

Chapter 1: Introduction

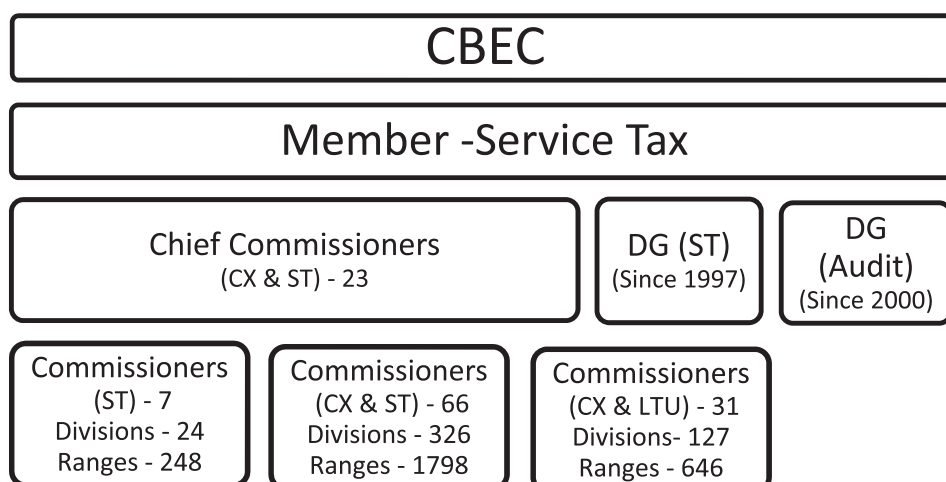
1.1 The essence of indirect (service) taxation is that a service should be taxed in the jurisdiction of its consumption. This principle is more or less universally applied. In terms of this principle, exports are not charged to tax, as the consumption is elsewhere, and services are taxed on their importation into the taxable territory.¹

1.2 Import of services is one of the specified categories in the Finance Act/Service Tax Rules where liability to pay Service Tax (ST) falls on the service recipient based on the reverse charge mechanism. Under reverse charge method, a legal fiction is created as if the recipient had himself provided the services domestically and accordingly, the recipient of service is treated as deemed service provider.² ST liability in respect of import of services is now recognised as effective from 18 April 2006, the date of enactment of section 66A of the Finance Act, 1994.

Organisational set up

1.3 Central Board of Excise and Customs (CBEC) administers the levy, assessment and collection of ST through the field formations under its control. 77 Commissionerates which include 7 exclusive ST Commissionerates, 66 integrated Central excise and ST Commissionerates and 4 Large Taxpayer Unit Commissionerates assess and collect ST across the country. Besides, the Government constituted an office of the Director General (ST) as a subordinate office in 1997 to coordinate ST work. The functions and powers of Director General (ST) include suggesting measures to increase revenue collection, streamlining procedures, study of law and procedures regarding ST to simplify the ST collection and assessment, and monitoring ST collections.

1.4 The following chart depicts the organisational structure under CBEC including subordinate formations, concerned directly or indirectly with the collection of ST revenues and the monitoring of the same.



¹ CBEC's Taxation of Services –An Education Guide.

² JS(TRU)'s letter dated 19 April 2006 (F. No. B1 / 4 / 2006-TRU) to CBEC Members and Commissioners

1.5 At the base of the hierarchy, the ranges headed by the Superintendents (Range Officers) are responsible for a variety of tasks including scrutiny of assessments, recovery of arrears of revenue and audit compliance. As part of the compliance verification mechanism, audit parties under the Internal Audit Wing of the Commissionerate conduct audit at assessee premises. The Director General of Audit, who is responsible for institutionalization of a credible audit system, provides functional direction in planning, co-ordination, supervision and conduct of audits by officers at field formations.

1.6 The department carries out most of its functions relating to ST by diverting staff from central excise and customs. The Union Cabinet had sanctioned 2094 posts for ST related functions in 2007. Cadre restructuring proposal (2010) updated in 2012 to seek inter alia, 14990 posts exclusively for ST, has been forwarded to the Department of Personnel and Training.

