commission income earned through vostro/nostro accounts⁸

M/s. Indian Overseas Bank (IOB), in Chennai (ST) commissionerate, received income earned through Vostro/Nostro accounts for the financial years from 2005-06 to 2008-09. The assessee remitted service tax on the income earned from vostro/nostro accounts with effect from 1 April 2008. Service tax had not been paid for the financial years from 2005-06 to 2007-08.

Another assessee, M/s. Tamilnad Mercantile Bank Ltd., in the same commissionerate, also did not pay service tax on the income earned through these accounts for the financial years from 2006-07 to 2008-09.

The Service tax leviable worked out to ₹ 1.11 crore.

When we pointed this out in October 2009, in the case of M/s. Indian Overseas Bank (IOB), in Chennai (ST) commissionerate, the department intimated (March 2011) that SCN for ₹ 97 lakh had been issued for audit observation period 2005-06 to 2007-08 in August 2010.

In the case of M/s. Tamilnad Mercantile Bank Ltd., in Chennai (ST) commissionerate, when we pointed this out in December 2009, the department did not accept the audit observation (July 2010) and stated that the incentives received by the assessee were not taxable. The reply of the department is contradictory because similar commission income earned through vostro/nostro account by Indian Overseas Bank, Chennai has been treated as taxable service by the department.

⁸ **Nostro** and **vostro** (Italian, from Latin, *noster* and *voster*; English, 'ours' and 'yours') are accounting terms used to distinguish an account held for another entity from an account held by another entity. Speaking from the bank's point-of-view a *nostro* is our account of our money, held by you and a *vostro* is our account of your money, held by us.

1.6.10 Non-levy of service tax on upfront fee

M/s. State Bank of India, Corporate Accounts Group, in Chennai (ST) commissionerate, received upfront fee at 1 per cent of the term loan sanctioned. Service tax was paid on the above fees collected during the financial years from 2007-08 and 2008-09. Service tax was, however, not paid for the fees collected during the financial year 2006-07. The Service tax recoverable worked out to ₹ 31 lakh.

When we pointed this out (November 2009), the department accepted the audit observation (January 2010) and intimated that SCN for ₹ 31 lakh had been issued in March 2010.

1.6.11 Short payment of service tax

M/s Yes Bank Ltd, in Mumbai commissionerate, had made an adjustment of ₹ 30.25 lakh paid in excess as service tax in November 2008 under Investment Banking, while determining the service tax liability for the month of March 2009. This adjustment was not shown in the yearly ST-3 return of 2008-09 submitted to the department. This resulted in short payment of service tax amounting to ₹ 30.25 lakh in March 2009.

We pointed this out in October 2009. The reply of the department was awaited (April 2011).

Similarly, M/s. Mahindra and Mahindra Financial Services Ltd. and M/s Shriram Transport Finance Company Limited had short paid service tax of ₹ 8.01 lakh and ₹ 5.10 lakh during the period 2007-08 and 2006-07 respectively.

When we pointed this out (October and November 2009), the department intimated that M/s. Mahindra and Mahindra Financial Services Ltd. and M/s Shriram Transport Finance Company Limited had deposited service tax alongwith interest of ₹ 8.97 lakh and ₹ 7.19 lakh during October 2009 and December 2009 respectively.

1.6.12 Non levy of service tax on the gold consignment agents' income

As per section 65(12)(v) of Finance Act, 1994, custodial services attract service tax under the banking and other financial services.

M/s. Indian Overseas Bank, in Chennai LTU commissionerate, imports gold on consignment basis from M/s. Union Bank of Switzerland (UBS), ZURICH and MKS Finance, Geneva after paying customs duty, education cess etc. When customers place orders for gold, the bank fixes the price of gold in consultation with the foreign banks, collects the money from the customers, sends the money to the banks and delivers gold to the customers. As such, the assessee bank functions like a custodian of the gold. The income earned in the process is in the nature of custodial services which attracts service tax.

The service tax leviable on such custodial services worked out to ₹ 3.02 crore during the period from 2006-07 to 2008-09. This amount was recoverable with interest and penalty.

When we pointed this out (October 2009), the department partially accepted the audit observation (August 2010) and intimated that the issue of SCN was under process. Further development was awaited (April 2011).