Why we chose the topic

1.7 Significant rise in volume of imported services consequent upon liberalization and global integration would imply that collections of consumption based ST should also rise. During a preliminary study, Audit identified 37 out of 99 purpose codes prescribed by RBI for reporting foreign exchange remittances as being prima facie likely to relate to transactions on which ST liability under section 66A would arise. The list of such purpose codes is annexed (**Appendix 1**). As per the information reported by authorised dealers to RBI, remittances exceeding ₹ 8 lakh crore categorised under the 37 purpose codes have gone out of the country during the four years 2007-08 to 2010-11. Keeping in view the volume of remittances, we decided to examine the adequacy of statutory provisions, effectiveness of information gathering in the department as well as the adequacy of systems and procedures to minimise tax gap relating to ST liability on import of services.

Audit objectives

- 1.8** We conducted the performance audit based on the following audit objectives,
- a. to evaluate effectiveness of systems in place, if any, to obtain and analyse data on foreign remittances from authorities such as Reserve Bank of India/authorised dealers/income tax department which could facilitate increase in tax collections as well as broadening of the ST base;
 - b. to evaluate effectiveness of systems and procedures to monitor and update status of taxpayer - as service provider/service recipient/both which would facilitate maintenance of database and monitoring of tax collections relating to import of services;
 - c. to evaluate adequacy of checks prescribed for scrutiny of returns in relation to import of services and compliance thereof; and

d. to ascertain whether liability to pay ST under reverse charge is taken as a risk parameter for selection of units while conducting audit checks by internal audit and whether the data of foreign remittances is/could be utilised as a key input for selection of units for audit.

Audit scope

1.9 We reviewed ST compliance in respect of cross-border transactions; and, restricted the scope of the review to the ST liability in respect of outward remittances through commercial banks as authorised dealers (among the authorised persons under section 10 of the Foreign Exchange Management Act, 1999). We limited the period of coverage to 2009-12. However, depending on the issues involved, we did look into data up to 2007-08 in some cases.

Audit Methodology

1.10 We carried out examination of records at selected Commissionerates as well as at premises of manufacturers and service providers, selected from the data of remittances through authorised dealers for which we approached RBI as well as the authorised dealers. There were 3 (out of 4) Large Taxpayer Unit (LTU) Commissionerates in 14³ selected Commissionerates (out of 104) taken up by Audit for its review.

1.11 We also carried out visits to selected premises of service recipients as well as based on samples (registered service providers/manufacturers) selected through stratified sampling from their remittance details (under 37 identified purpose codes) obtained from Authorised Dealers. Fifty three authorised dealers, out of over a hundred approached by Audit furnished data pertaining to the period 2007-11. The data indicated over 11 lakh transactions totaling remittances worth ₹ 3.77 lakh crore over the period 2007-11. We selected fifty five registered manufacturers and 286 registered service providers for audit at their premises. In respect of multi-locational assesseees, we scrutinised records at selected premises given our limitation of resources. We also selected 947 remitters possessing ST registration whom we approached through detailed questionnaires. We have also included audit observations from the pilot study. In certain cases where we wanted to lay emphasis on the system issues, we have retained some audit observations raised by CERA as well as by Internal Audit (as informed by the Ministry in its detailed reply dated 22 March 2013).

³ Ahmedabad ST, Bengaluru ST & LTU, Chennai ST & LTU, Delhi ST, Hyderabad II & IV, Kolkata ST, Mumbai ST-I, ST-II & LTU, Noida & Panchkula

Legal provisions

1.12 An amendment incorporating an explanation (effective from 16 June 2005) to Section 65(105) of Finance Act, 1994 gave statutory recognition to the concept of consumption-based levy on imported services. Section 66A replaced the explanation wef 18 April 2006. The Apex Court later dismissed appeals by the department seeking to give effect to the levy effective from a prior date. The Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 also came into effect almost simultaneously. The Central Government notified that with effect from 1 July 2012, section 66A would be limited in its applicability to things done or omitted to be done prior to this date. Recently introduced provisions sections 66B and 68 of the Finance Act are to be read along with Rule 2(m) of the Place of Provision of Services Rules, 2012 and Notification no. 30/2012 dated 20 June 2012. The person liable to pay the tax under rule 2(1)(d) of the ST Rules, 1994 in respect of any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory is the service recipient who shall bear 100 per cent of the ST liability.

Acknowledgement

1.13 We acknowledge the cooperation extended by the Department of Revenue and the subordinate formations in providing the necessary records during the conduct of this audit. We discussed the audit objectives and scope of the performance audit in an entry conference with CBEC officers on 10 May 2012. We conducted the exit conference with CBEC on 11 March 2013.